# CLAL INDUSTRIES AND INVESTMENTS LTD.

# MARCH 31, 2006

- MANAGEMENT DISCUSSION AND ANALYSIS FOR THE PERIOD JANUARY – MARCH 2006
- CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

**The English version of the 1th quarter of 2006 is a translation of part of the Hebrew version, and is made for convenience purposes only. Please note that the Hebrew version constitutes the binding version.**

Tel-Aviv, May 21, 2006

# CLAL INDUSTRIES AND INVESTMENTS LTD.

## MANAGEMENT DISCUSSION AND ANALYSIS

## FOR THE PERIOD JANUARY – MARCH 2006

## 1. COMPANY DESCRIPTION

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

The Company is engaged, directly and through its subsidiaries, in the establishment, acquisition, development and upgrading of companies in various industries. The Company strives to be involved in the management and formulation of the strategy in its investee companies, primarily when the Company possesses significant holdings in these companies. The Company strives to enhance and maximize the value of its existing investments, with a view to realizing those investments at the appropriate time. The Company has access to a variety of business opportunities, being constantly alert for investments with a suitable potential return, in those sectors where it is experienced and knowledgeable.

The Clal Industries and Investments Group companies are engaged in a variety of industries, including primarily: cement, high technology, electronics and venture capital funds, textile, biotechnology, communication services, real estate and other industries.

The Company's activities are conducted through subsidiaries (companies in which the Group holds 50% of the rights, either directly or indirectly), jointly controlled entities (companies in respect of which the Group has contractual consent with other entities for joint control), affiliates (companies in which the Group exercises significant influence and which are accounted for by the equity method), and through other companies wherein the Company does not exercise significant influence (the investment in which is reflected in the financial statements on the cost basis).

The Company's principal targets are:

- Improve business performance in order to achieve maximum return on capital in the long run, with regular economic evaluations of business alternatives and advantageous opportunities.

- In the coming years - complete the process for redesigning the Company as an investment company which focuses on holdings in the following industries: basic manufacturing, high technology and biotechnology, logistics, consumer products and infrastructure.

In order to achieve these targets, the Company has formulated the following business strategy:

- Focus on a limited number of material holdings possessing stable growth potential, in respect of which the Company can exert a significant influence.
- Continue to evaluate investment opportunities in leading companies, including in investees.
- Utilize opportunities in relevant markets in order to realize investments.
- Continue to search for opportunities to increase value of investees.
- Intensify international operations, including those of investees.
- Nurture and strengthen the ties with existing and potential strategic partners in Israel and worldwide.
- Manage the Company's headquarters as a dynamic entity that works in cooperation with the investees.
- Outsource periodically the management of certain activities, while exercising appropriate controls.
- Contribute to and assist the community in Israel.

The Company's operating results are affected, in large measures, by gains from realization of investments, adjustments of the value of investments and by other non-recurring factors. Accordingly, extensive fluctuation may be evident in the financial results between different reporting periods.

## 2. RESULTS OF OPERATIONS

### a. Statements of income:

The Company's net income in the reporting period amounted to NIS 76 million, compared to a net income of NIS 101 million in the corresponding period of the previous year and a net income of NIS 407 million in all of 2005.

In the reporting period, current income totaled NIS 23 million compared to NIS 112 million in the corresponding period of the previous year. The decrease in current income compared to the corresponding period of the previous year is mainly a result of an extremely large transaction for the sale of real estate by KBA, which contributed a gain of NIS 78 million in the corresponding quarter of 2005.

The income in the reporting period was derived from adjustment of the value of investments, other non-recurring factors and from realization of investments and amounted to NIS 53 million, compared to a loss of NIS 11 million in the corresponding period of the previous year.

The non-recurring factors in the reported period resulted mainly from a decrease in the holding rate in Golf (NIS 33 million), the cancellation of the provision for dilution in respect of convertible debentures in investees as a result of the initial adoption of Accounting Standard No. 22 (NIS 23 million) and the update of the value of the investment in Compugen (NIS 18 million). These factors were offset due to the provision for the streamlining plan in Nesher (NIS 12 million) and a loss from the dilution resulting from the exercise of options by employees in investees (NIS 13 million).

As of the first quarter of the year, the Company includes the operating results of Barak. The addition to revenue turnover and cost of sales in the quarter amounted to NIS 179 million and NIS 121 million, respectively. The addition to consolidated assets as of December 31, 2005 is NIS 803 million. In the corresponding period of last year, the revenue turnover from an extremely large transaction included NIS 248 million from the sale of real estate by KBA, whose cost amounted to NIS 24 million. The initial consolidation of Barak's results on the one hand and the real estate transaction last year on the other hand affected gross profit, gross profit margin and tax expenses in the reported period compared to the corresponding period of last year.

Net earnings per share in the reporting period amounted to NIS 0.48, compared to net earnings of NIS 0.65 in the corresponding period of the previous year and net earnings of NIS 2.56 in all of 2005.

**b. Analysis of income by business segments** (NIS in millions):

| | Three months ended March 31 | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | | | 2005 | | |
| | Current | Other [1] | Total | Current | Other [1] | Total |
| Business segments: | | | | | | |
| Cement | 25 | (13) | 12 | 22 | - | 22 |
| Textiles | 10 | 33 | 43 | 12 | (3) | 9 |
| High technology, electronics and venture capital funds | 1 | 12 | 13 | 7 | (2) | 5 |
| Biotechnology | (7) | 17 | 10 | (9) | (6) | (15) |
| Real estate | 1 | - | 1 | 81 | - | 81 |
| Communication services | (4) | - | (4) | (1) | - | (1) |
| Other | 10 | 4 | 14 | 11 | - | 11 |
| | 36 | 53 | 89 | 123 | (11) | 112 |
| Financing and corporate | (13) | - | (13) | (11) | - | (11) |
| Income (loss) before discontinued operation | 23 | 53 | 76 | 112 | (11) | 101 |

1 Includes results of realization of investments, updating of value of investments and non-recurring factors.

**Cement** – See analysis of the results of companies in the cement segment in section d below.

**Textiles** – The increase in the contribution of this segment to income compared to the corresponding period of last year stems mainly from a positive non-recurring effect from the Golf issuance in the amount of NIS 33 million. See also the analysis of the results of Golf in section d below.

**High technology, electronics and venture capital funds** – The increase in the contribution of this segment compared to the corresponding period of last year stems mainly from positive non-recurring effects of NIS 12 million (mainly a positive non-recurring effect of NIS 19 million from the adoption of new accounting standards net of the negative non-recurring effect of NIS 12 million from the exercise of employee options in investees) compared to negative non-recurring effects of NIS 2 million in the corresponding period of last year, which were offset against the decrease in the segment's contribution to the current income of the companies compared to the corresponding period. See also the analysis of the results of ECI, Scitex and Fundtech in section d below.

**Biotechnology** – The results of companies in this segment are mainly affected by their investments in research and development, by the adjustment of the value of investments and realization of investments. The improved results of this segment in the reporting period compared to the corresponding period of the previous year are due principally to a positive non-recurring effect of NIS 18 million following the decrease in provision for impairment of CBI's investment in Compugen.

