

CLAL INDUSTRIES AND INVESTMENTS LTD.

MANAGEMENT DISCUSSION AND ANALYSIS

AS OF MARCH 31, 2003

1. *Description of Company*

Clal Industries and Investments Ltd. ("CII") is an investment company, whose principal holdings are in the manufacturing and high-technology industries. The Company is controlled by IDB Development Corporation Ltd.

On May 19, 2003, El Yam Financial Holdings (Hamigdal), The Israeli Company for Financing and Investments and Israel Financial Holdings, completed the sale of all of their holdings (51.7%) in IDB Holdings Ltd. ("IDB Holdings"), the controlling shareholder of the parent company, to a group comprising Gaden Holdings, Gaden Investments IDB, Manor Investments IDB and Avraham Livnat Investments (2002) ("the buyers").

The Company is unable to estimate the possible effects of the change in controlling shareholders of IDB Holdings on the Company, its business, management, strategy and holdings structure.

The Company is principally engaged in the acquisition, development, providing assistance and establishment of companies in various industries, including formulation of their strategy, principally when the Company has a significant interest in the investee company. The Company has access to a variety of business opportunities, being constantly alert for investments with appropriate potential return. Simultaneously, the Company strives to enhance the value of its existing investments, with a view to realizing those investments at the appropriate time.

The CII group of companies is engaged in a variety of business segments, which primarily include: cement, textiles, advanced technology and electronics, paper and cardboard, biotechnology, communications and venture capital funds.

In May 2002, the Board of Directors of the Company approved the basic principles for a new long-term business plan for the Company that was formulated by the management of the Company together with a strategy consulting company. The basic principles include emphasis on development of management resources; focus on a limited number of material holdings with realizable growth potential in respect of which the Company can exert a significant influence; and focus on investments in a rapid growth sector including support and encouragement of long-term strategic processes in the investee companies. These processes will be examined and adapted on a continuing basis. Secondly, the Company will adapt its operating profile through adoption of advanced management and business tools.

As a result of adoption of the plan, the Company's investments were classified into four groups: core holdings, venture capital, biotechnology and other real holdings.

The Company's results of operations are affected, to a significant extent, by capital gains and write-downs. Accordingly, significant fluctuation is likely in the Company's results of operations as between the various reporting periods.

The Company regards its contribution to the community as an important component of its business strategy.

2. *Operating results*

- A. The Company's loss in the reported period amounted to NIS 85 million, as compared with net income of NIS 2 million in the corresponding quarter of the prior year and a loss of NIS 429 million for all of 2002.

The loss includes net negative non-recurring factors amounting to NIS 30 million, attributable principally to efficiency measures implemented in Neshet (NIS 13 million) and write-downs of investments in the venture capital segment (NIS 7 million). The corresponding period of the prior year included net positive non-recurring factors amounting to NIS 28 million.

The increase in the regular loss (before non-recurring factors) in the reported period compared with the corresponding period of the prior year is derived from the loss in Neshet, from write-downs of investments in venture capital funds and from net financing expenses.

The loss per share in the reported period was NIS 0.54, compared with net income of NIS 0.01 in the corresponding period of the prior year and a loss of NIS 2.73 for all of 2002.

Following is an analysis of the operating results (in NIS millions):

	Three months ended March 31, 2003			Three months ended March 31, 2002		
	Regular	Non- recurring	Total	Regular	Non- recurring	Total
Core holdings	(22)	(17)	(39)	(7)	35	28
Venture capital	(16)	(7)	(23)	(6)	(3)	(9)
Biotechnology	(16)	(6)	(22)	(12)	(1)	(13)
Other real holdings	6	-	6	(2)	(3)	(5)
Company						
Headquarters	(1)	-	(1)	(3)	-	(3)
Financing	(6)	-	(6)	4	-	4
Net income (loss)	(55)	(30)	(85)	(26)	28	2