**Real estate** - The principal company in this segment is KBA whose operating results are generally characterized by fluctuation, resulting from the timing of sales of its real estate. The results in the reporting period include a gain in the amount of NIS 1 million compared to a gain of NIS 81 million in the corresponding period of the previous year (a gain of NIS 78 million from a real estate sale transaction by KBA was included in the corresponding period of the previous year).

**Communication services** – Up until the Company's investment in Barak during December 2005, the activity in the communications segment was carried out by Clalcom (a subsidiary held at a rate of 72%) and was presented under the other segment. Following the investment in Barak, the Company views the communications segment as a reportable segment and, accordingly, restated the comparative figures. See also the analysis of the results of Barak in section d below.

**Other** – The increase in this segment's contribution to income in the reported period compared to the corresponding period of the previous year is mainly a result of a positive non-recurring effect of NIS 4 million from the adoption of the new accounting standards net of the decrease in the contribution to the income of AIPM in the reported period compared to the corresponding period of the previous year. See also the analysis of the results of AIPM in section d below.

**c. Data of principal investees [2] and their contribution to income:**

The following are data from the financial statements of principal investees. The data are presented in the functional currency of each company (in millions):

| | Sales | | Net income (loss) | |
|---|---|---|---|---|
| | Three months ended March 31 | | | |
| | 2006 | 2005 | 2006 | 2005 |
| Companies that prepare financial statements in NIS: | | | | |
| Mashav | 459 | 359 | 21 | 34 |
| Golf | 134 | 118 | 8 | 6 |
| AIPM | 131 | 122 | 8 | 14 |
| Barak | 179 | 157 | 20 | (7) |
| Companies that prepare financial statements in $: | | | | |
| ECI | $ 162 | $ 145 | $ 3 | $ 10 |
| Fundtech | $ 19 | $ 17 | $ 0.2 | $ 0.5 |

**Contribution to income from principal investees** (NIS millions):

| | Three months ended March 31 | |
|---|---|---|
| | 2006 | 2005 |
| Mashav | 16 | 25 |
| Golf | 8 | 6 |
| AIPM | 3 | 5 |
| ECI | - | 13 |
| Fundtech | 1 | 1 |
| Barak | (4) | - |

**d. Review of operations of principal companies during the reporting period:**

**The cement segment companies** – Revenues in the quarter totaled NIS 323 million, compared to NIS 265 million in the corresponding period of the previous year (an increase of about 22%), due to an increase in local sales. Net income in the quarter totaled NIS 16 million (after a negative non-recurring effect of NIS 16 million due to streamlining measures) compared to a net income of NIS 30 million in the corresponding period of 2005. The increase in current income this year compared to last year arises from an increase in sales partly offset by a significant increase in energy prices and due to high manufacturing costs in the Hartuv plant which renewed the manufacture of clean-care products during the second quarter of 2005 and whose manufacturing costs are higher than the Ramle plant.

[2] Relates to financial statements published by ECI and Fundtech on the basis of generally accepted accounting principles in the United States. The Company included the results of these companies according to generally accepted accounting principles in Israel.

**ECI** – Revenues in the quarter totaled $ 162 million, compared to $ 145 million in the corresponding quarter of the previous year, an increase of 11%.

Revenues of the optical networks division in the quarter totaled $ 89 million, compared to $ 77 million in the corresponding quarter of the previous year (an increase of 17% in the division's revenue). The division continued to improve its profitability and recorded operating income of $ 12.7 million in the quarter, compared to income of $ 4.9 million in the corresponding quarter of the previous year.

Revenues of the broadband access division in the quarter totaled $ 62 million, compared to $ 63 million in the corresponding quarter of the previous year (a decrease of 1% in the division's revenues). Operating income of the division totaled $ 5.9 million, compared to $ 8.5 million in the corresponding quarter of the previous year.

The operating loss of the new data networks division (formerly: Laurel Networks Inc. acquired in June 2005) amounted to $ 9.5 million in the quarter.

The net income for the quarter amounted to $ 3.1 million compared to $ 10.4 million in the corresponding quarter of the previous year. The results of the quarter include an expense of $ 2.9 million as a result of the initial adoption of a new accounting standard regarding share-based payment.

**AIPM** – Operating income for the quarter totaled NIS 13.3 million, compared to NIS 14.5 million for the corresponding quarter of the previous year. The decrease in operating income resulted from the continued increase in prices of energy and raw materials and was partly offset by an increase of NIS 10 million in the scope of sales in the quarter compared to corresponding quarter of the previous year. Net income for the quarter totaled NIS 8 million, compared to NIS 14 million in the corresponding quarter of the previous year. The decrease in net income was mainly a result of the decrease (of NIS 5 million) in AIPM's share in earnings of affiliates. The results of the affiliates were mostly affected by the increase in prices of energy and raw materials.

**Golf** – Sales in the quarter totaled NIS 134 million compared to sales of NIS 118 million in the corresponding quarter of the previous year. The increase in sales this quarter is mainly a result of the increase in sales in existing stores. The gross profit this quarter amounted to NIS 73 million compared to NIS 65 million in the corresponding quarter of the previous year. The decrease in the gross profit margin (from 55.3% to 54.1%) resulted mainly from the clearing rate of inventory balances in Sprint stores. The net income for the quarter totaled NIS 8 million, compared to NIS 6 million in the corresponding quarter of the previous year. The increase in net income was mainly a result of the growth in gross profit offset by a more moderate growth in selling and marketing expenses (a growth of NIS 4 million).

As for the issuance of Golf shares in March 2006, see 3 below.

**Fundtech** – Net income in the quarter amounted to $ 0.2 million, compared to $ 0.5 million in the corresponding quarter of the previous year. The decrease in income was due principally to recording salary expenses in the quarter in respect of employee options totaling $ 0.6 million.

**Barak** – Revenues for the quarter amounted to NIS 179 million compared to revenues of NIS 157 million in the corresponding quarter of the previous year. The increase in revenues in the quarter is a result of the increase in revenues from the different areas of activity. Gross profit in the reported period amounted to NIS 58 million compared to NIS 51 million in the corresponding quarter of the previous year while maintaining a gross profit margin of 32%. Net income for the quarter amounted to NIS 20 million compared to a net loss of NIS 7 million in the corresponding quarter of the previous year. The increase in net income was mainly a result of the increase in gross profit (NIS 7 million) and a decrease in financial expenses (NIS 17 million) following the settlement of the debentures and the investment in the share capital of Barak, both completed in December 2005.

In general, the results of most of the Group companies in Israel during the reporting period were affected by retention of the level of demand due to the relative calm in the security situation. The Group companies operating in the hi-tech sector were generally affected by the continued growth in the amount of acquisitions of capital equipment abroad, which contributed to the growth in the volume of sales in this segment. Retention of the relatively high level of activity, together with the positive impact of the efficiency measures being implemented by most of the companies in the Group, and notwithstanding the increase in energy prices compared to the corresponding quarter of the previous year, resulted in an improvement in results and in net income in the quarter for all of the principal companies.

Moreover, the relative stability in capital markets in Israel and worldwide contributed to a positive environment for debt financing at reasonable prices, and an improvement in financial strength for some of the Group companies.

## 3. PRINCIPAL CHANGES IN INVESTMENTS AND IN INVESTEES

### 3.1 <u>The textile segment</u>

In March 2006, Golf issued 4.65 million Ordinary shares, 4.65 million warrants (series 1) and 4.65 million warrants (series 2) in the context of an IPO on the Tel Aviv Stock Exchange for total net proceeds of NIS 71 million. The exercise increment for the warrants (series 1 and 2) was NIS 19 and NIS 20, respectively (subject to adjustments), linked to the Israeli CPI and exercisable by March 8, 2009 and March 8, 2010, respectively.

The gain which Kitan Consolidated derived from the decrease in the holding rate in Golf amounted to NIS 33 million.

Following the offering, Kitan Consolidated holds 84% of the share capital. Provided that all the warrants are exercised into shares, the holding rate will drop to 62%.

### 3.2 <u>The biotechnology segment</u>

- In May 2006, all the prerequisites for the completion of the two agreements arranging Teva Pharmaceutical Industries Ltd.'s investment in Curetech Ltd. were met but the agreements were not finalized. For more details, see Note 8g(2) to the annual financial statements.

- In view of the gap between Compugen's share market price and the price derived from the outstanding investment in the books, and given the evaluation obtained by Clal Biotechnology Industries Ltd. ("CBI"), a subsidiary, from an independent outside appraiser, which determined that Compugen's share value is not below $ 3.25 (as of March 31, 2006, Compugen's share price is $ 3.85), CBI canceled part of the provision for the impairment of its investment in Compugen in the interim financial statements totaling NIS 22 million (of which the Company's share is NIS 18 million).

### 3.3 <u>The communication services segment</u>

In February 2006, the Company ordered a general valuation of Barak in order to attribute the excess of cost totaling NIS 513 million created upon the investment in Barak. The valuation determined that the excess of cost should be attributed to intangible assets (NIS 131 million) and to Barak's liabilities (NIS 119 million). For more details, see the evaluation of assets regarding attribution of excess of said cost attached to these interim statements.

### 3.4 <u>The other segment</u>

In January 2006, the Company purchased about 2.5% of the share capital of AIPM, in on and off-the-market transactions, in consideration of approximately NIS 24 million. Following said acquisitions, the Company holds about 38.1% of AIPM.

### 3.5 <u>Additional investments in the reported period</u>

During the reported period, the Company invested, directly and indirectly (through wholly-owned subsidiaries) approximately NIS 2 million in other companies in the high-technology, electronics and venture capital funds segment.

### 3.6 <u>Events subsequent to balance sheet date</u>

<u>The communication services segment</u>

- <u>Investment in Barak</u>

  In April 2006, the Company and the Sky Fund ("the Fund") signed an agreement whereby the Company and the Fund will invest in Barak as follows:

The Fund, the Company and Clalcom Ltd. ("Clalcom"), a subsidiary of the Company which announced its intention to participate in the investment in Barak, will invest a total of $ 15 million in Barak's share capital, of which $ 10 million will be invested by the Fund, $ 3.2 million will be invested by the Company and $ 1.8 million will be invested by Clalcom. In addition, an amount of $ 20 million will be invested in convertible debentures, of which $ 10 million will be invested by the Fund, approximately $ 6.4 million will be invested by the Company and approximately $ 3.6 million will be invested by Clalcom.

The convertible debentures will be redeemed in one payment at the end of five years from the date of their issuance, will bear annual interest of 5.5%, to be paid on a quarterly basis, and will be convertible into Ordinary shares of Barak at any time until they are redeemed for a price reflecting a company valuation of Barak of $ 47 million, subject to adjustments. If the Company converts the debentures into shares, the Fund and Clalcom will also be committed to convert their debentures. Furthermore, in the event of a merger between Barak and Netvision Ltd. ("Netvision"), which is controlled by Discount Investments Corporation Ltd., a member of the IDB Group, the Company, the Fund and Clalcom will convert the debentures into shares upon the completion of such merger, if and when it is executed. There is no certainty that such a merger will indeed be effected.

If, by the end of the third year from the date of completing the transaction, a merger agreement is not signed between Barak and Netvision, the Fund will have a put option for selling its holdings in Barak to the Company by the end of the fifth year, with no return on its investment. On the other hand, the Company will have a call option for the purchase of the Fund's holdings in Barak for a price reflecting a cumulative annual return of 30% of the Fund's investment in Barak (in this context, the Fund will be obligated to vote in the same way as the Company regarding the merger between Barak and Netvision, if and when it is effected). The exercise of the call option, if and when it is carried out, will be subject to the approvals required by any law and based on Barak's articles of association.

There is no guarantee that said transaction will be executed. The completion of the transaction is contingent upon a series of prerequisites, including, among other things, obtaining the approvals required by any law as well as raising an additional amount of $ 30 million in order to allow the early redemption of the outstanding debenture principal of Barak, totaling approximately $ 65 million.

Subsequent to the investment in the share capital of Barak, the Fund will hold 21% of Barak's share capital whereas the Company will hold 66%, directly and through Clalcom (61% on a fully diluted basis).

- <u>Examining the merger between Barak and Netvision</u>

In Barak's board meeting from April 29, 2006, the following was determined:

a. To examine the preparation of a merger transaction between Barak and Netvision and its implications.
b. To authorize Barak's management to formulate a merger proposal and to conduct negotiations with regard to the merger agreement.

c. To act to nominate a joint independent appraiser for Barak and Netvision that will determine the values or exchange ratios upon the merger, if it is effected.

d. To act to nominate another independent appraiser for granting Barak a fairness opinion regarding the consideration.

e. To the best of the Company's knowledge, Netvision also resolved to examine the merger transaction under the required amendments.

There is no guarantee that the merger will be executed. If and as far as Barak and Netvision agree on the merger, it will be subject, among other things, to signing a merger agreement between the parties, to the approval of the merger by the parties (the approval of the qualified authorities in Barak and the Company) and to obtaining the other required approvals by any law.

- Consolidation of Barak's accounts

As of December 31, 2005, the Company consolidates Barak's financial statements. The added revenues from sales and services during the first quarter of 2006 amount to NIS 179 million and the addition to assets in the consolidated balance sheet amounts to NIS 681 million as of December 31, 2005.

## 4. FINANCIAL POSITION AND SOURCES OF FINANCING

Total assets in the consolidated balance sheet as of March 31, 2006 totaled NIS 6,823 million, compared to NIS 6,789 million as of December 31, 2005.

Consolidated working capital amounted to NIS 618 million. As of March 31, 2006, short-term liquid assets amounted to NIS 1,014 million, and are included in short-term investments and in cash and cash equivalents. The quick ratio of the consolidated Group companies is 1.02 (December 31, 2005 – 1.18). The principal sources of cash were from dividends received from affiliates in the amount of NIS 75 million and from the issuance of shares to minority in subsidiary in the amount of NIS 71 million. Cash was utilized principally for purchase of fixed assets in the amount of NIS 72 million.

Shareholders' equity as of March 31, 2006 totaled NIS 1,843 million compared to NIS 2,025 million as of December 31, 2005. The decrease in equity totaling NIS 182 million resulted mainly from a dividend declared in the amount of NIS 270 million offset by the income of NIS 76 million in the quarter.