B. Data of Principal Investee Companies⁽¹⁾

Following are data taken from the financial statements of the principal investee companies (in NIS millions):

	<u>Sales</u>		<u>Net income (loss) (1)</u>	
	<u>For the three months ended March 31</u>		<u>For the three months ended March 31</u>	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Mashav	306	317	(18)	3
ECI	556	822	(37)	(244)
Scitex	294	284	(32)	(5)
AIPM	126	117	14	9
Kitan	201	202	(4)	2
Polgat	179	160	1	6
Ormat	119	51	12	(11)
Barak	166	177	29	(5)
Fundtech	52	45	(3)	(18)

(1) Net income (loss) includes non-recurring items.

C. Review of operations of principal companies⁽¹⁾

Nesher – There was a decrease in revenues from sales of cement (7%) as compared to the corresponding period of the prior year, mainly as a result of a decrease in quantities sold (5%) together with continuing erosion of selling prices. The loss for the period, in the amount of NIS 20 million, includes a non-recurring expense, due to efficiency measures carried out, in the amount of NIS 27 million (NIS 18 million after related tax effect). The regular loss for the period of companies in the cement segment amounted to NIS 2 million as compared to regular income of NIS 11 million in the corresponding period of the prior year. The decrease in regular income in the quarter as compared to the corresponding period of the prior year was derived from the relatively rainy winter compared to the prior year and from expenses in respect of the reconditioning of one of the kilns, as well as the continuing slowdown in the construction industry and the security related events in the area.

During the reported period, Nesher revised the estimated useful lives of its assets utilized in the manufacture of cement. As a result, the period of the depreciation was extended from 10 – 15 years to 20 years. Most of the decrease in depreciation expense for the quarter, in the amount of NIS 20 million, caused a decrease in the value of inventories and was offset by an increase in deferred taxes. Therefore, the change in the estimate resulted in a decrease of only NIS 1 million in the net loss for the period (see also Note 4A to the financial statements).

(1) Relate to the published financial statements of ECI, Scitex and Fundtech prepared in accordance with accounting principles generally accepted in the United States.

ECI - Gross profit in the reported period amounted to NIS 228 million (gross profit margin – 41%), compared to NIS 314 million (gross profit margin – 45%) reported in the fourth quarter of 2002 and NIS 300 million (gross profit margin – 36.5%) in the corresponding period of the prior year. The net loss for the period excluding non-recurring items amounted to NIS 27 million, compared to income of NIS 3 million in the corresponding period of the prior year. Subsequent to March 31, 2003, ECI finalized the sale of Innowave in consideration for US\$ 20 million. ECI continued to record an improvement in its cash balances. The Inovia division recorded an improvement in its results as a result of an improvement in gross margin concurrently with a decrease in operating expenses. The subsidiary, ECTel, recorded a loss in the quarter compared to income in the corresponding quarter of the prior year, as a result of sharp decline in sales.

Scitex – During the reported period, the merger of Scitex Vision with Aprion Digital was finalized, subsequent to which Scitex holds 75% of the merged entity and the operating results of Aprion are consolidated with those of Scitex as of the beginning of 2003. The operating loss for the period amounted to NIS 9 million, compared to operating income of NIS 6 million in the corresponding period of the prior year. The decrease in operating income was derived from an increase in operating expenses due to the merger of Aprion, part of which was offset by an increase in sales and in the gross margin. The net loss for the period before non-recurring expenses amounted to NIS 19 million, compared to a loss of NIS 5 million in the corresponding period of the prior year (the net loss for the period includes non-recurring expenses of NIS 13 million derived mainly from tax expenses and reorganization expenses of the merged entity).

AIPM – Operating income amounted to NIS 14 million in the reported period, compared to NIS 4 million in the corresponding period of the prior year. The improvement in operating income was due to efficiency measures implemented by AIPM Group companies that resulted in a decrease in payroll costs, reduction of costs of raw materials and various manufacturing costs and a continuing increase in the use of electricity generated from self-production instead of purchased electricity. The efficiency measures together with an increase in sales resulted in an increase of NIS 10 million in gross profit that was offset in part by net financing expenses compared to net financing income in the corresponding period of the prior year.