Minority interests as of March 31, 2006 totaled NIS 300 million (December 31, 2005 – NIS 288 million). Shareholders' equity and minority interests together constituted sources for financing 31% of the Group's assets (December 31, 2005 – 34%).

As of March 31, 2006, the Group's long-term financing sources totaled NIS 2,757 million (December 31, 2005 – NIS 2,780 million), 8% of which are repayable in the coming year. As of March 31, 2006, the Group's short-term financing sources totaled NIS 129 million (December 31, 2005 – NIS 127 million).

As of March 31, 2006, the balance of liabilities, net, of the Company and its wholly owned headquarter companies (mainly debentures) amounted to NIS 1,200 million (December 31, 2005 – NIS 1,090 million).

## 5. DIVIDEND

On April 26, 2006, the Company distributed a cash dividend of NIS 270 million, representing NIS 1.7159 per NIS 1 par value.

On the date of the approval of the financial statements, the Company's board decided to distribute a cash dividend in the amount of approximately NIS 108 million, representing NIS 0.6863 per NIS 1 par value. The dividend will be paid on July 3, 2006, the record date determined to be June 18, 2006 and the ex day June 19, 2006.

## 6. QUALITATIVE REPORT REGARDING EXPOSURE TO AND MANAGEMENT OF MARKET RISKS

The following report relates to the Company and to its wholly owned subsidiaries whose market risks are managed by the Company ("the Corporation"). Regarding subsidiaries, see section 6.2 below.

There were no material changes in the reporting period regarding the Company's exposure to and management of market risks (as described in the Securities Authority directive) in relation to the Company's report on this subject dated March 23, 2006.

### 6.1 Consolidated report on linkage bases as of March 31, 2006 (NIS in millions):

| | Linked to the Israeli CPI | Linked to U.S. dollar | Linked to other foreign currencies | Unlinked | Non-monetary balances | Total |
|---|---|---|---|---|---|---|
| Current assets | 155 | 200 | 31 | 1,247 | 642 | 2,275 |
| Non-current assets | 110 | 25 | 9 | 7 | 4,397 | 4,548 |
| Current liabilities | (292) | (193) | (89) | (1,079) | (4) | (1,659) |
| Non-current liabilities | (2,137) | (369) | (3) | (80) | (734) | (3,330) |
| Balance sheet, net | (2,164) | (337) | (52) | 95 | 4,301 | 1,843 |

### 6.2 Subsidiaries

In the reporting period, there were no material changes in Nesher, Kitan, Taavura and Barak regarding exposure to and management of market risks (as described in the Securities Authority directive) in relation to the report on this subject dated March 23, 2006.

### 6.3 Positions in derivatives

There were no material changes in the reporting period in relation to the annual report.

### 6.4 Events subsequent to balance sheet date

There were no material events relating to the market risks of the corporation subsequent to balance sheet date.

## 7. SHARE CAPITAL

In the reported period, 46,572 additional shares were issued upon the exercise of 108,266 options, and 9,782 options expired. As of the date of the approval of the financial statements, the share capital amounts to 157,354,542 Ordinary shares.

## 8. ISSUANCE OF DEBENTURES

In April 2006, the Company issued to institutional investors through a private placement approximately 91 million debentures (series L) in consideration of NIS 94 million as well as approximately 151 million debentures (series M) in consideration of NIS 156 million. The issued debentures were added to the Company's debentures (series L) and debentures (series M) that are listed for trade on the Tel Aviv Stock Exchange, with identical terms to the terms of the debentures from said series. The consideration amounts from the debentures reflect a redemption return of about 4.7% and 4.9%, respectively. Maalot the Israel Securities Rating Company Ltd. ranked the expansion of the two debenture series as (AA).

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

| | | |
|---|---|---|
| **Nochi Dankner** | **Avi Fisher** | **Zvika Livnat** |
| Chairman of the Board of Directors | Director and Co-CEO | Co-CEO |

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**CLAL INDUSTRIES AND INVESTMENTS LTD.**

**CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**AS OF MARCH 31, 2006**

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## CONSOLIDATED BALANCE SHEETS

| | March 31, 2006 | March 31, 2005 | December 31, 2005 |
|---|---|---|---|
| | Unaudited | Unaudited | Audited |
| | Reported NIS in millions | | |
| ASSETS | | | |
| CURRENT ASSETS: | | | |
| Cash and cash equivalents | 671 | 571 | 713 |
| Short-term investments | 343 | 135 | 315 |
| Trade receivables | 583 | 437 | 602 |
| Other receivables | 92 | 89 | 104 |
| Inventories | 586 | 535 | 542 |
| | 2,275 | 1,767 | 2,276 |
| LONG-TERM DEPOSITS, LOANS AND RECEIVABLES | 88 | 70 | 91 |
| INVESTMENTS: | | | |
| Affiliates | 1,395 | 1,094 | 1,384 |
| Other | 440 | 427 | 416 |
| | 1,835 | 1,521 | 1,800 |
| FIXED ASSETS: | | | |
| Cost | 7,517 | 6,668 | 7,464 |
| Less - accumulated depreciation | 5,451 | 4,862 | 5,420 |
| | 2,066 | 1,806 | 2,044 |
| OTHER ASSETS AND DEFERRED CHARGES | 559 | 219 | *) 578 |
| | 6,823 | 5,383 | 6,789 |

*) Reclassified, see Note 3c.

The accompanying notes are an integral part of the interim consolidated financial statements.

## CONSOLIDATED BALANCE SHEETS

| | March 31, | | December 31, |
|---|---|---|---|
| | 2006 | 2005 | 2005 |
| | Unaudited | | Audited |
| | Reported NIS in millions | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
| CURRENT LIABILITIES: | | | |
| Credit from banks | 243 | 369 | 248 |
| Trade payables | 530 | 247 | 554 |
| Other payables | 504 | 475 | 558 |
| Dividend payable | 279 | 108 | - |
| Other current liabilities | 101 | 297 | *) 105 |
| | 1,657 | 1,496 | 1,465 |
| LONG-TERM LIABILITIES: | | | |
| Debentures | 2,403 | 1,188 | *) 2,414 |
| Loans | 148 | 140 | 145 |
| Deferred taxes | 249 | 300 | 260 |
| Accrued severance pay | 173 | 148 | 155 |
| Other liabilities | 50 | 10 | 37 |
| | 3,023 | 1,786 | 3,011 |
| MINORITY INTEREST | 300 | 237 | 288 |
| SHAREHOLDERS' EQUITY | 1,843 | 1,864 | 2,025 |
| | 6,823 | 5,383 | 6,789 |

*) Reclassified, see Note 3c.

The accompanying notes are an integral part of the interim consolidated financial statements.

## CONSOLIDATED STATEMENTS OF INCOME

| | Three months ended March 31, | | Year ended December 31, |
|---|---|---|---|
| | 2006 | 2005 | 2005 |
| | Unaudited | | Audited |
| | Reported NIS in millions (except per share data) | | |
| Revenues, net: | | | |
| Sales and services | 844 | 833 | 2,967 |
| Other income | 24 | - | 83 |
| Group's equity in earnings of affiliates | 6 | 18 | 211 |
| | 874 | 851 | 3,261 |
| Costs and expenses: | | | |
| Cost of sales and services | 600 | 424 | 1,824 |
| Selling and marketing expenses | 97 | 76 | 314 |
| General and administrative expenses | 56 | 46 | 210 |
| Other expenses, net | - | 2 | - |
| Financial expenses, net | 40 | 14 | 128 |
| | 793 | 562 | 2,476 |
| Income before taxes on income | 81 | 289 | 785 |
| Taxes on income | 18 | 104 | 229 |
| Income after taxes on income | 63 | 185 | 556 |
| Minority interest in earnings of subsidiaries, net | (10) | (81) | (146) |
| Income before cumulative effect of change in accounting principle | 53 | 104 | 410 |
| Cumulative effect as of the beginning of the period of change in accounting principles, net | 23 | (3) | (3) |
| Net income | 76 | 101 | 407 |
| Net earnings per share (in NIS)*): | | | |
| Basic net earnings: | | | |
| Earnings before cumulative effect as of the beginning of the period of change in accounting principles, net | 0.33 | 0.67 | 2.58 |
| Earnings (loss) from cumulative effect as of the beginning of the period of change in accounting principles, net | 0.15 | (0.02) | (0.02) |
| | 0.48 | 0.65 | 2.56 |
| Diluted net earnings: | | | |
| Earnings before cumulative effect as of the beginning of the period of change in accounting principles, net | 0.33 | 0.65 | 2.52 |
| Earnings (loss) from cumulative effect as of the beginning of the period of change in accounting principles, net | 0.15 | (0.02) | (0.02) |
| | 0.48 | 0.63 | 2.50 |

*) 2005 - restated, see Note 2b(2).

The accompanying notes are an integral part of the interim consolidated financial statements.

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

| | Share capital | Capital reserves *) | Retained earnings: Dividend declared subsequent to balance sheet date | Retained earnings: Undistributed retained earnings | Total |
|---|---|---|---|---|---|
| | Reported NIS in millions | | | | |
| **Unaudited** | | | | | |
| Balance as of January 1, 2006 | 1,257 | 437 | 270 | 61 | 2,025 |
| Issuance of share capital | **) - | - | - | - | **) - |
| Foreign currency translation adjustments | - | 12 | - | - | 12 |
| Dividend declared | - | - | (270) | - | (270) |
| Net income | - | - | - | 76 | 76 |
| Dividend declared subsequent to balance sheet date | - | - | 108 | (108) | - |
| Balance as of March 31, 2006 | 1,257 | 449 | 108 | 29 | 1,843 |
| **Unaudited** | | | | | |
| Balance as of January 1, 2005 | 1,257 | 395 | 108 | 104 | 1,864 |
| Issuance of share capital | **) - | - | - | - | **) - |
| Foreign currency translation adjustments | - | 7 | - | - | 7 |
| Dividend declared | - | - | (108) | - | (108) |
| Net income | - | - | - | 101 | 101 |
| Balance as of March 31, 2005 | 1,257 | 402 | - | 205 | 1,864 |
| **Audited** | | | | | |
| Balance as of January 1, 2005 | 1,257 | 395 | 108 | 104 | 1,864 |
| Issuance of share capital | **) - | - | - | - | **) - |
| Foreign currency translation adjustments | - | 41 | - | - | 41 |
| Capital reserve from transaction with controlling shareholder | - | 1 | - | - | 1 |
| Dividend | - | - | (108) | (180) | (288) |
| Net income | - | - | - | 407 | 407 |
| Dividend declared subsequent to balance sheet date | - | - | 270 | (270) | - |
| Balance as of December 31, 2005 | 1,257 | 437 | 270 | 61 | 2,025 |

The accompanying notes are an integral part of the interim consolidated financial statements.

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

*) Composition:

| | March 31, 2006 | March 31, 2005 | December 31, 2005 |
|---|---|---|---|
| | Unaudited | | Audited |
| | Reported NIS in millions | | |
| Capital reserves: | | | |
| Share premium | 574 | 574 | 574 |
| Capitalized earnings | 23 | 23 | 23 |
| Expired stock options of investees | 12 | 12 | 12 |
| Capital reserve from transactions with controlling shareholder | 19 | 18 | 19 |
| | 628 | 627 | 628 |
| Foreign currency translation adjustments | (179) | (225) | (191) |
| | 449 | 402 | 437 |

**) Less than NIS 1 million.

The accompanying notes are an integral part of the interim consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Three months ended March 31, 2006 | Three months ended March 31, 2005 | Year ended December 31, 2005 |
|---|---|---|---|
| | Unaudited | Unaudited | Audited |
| | Reported NIS in millions | | |
| Cash flows from operating activities: | | | |
| Net income | 76 | 101 | 407 |
| Adjustments to reconcile net income to net cash provided by operating activities (a) | (51) | 193 | 257 |
| Net cash provided by operating activities | 25 | 294 | 664 |
| Cash flows from investing activities: | | | |
| Purchase of fixed and other assets | (72) | (40) | (205) |
| Acquisition of newly consolidated subsidiaries (b) | - | (4) | (77) |
| Acquisition of minority rights in subsidiary | - | - | (4) |
| Investments in affiliates and other companies | (34) | (31) | (205) |
| Decrease (increase) in marketable securities, net | 2 | 54 | (132) |
| Proceeds from disposal of fixed assets | 4 | 6 | 34 |
| Proceeds from disposal of investments | 5 | 53 | 160 |
| Sale of previously consolidated subsidiaries (c) | - | - | - |
| Decrease in short-term deposits, loans and investments, net | - | 12 | 19 |
| Short-term investments in IDB Group companies, net | (29) | (14) | (14) |
| Increase in deposits and long-term loans | - | - | (1) |
| Collection of other long-term loans and receivables | 2 | - | 33 |
| Net cash provided by (used in) investing activities | (122) | 36 | (392) |
| Cash flows from financing activities: | | | |
| Receipt of loans and other long-term liabilities: | | | |
| From banks and others | 42 | 9 | 81 |
| From issuance of debentures | - | - | 926 |
| Repayment of loans and other long-term liabilities: | | | |
| From banks and others | (20) | (75) | (184) |
| From companies in the IDB Group | - | (5) | (5) |
| Redemption of debentures | (15) | (15) | (291) |
| Short-term credit from banks, net | 2 | 43 | (88) |
| Increase (decrease) in other current liabilities, net | (1) | - | 1 |
| Issuance of shares by subsidiary to minority interest | 71 | - | 38 |
| Dividends paid by subsidiaries to minority interest | (24) | (94) | (127) |
| Dividends paid | - | - | (288) |
| Net cash provided by (used in) financing activities | 55 | (137) | 63 |
| Increase (decrease) in cash and cash equivalents | (42) | 193 | 335 |
| Cash and cash equivalents at the beginning of the period | 713 | 378 | 378 |
| Cash and cash equivalents at the end of the period | 671 | 571 | 713 |