Kitan – The operating loss for the period amounted to NIS 2.5 million, compared to operating income of NIS 3 million in the corresponding period of the prior year. The loss in the reported period compared to the corresponding period of the prior year was due to a decrease in retail sales which were affected by the timing of the Passover holiday that occurred this year in the second quarter, from the longer winter season and from the war in Iraq. The decrease in income was offset in part by an increase in sales of the manufacturing plant and an improvement in the results of this segment.

Polgat – Gross profit in the reported period amounted to NIS 40 million (gross profit margin – 22%), compared to NIS 33 million (gross profit margin – 21%) in the corresponding period of the prior year. The increase in gross profit was due mainly to an increase in production outside of Israel, improvement in operating parameters and increased sales.

Net income for the reported period amounted to NIS 1 million, compared to net income of NIS 6 million in the corresponding period of the prior year. The decrease in net income was derived mainly from an increase in selling expenses as a result of the increase in sales and establishment of new marketing channels, from an increase in the provision for doubtful debts and from net financing expenses, compared to net financing income in the prior period.

Ormat – Revenues from sales in the reported period amounted to NIS 119 million, compared to NIS 51 million in the corresponding period of the prior year. The increase was due mainly to an increase in the operations of geothermic power stations in the United States and from supply of equipment to utilities in other locations worldwide. Net income for the period amounted to NIS 12 million, compared to NIS 2 million (before non-recurring expenses of NIS 12 million from discontinued operations in Kazakhstan) in the corresponding period of the prior year. The increase in net income was due principally to implementation of Ormat's business plan – transition to ownership of utilities that generate income from sale of electricity.

Barak – Revenues from sales in the reported period amounted to NIS 166 million, compared to NIS 177 million in the corresponding period of the prior year. The decrease in sales was the result of an erosion of prices, aggressive competition and the continued recession, that was offset in part by an increase in income in the rapid Internet segment. Net income for the period amounted to NIS 20 million, compared to a loss of NIS 5 million in the corresponding period of the prior year. Most of the change in net income was due to a decrease in financing expenses that were offset in part by a decrease in income, erosion of gross profit as a result of the change in the composition of sales and an increase in selling and marketing expenses.

Fundtech – The loss for the reported period amounted to NIS 3 million, compared to a loss of NIS 18 million in the corresponding period of the prior year. The improvement in results was derived from an increase in sales (16%) and a decrease in development expenses (of approximately NIS 8.5 million) compared to the corresponding period of the prior year.

During the period, 35 new transactions were consummated, of which two transactions were for the next generation of cash management, CASHPlus, developed by Fundtech. In addition, six banks joined its clientele as new customers.

In general, the results of the Group companies in the reported period were affected by the economic slowdown, in the world markets as well as in the domestic market, by the security situation and by the crisis in the capital markets, especially in the technology and communications segments. The Group companies in the domestic market were affected negatively by the rainy winter and the timing of the Passover holiday that were responsible for a decrease in demand and an increase in competition that resulted in an erosion of prices and a decrease in profitability. Group companies with foreign sales were affected mainly by a decrease in capital acquisitions by companies in various segments. The effect of these factors was moderated in part due to restructurings and efficiency measures taken by most of the Group companies.

As long as the recession continues, both in the domestic economy and in world markets, it could have a continuing effect on the performance of Group companies.

3. *Evaluation of Investments*

The Company assesses the value of its investments in companies in accordance with generally accepted accounting principles. Based on the results of the assessment, the Company recorded write-downs for impairment of some of its investments.

For a number of investee companies whose shares are publicly-traded, there is a difference between the carrying value of the investment and market value. The Company assessed its investment in these companies and believes that the carrying value of its investments does not exceed the recoverable amount.