The accompanying notes are an integral part of the interim consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Three months ended March 31, 2006 | Three months ended March 31, 2005 | Year ended December 31, 2005 |
|---|---|---|---|
| | Unaudited | Unaudited | Audited |
| | Reported NIS in millions | | |
| (a) Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Income and expenses not involving operating cash flows: | | | |
| Minority interest in earnings of subsidiaries, net | 10 | 81 | 146 |
| Group's equity in earnings of affiliates, net of dividends received *) | 69 | (1) | (177) |
| Loss (gain) on sale of investments, net | 11 | (1) | (89) |
| Gain from issuance to minority in subsidiary | (33) | - | (8) |
| Decrease (increase) in value of investments and assets, net | (26) | 12 | 42 |
| Depreciation and amortization | 67 | 42 | 172 |
| Gain on sale of fixed and other assets, net | (2) | (3) | (11) |
| Deferred taxes, net | (13) | (5) | (30) |
| Increase (decrease) in accrued severance pay | 18 | (2) | 3 |
| Erosion (revaluation) of assets and liabilities, net | 5 | (6) | 50 |
| Cumulative effect as of the beginning of the period of change in accounting principle, net | (23) | 3 | 3 |
| Changes in operating assets and liabilities: | | | |
| Decrease (increase) in other receivables | 6 | (27) | (31) |
| Increase in inventories | (46) | (24) | (33) |
| Increase (decrease) in other payables | (94) | 124 | 220 |
| | (51) | 193 | 257 |
| *) Dividends received | 75 | 17 | 34 |

The accompanying notes are an integral part of the interim consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Three months ended March 31, 2006 | Three months ended March 31, 2005 | Year ended December 31, 2005 |
|---|---|---|---|
| | Unaudited | Unaudited | Audited |
| | Reported NIS in millions | | |
| (b) Acquisition of newly consolidated subsidiaries: | | | |
| Assets and liabilities of subsidiaries at date of acquisition: | | | |
| Working capital deficiency, excluding cash | - | 6 | 248 |
| Investments in investees and other companies | - | 1 | (10) |
| Fixed assets, other assets and deferred charges | - | (14) | (249) |
| Long-term liabilities | - | 3 | 447 |
| Excess of cost created upon the acquisition | - | - | (513) |
| | - | (4) | (77) |
| (c) Sale of previously consolidated subsidiaries: | | | |
| Assets and liabilities of subsidiaries as of the date of sale: | | | |
| Working capital deficiency, excluding cash | - | - | (2) |
| Investments, fixed assets, other assets and deferred charges | - | - | 2 |
| Long-term liabilities | - | - | (1) |
| | - | - | (1) |
| (d) Significant non-cash activities: | | | |
| Dividend receivable from investee | 4 | - | 30 |
| Dividend declared | 279 | 108 | - |
| Transfer of inventories to fixed assets | 2 | 2 | 4 |
| Purchase of properties on credit | 9 | 1 | 3 |
| Sale of investments in companies, fixed and other assets on credit | - | - | 5 |

The accompanying notes are an integral part of the interim consolidated financial statements.

## NOTE 1:- GENERAL

a. These financial statements have been prepared in a condensed format as of March 31, 2006 and for the three months then ended. These financial statements should be read in conjunction with the Company's annual financial statements and accompanying notes as of December 31, 2005 and for the year then ended.

b. The Company is a subsidiary of IDB Development Corporation Ltd. The term "IDB Group company" in these financial statements refers to an investee of the parent company, other than companies in the Clal Industries and Investments Ltd. Group ("investees"). The term "Group companies" in these financial statements refers to the Company and its investees.

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

a. The interim financial statements have been prepared in accordance with generally accepted accounting principles for the preparation of financial statements for interim periods, as prescribed in Accounting Standard No. 14 of the Israel Accounting Standards Board and in accordance with Chapter D of the Securities Regulations (Periodic and Immediate Reports), 1970.

The significant accounting policies and methods of computation followed in the preparation of the interim financial statements are identical to those followed in the preparation of the latest annual financial statements, except as described in b below.

b. Initial adoption of new Accounting Standards:

1. Initial adoption of Accounting Standard No. 20 (Revised) regarding the accounting for goodwill and intangible assets upon acquisition of investee:

   On January 1, 2006, the Company adopted the provisions of Accounting Standard No. 20 (Revised), "Accounting for Goodwill and Intangible Assets upon Acquisition of Investee" ("the Standard"), of the Israel Accounting Standards Board. The Standard prescribes the accounting treatment of goodwill and intangible assets upon the acquisition of a subsidiary and an investee which is not a subsidiary, including a company under joint control. In accordance with the provisions, the Standard is being applied prospectively and comparative data have not been restated.

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The principal changes promulgated by the Standard in contrast to the principles applied prior to January 1, 2006 are: allocating the excess of cost of an investment in an investee also to the investee's identifiable intangible assets; distinguishing between intangible assets with a finite useful life and intangible assets with an indefinite useful life; immediate recognition as a gain in the statement of income of the balance of negative goodwill arising upon acquisition and remaining after deduction from the cost of the investee's intangible assets and non-monetary assets; the discontinuance of the systematic amortization of goodwill and intangible assets with an indefinite useful life; assessment for impairment of goodwill in respect of a subsidiary or jointly controlled company and of intangible assets with an indefinite useful life on an annual basis, or more frequently, if there are indications of impairment; distinguishing between goodwill relating to the acquisition of a subsidiary and a jointly controlled company as opposed to that of an affiliate in respect of the assessment of impairment, such that impairment of goodwill for an affiliate is evaluated in the context of the assessment of impairment of the investment as a whole. Impairment is accounted for in accordance with Accounting Standard No. 15, "Impairment of Assets".

As a result of the initial adoption of the provisions of the Standard, the Company discontinued the systematic amortization of goodwill whose balance as of December 31, 2005 is NIS 16 million. The need to record an impairment loss in respect of goodwill will be examined as discussed above.

Following are data of goodwill amortization in previous reporting periods:

| | Three months ended March 31, 2005 | Year ended December 31, 2005 |
|---|---|---|
| | Reported NIS in millions | |
| Goodwill amortization | 1 | 3 |

As for excess of cost created upon the acquisition of Barak I.T.C. (1995) - the International Telecommunication Services Corp. Ltd. ("Barak"), see Note 3c below.

2. Initial adoption of Accounting Standard No. 21 regarding earnings per share:

On January 1, 2006 ("the effective date"), the Company adopted the provisions of Accounting Standard No. 21, "Earnings per Share" ("the Standard") of the Israel Accounting Standards Board. The Standard prescribes the principles for the computation and presentation of earnings (loss) per share in the financial statements and supersedes Opinion No. 55 of the Institute of Certified Public Accountants in Israel.

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

According to the Standard, earnings per share are computed based on the number of ordinary shares (and not per NIS 1 par value of the shares as computed until the effective date). Basic earnings per share include only shares which are outstanding during the period whereas convertible securities (such as convertible debentures and options) are only included in the computation of diluted earnings per share, in contrast to the principles applied until the effective date according to which in cases where a convertible security is likely to be converted, it is included in the computation of basic earnings per share. In addition, convertible securities which are converted during the period, are included in diluted earnings per share up to the date of conversion and are included in basic earnings per share from that date. Pursuant to the Standard, options are included in diluted earnings when their exercise results in the issuance of shares for a consideration which is less than the market price of the shares. The amount of dilution is the market price of the shares minus the amount that would have been received as a result of the conversion of the options into shares. This is in contrast to the method of computation prescribed by Opinion No. 55, which also included adjustments to earnings.