Following are data regarding the investments in these companies (in NIS millions):

	Company's share of investee's equity	Carrying value	Market value	Difference between carrying value and market value	Market value	Difference between carrying value and market value
	As of March 31, 2003				As of May 20, 2003	
ECI	432	360	149	211	174	186
Scitex	222	181	85	96	83	98
Polgat	161	145	72	73	94	51
Fundtech	123	113	87	26	123	-
Total	1,276	1,131	752	379	444	335

The Company believes that these companies have realizable growth potential and that the Company is able to significantly influence the processes in these companies. The Company's holdings in these shares constitute a long-term investment. The companies themselves assess whether there has been an impairment of their assets and, when necessary, record write-downs that are reflected in the Company's financial statements (see also Note 4 to the financial statements).

4. *Financial Position and Sources of Finance*

The consolidated balance sheet reflects a working capital deficiency of NIS 100 million. As of balance sheet date, short-term liquid assets in the consolidated balance sheet amounted to NIS 247 million; these assets are included within short-term investments and cash and cash equivalents. The consolidated liquid ratio is 0.50 (December 31, 2002 - 0.46). The principal sources of funds were from realization of investments in the amount of NIS 74 million, issuance of commercial paper in the amount of NIS 50 million and receipt of long-term loans in the amount of NIS 35 million. Most of the cash was utilized for the repayment of long-term loans in the amount of NIS 91 million and investment in companies in the amount of NIS 39 million.

As of March 31, 2003, the Company's shareholders' equity amounted to NIS 2,469 million, as compared to NIS 2,575 million as of December 31, 2002. The minority interest was NIS 112 million (December 31, 2002 - NIS 106 million). There was a 4% decrease in the Company's shareholders' equity and a 6% increase in the minority interest, which together constitute a source of finance for 48% of the Group's assets.

The Group's external long-term sources of finance totaled NIS 1,114 million as of March 31, 2003 (December 31, 2002 - NIS 1,185 million). Approximately 29% of this financing is repayable within the next year.

As of March 31, 2003, the balance of the Company's and its wholly owned headquarter companies net liabilities amounted to NIS 738 million (December 31, 2002 - NIS 857 million).

One of the conditions included in the permit granted to the buyers from the Governor of the Bank of Israel on May 12, 2003, was that the Nochi Dankner Group, including companies controlled by him (which includes the Company and its investee companies), will not increase, in real terms, its debt to the Bank Hapoalim Group above the amount existing as of the date the permit was granted. Any change in this debt will be approved in accordance with the procedures of Bank Hapoalim relating to approval of transactions with "related individuals". These conditions will be in effect until the Supervisor of Banks advises that he is satisfactorily convinced that the business relationships between the family of Yitzhak Dankner (father of Nochi Dankner) and the other Dankner and Geneao family members have been terminated.

5. *Principal Changes in Investments and in Investee Companies*

- 5.1 In January 2003 the Company sold its holdings in shares and debentures of Orckit in consideration for NIS 72 million. The Company did not have a gain or loss from this sale.
- 5.2 In February, the Company invested NIS 3 million in Shellcase and converted convertible loans in the amount of NIS 15 million. After this investment and conversion of the loans to shares, the Company's holdings in Shellcase are 28%.
- 5.3 During the reported period, the Company invested in other companies, directly and indirectly (through wholly owned subsidiaries), as follows (in NIS millions):

	Three months ended March 31, 2003
Core holdings	4
Venture capital	21
Biotechnology	10
Other real holdings	-
Total	35

- 5.4 During the period from March 31, 2003 until the date of approval of the financial statements, the Company invested, directly and indirectly (through wholly owned subsidiaries), NIS 23 million, mainly in the venture capital segment.

6. *Analysis of Market Risks to which the Group is Exposed and the Management of those Risks*

The following relates to the Company and its wholly-owned subsidiaries, whose exposure to market risks is managed by the Company. Regarding other subsidiaries, see 6.2 below.