The investor's share of earnings of an investee is included based on the earnings per share of the investee multiplied by the number of shares held by the investor.

As a result of the initial adoption of the provisions of the Standard, the comparative data of earnings per share relating to previous periods have been restated.

3. Initial adoption of Accounting Standard No. 22 regarding financial instruments: disclosure and presentation:

On January 1, 2006 ("the effective date"), the Company adopted the provisions of Accounting Standard No. 22, "Financial Instruments: Disclosure and Presentation" ("the Standard") of the Israel Accounting Standards Board. The Standard prescribes principles for the presentation and disclosure of financial instruments and supersedes Opinions No. 48 and 53 of the Institute of Certified Public Accountants in Israel. In accordance with the provisions, the Standard is being applied prospectively and comparative data have not been restated or reclassified.

The principal changes promulgated by the Standard in contrast to the principles applied prior to January 1, 2006 are: transaction costs in respect of a financial liability are deducted from the liability and are taken into account in the computation of the effective interest rate; upon the issuance of several types of financial instruments in a single unit (shares, debentures and warrants), the components of the unit, including related transaction costs, are classified separately upon initial recognition into the various financial instruments based on their fair value; compound financial instruments that include both a liability and an equity component (such as convertible debentures) are bifurcated between the equity component (receipts from conversion option) and the liability component and each component is classified separately (net of transaction costs attributed to the different components).

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Standard supersedes the provisions of Opinions No. 48 and 53 of the Institute of Certified Public Accountants in Israel, according to which in certain circumstances, an investor was required to record a provision for a loss resulting from a decrease in its holdings in an investee, due to the probable conversion of convertible instruments issued by the investee ("loss provision").

As a result of the initial adoption of the provisions of the Standard, a loss provision in the amount of NIS 23 million which had been included in the Company's financial statements as of December 31, 2005, was eliminated on January 1, 2006 and credited to the statement of income as the "Cumulative effect as of the beginning of the period of a change in accounting principles, net".

4. Initial adoption of Accounting Standard No. 24 regarding share-based payment:

On January 1, 2006, the Company adopted the provisions of Accounting Standard No. 24, "Share-Based Payment" ("the Standard") of the Israel Accounting Standards Board. The Standard prescribes rules for measurement and other requirements for three types of share-based transactions:

a) Equity-settled share-based payment transactions;
b) Cash-settled share-based payment transactions;
c) Share-based payment transactions which allow the entity or counterparty to choose the manner of settlement.

The initial adoption of the Standard had no material effect on the interim financial statements.

5. Initial adoption of Accounting Standard No. 25 regarding revenues:

On January 1, 2006, the Company adopted the provisions of Accounting Standard No. 25, "Revenues" ("the Standard") of the Israel Accounting Standards Board. The Standard deals with the recognition of revenue from three types of transactions: sale of goods, rendering of services and revenue from interest, royalties and dividends and prescribes the required accounting treatment (principles of recognition, measurement, presentation and disclosure) regarding these three types of transactions.

The initial adoption of the Standard had no material effect on the interim financial statements.

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

c. Following are data regarding the Israeli CPI and the exchange rate of the U.S. dollar:

| As of | Israeli CPI | Exchange rate of one U.S. dollar |
|---|---|---|
| | Points *) | NIS |
| March 31, 2006 | 110.6 | 4.665 |
| March 31, 2005 | 106.8 | 4.361 |
| December 31, 2005 | 110.0 | 4.603 |
| **Change during the period** | % | % |
| March 2006 (three months) | 0.6 | 1.3 |
| March 2005 (three months) | (0.6) | 1.2 |
| December 2005 (12 months) | 2.4 | 6.8 |

*) The index is on an average basis of 2000 = 100.

**NOTE 3:- INVESTMENTS**

a. Principal changes during the reported period:

The textile segment:

- Public issuance of securities of Golf & Co. Group Ltd. ("Golf"):

In February 2006, Golf (as of that date a wholly owned subsidiary) published a prospectus according to which it issued to the public about 4.7 million Ordinary shares, about 4.7 million warrants (series 1) and about 4.7 million warrants (series 2).

The warrants (series 1) are exercisable such that each warrant is exercisable into one Ordinary share of NIS 0.01 par value of Golf in consideration of an exercise price of NIS 19, linked to the Israeli CPI published in January 2006 (subject to adjustments). The warrants (series 1) are exercisable until March 8, 2009. The warrants (series 2) are exercisable such that each warrant is exercisable into one Ordinary share of NIS 0.01 par value of Golf in consideration of an exercise price of NIS 20, linked to the Israeli CPI published in January 2006 (subject to adjustments). The warrants are exercisable until March 8, 2010.

Total proceeds (net of issuance expenses) amounted to NIS 71 million. The proceeds from the issuance were allocated between the shares and options based on their relative market value in the first three trading days.

Following the issuance, the Company's interest in Golf decreased to about 84.3% (62.4% on a fully diluted basis). The Company recorded a gain totaling NIS 33 million which was carried to the statement of income under other income.

**NOTE 3:- INVESTMENTS (Cont.)**

The high technology and electronics segment:

- In furtherance to Note 8c to the annual financial statements, in April 2006, Nova Measuring Instruments Ltd. ("Nova"), an affiliate held at a rate of about 18.3%, restated its financial statements for 2004. Due to immateriality, the Company's share in the loss incurred as a result of the restatement in Nova's financial statements, amounting to NIS 2 million, was carried in the reported period to the statement of income under "the Group's equity in earnings of affiliates".

The biotechnology segment:

- The investment of Teva Pharmaceutical Industries Ltd. ("Teva") in Curetech Ltd. ("Curetech"):

  In May 2006, all the prerequisites for the completion of the two agreements arranging Teva's investment in Curetech were met but the agreements were not finalized. Curetech is a subsidiary indirectly held at a rate of 64% (51% on a fully diluted basis).

  Upon the completion of the first stage of the transaction and given the fact that Curetech is currently in research and development stages, the gain from the decrease in the holding rate, amounting to approximately NIS 13 million, will be recorded as deferred revenue. The deferred revenue will be carried to the statements of income in equal parts over a period of three years or up to the Company's share in Curetech's losses in said period, whichever is higher on a cumulative basis.

  Should Teva exercise the option for purchasing the holdings and options of the other shareholders in Curetech, including the holdings of the Company and parent company, the Company's share in said proceeds will range between $ 57 million and $ 83 million. For more details, see Note 8g(2) to the annual financial statements.

- Compugen Ltd. ("Compugen"):

  Compugen's share is traded on the Tel Aviv Stock Exchange and on the Nasdaq. The market price of the share in the long run is higher than the market price of Compugen's share as derived from the outstanding investment in the books. In view of the gap between Compugen's share market price and the price derived from the outstanding investment in the books, and given the evaluation obtained by Clal Biotechnology Industries Ltd. ("CBI"), a subsidiary, from an independent outside appraiser, which determined that Compugen's share value is not below $ 3.25 (as of March 31, 2006, Compugen's share price is $ 3.85), CBI canceled part of the provision for the impairment of its investment in Compugen in the interim financial statements totaling NIS 22 million (of which the Company's share is NIS 18 million).