There were no material changes in the reported period in respect of the Company's exposure to market risks and their management (as described in the directives of the Securities Authority) in relation to the Company's report in this regard on March 20, 2003.

6.1 Consolidated Schedule of Basis of Linkage (in NIS millions)

	Linked to the Consumer Price Index	Linked to the U.S. dollar	Linked to other foreign currency	Not linked	Non- monetary balances	Total
<u>March 31, 2003</u>						
Current assets	39	213	112	407	754	1,525
Non-current assets	45	28	-	2	3,746	3,821
Current liabilities	(326)	(394)	(132)	(765)	(8)	(1,625)
Non-current liabilities	(722)	(27)	(1)	(48)	(454)	(1,252)
Net balance sheet amounts	<u>(964)</u>	<u>(180)</u>	<u>(21)</u>	<u>(404)</u>	<u>4,038</u>	<u>2,469</u>

6.2 Subsidiaries

There were no material changes in Neshet, Polgat, Kitan and Taavura in the reported period regarding exposure to market risks and their management (as described in directives of the Securities Authority), in relation to the report in this regard on March 20, 2003.

6.3 Derivatives

There were no material changes in derivative positions in the reported period in relation to the Company's report in this regard on March 20, 2003.

6.4 Subsequent Events

There were no material events in respect of market risks subsequent to balance sheet date.

7. Board of Directors

After approval of the Report of the Directors, Messrs. Leon Recanati, Ariel Carasso, Nachum Amit, Richard Armon and Aviezer Chelouche resigned from the Board of Directors, and Messrs. Nochi Dankner, Isaac Manor, Zvi Livnat, Avi Fischer, Darko Horvat, Ms. Shelly Dankner-Bergman, Messrs. Marc Schimmel, Refael Bisker, Lior Hannas, Dory Manor and Yecheskel Dovrat were appointed to the Board of Directors.

Mr. Nochi Dankner was elected Chairman of the Board of Directors in place of Mr. Leon Recanati.

We wish to thank the Group's directors and employees for their contribution to the advancement and development of the Group.

LEON RECANATI
Director

MEIR SHANNIE
General Manager

CLAL INDUSTRIES AND INVESTMENTS LTD.

SELECTED CONSOLIDATED BALANCE SHEET DATA

In millions of shekels of March 2003

	<u>March 31</u>		<u>December 31</u>
	<u>2003</u>	<u>2002</u>	<u>2002</u>
	<u>(Unaudited)</u>		<u>(Audited)</u>
<u>Assets</u>			
Current assets	1,525	1,496	1,469
Long term deposits, loans and receivables	35	77	43
Investments	1,800	2,342	1,937
Fixed assets, other assets and deferred expenses	<u>1,986</u>	<u>2,182</u>	<u>2,023</u>
	<u>5,346</u>	<u>6,097</u>	<u>5,472</u>
<u>Liabilities and Shareholders' Equity</u>			
Current liabilities	1,625	1,515	1,637
Long-term liabilities	1,140	1,384	1,154
Minority interests	112	113	106
Shareholders' equity	<u>2,469</u>	<u>3,085</u>	<u>2,575</u>
	<u>5,346</u>	<u>6,097</u>	<u>5,472</u>

CLAL INDUSTRIES AND INVESTMENTS LTD.

SELECTED CONSOLIDATED STATEMENT OF OPERATION DATA

In millions of shekels of March 2003

	For the three months ended March 31		For the year ended December 31
	2003	2002	2002
	(Unaudited)		(Audited)
Revenues, net	614	663	2,605
Costs and expenses	692	656	2,942
Income (loss) before taxes	(78)	7	(337)
Taxes on income	-	4	71
Income (loss) after taxes	(78)	3	(408)
Minority interest in earnings of subsidiaries, net	7	1	21
Net income (loss)	(85)	2	(429)
Earnings (loss) per NIS 1par value of share capital (in NIS)	(0.54)	0.01	(2.73)