The other segment:

- In January 2006, the Company purchased about 2.5% of the share capital of American Israeli Paper Mills Ltd. ("AIPM"), in on and off-the-market transactions, in consideration of approximately NIS 24 million. As of March 31, 2006, the Company holds about 38.1% of AIPM.

## NOTE 3:- INVESTMENTS (Cont.)

b. Investments in listed companies:

| | Carrying amount at March 31, 2006 | Market value March 31, 2006 | Market value May 18, 2006 |
|---|---|---|---|
| | Reported NIS in millions | | |
| Affiliates: | | | |
| ECI Telecom Ltd. | 377 | 804 | 668 |
| Scailex Corporation Ltd. | 309 | 265 | 272 |
| American Israeli Paper Mills Ltd. | 220 | 289 | 321 |
| Fundtech Ltd. | 129 | 285 | 274 |
| Maman - Cargo Terminals and Handling Ltd. | 39 | 37 | 38 |
| Beit Shemesh Engine Holdings (1997) Ltd. | 35 | 29 | 33 |
| Nova Measuring Instruments Ltd. | 20 | 26 | 24 |
| Gold Bond Group Ltd. | 11 | 18 | 18 |
| Other companies: | | | |
| Saifun Semiconductors Ltd. | 181 | 411 | 394 |
| Compugen Ltd. | 45 | 53 | 46 |
| ECTel Ltd. | 14 | 26 | 24 |
| IDM Pharma Inc. | 12 | 14 | 8 |
| Other companies | 3 | 10 | 9 |

c. Investment in Barak:

In furtherance to Note 8g(3) to the annual financial statements, whereby the Company and Clalcom had invested approximately $ 26 million in the share capital of Barak, the Company derived excess cost totaling NIS 513 million. The Company entered into an engagement with an independent appraiser in order to evaluate the fair value of Barak's assets and liabilities, including intangible assets, as well as the remaining useful life of these assets.

## NOTE 3:- INVESTMENTS (Cont.)

According to Accounting Standard No. 20 (Revised) and based on the evaluation report as above, the excess of cost was attributed to Barak's intangible and tangible assets as follows:

| | Reported NIS in millions | Amortization period |
|---|---|---|
| Customer base | 119 | Seven years and based on the expected periods of economical benefits (most of the amortization will be carried within three years) |
| Brand name | 12 | Seven years and based on the expected periods of economical benefits (most of the amortization will be carried within five years) |
| Debentures | 122 | Five years and based on the life of the debentures |
| Goodwill | 260 | |
| Total | 513 | |

Excess of cost as of December 31, 2005, resulting from the acquisition and presented under other assets in full, was reclassified according to the subject of a paper regarding the attribution of excess of cost. The appraiser's report is enclosed to these statements.

As of December 31, 2005, the Company consolidates Barak's financial statements. The added revenues from sales and services during the first quarter of 2006 amount to NIS 179 million and the addition to assets in the consolidated balance sheet amounts to NIS 803 million as of December 31, 2005.

## NOTE 4:- ATTACHED FINANCIAL STATEMENTS OF AFFILIATE

a. The Company attaches to these financial statements the accounts of ECI Telecom Ltd. ("ECI"), the affiliate. Following is the effect of the adjustment of ECI's accounts, as reported according to generally accepted accounting principles in the United States, to generally accepted accounting principles in Israel and the accounting policy adopted by the Company:

| | March 31, 2006 | March 31, 2005 | December 31, 2005 |
|---|---|---|---|
| | Unaudited | Unaudited | Audited |
| | Reported NIS in millions | | |
| Shareholders' equity: | | | |
| As reported by the affiliate | 631,022 | 574,896 | 619,129 |
| Net adjustments to generally accepted accounting principles in Israel | (10,345) | (3,551) | (8,340) |
| As adjusted | 620,677 | 571,345 | 610,789 |

| | Three months ended March 31, 2006 | Three months ended March 31, 2005 | Year ended December 31, 2005 |
|---|---|---|---|
| | Unaudited | Unaudited | Audited |
| | Reported NIS in millions | | |
| Net income (loss) for the period: | | | |
| As reported by the affiliate | 3,062 | 10,432 | 39,864 |
| Net adjustments to generally accepted accounting principles in Israel | (3,837) | 12,093 | 16,288 |
| As adjusted | (775) | 22,525 | 56,152 |

b. Following the sale of the principal activities of Scailex Corporation Ltd. ("Scailex") in 2005, the Company ceased attaching Scailex's financial statements as of this quarter since Scailex does not comply with the tests determined for attaching the financial statements of an affiliate, nor is it expected to comply with them in the future.

## NOTE 5:- DIVIDEND

On March 21, 2006, the Company declared a dividend of NIS 270 million, representing NIS 1.7159 per NIS 1 par value. The dividend was paid on April 26, 2006. As for a dividend declared subsequent to balance sheet date, see Note 7 below.

## NOTE 6:- BUSINESS SEGMENTS

a. Segment revenues (1):

| | Three months ended March 31, 2006 | Three months ended March 31, 2005 | Year ended December 31, 2005 |
|---|---|---|---|
| | Unaudited | | Audited |
| | Reported NIS in millions | | |
| Cement | 323 | 265 | 1,326 |
| Textile | 201 | 210 | 876 |
| High-technology and electronics | 9 | 16 | 210 |
| Communication services | 176 | - | (10) |
| Biotechnology | (4) | (2) | (14) |
| Real estate | 2 | *) 261 | *) 308 |
| Other | 143 | 101 | 482 |
| | 850 | 851 | 3,178 |
| Other revenues, net | 24 | - | 83 |
| Total in the statement of income | 874 | 851 | 3,261 |

*) Mainly due to sale of land.

(1) Including segment's share of earnings of affiliates.

b. Segment results:

| | Three months ended March 31, 2006 | Three months ended March 31, 2005 | Year ended December 31, 2005 |
|---|---|---|---|
| | Unaudited | | Audited |
| | Reported NIS in millions | | |
| Cement | 36 | 50 | 261 |
| Textile | 44 | 17 | 86 |
| High-technology and electronics | (7) | 7 | 173 |
| Communication services | 18 | - | 72 |
| Biotechnology | 10 | (16) | (51) |
| Real estate | 3 | *) 233 | *) 270 |
| Other | 18 | 15 | 97 |
| | 122 | 306 | 908 |
| Adjustments (1) | (1) | (3) | 5 |
| Financial expenses | (40) | (14) | (128) |
| Income before taxes on income | 81 | 289 | 785 |

*) Mainly due to sale of land.
(1) Including other expenses, net, which were not allocated to a segment.

## NOTE 7:- EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

- Issuance of debentures:

  In April 2006, the Company issued to institutional investors through a private placement approximately 91 million debentures (series L) in consideration of NIS 94 million as well as approximately 151 million debentures (series M) in consideration of NIS 156 million. The issued debentures were added to the Company's debentures (series L) and debentures (series M) that are listed for trade on the Tel Aviv Stock Exchange, with identical terms to the terms of the debentures from said series. The consideration amounts from the debentures reflect a redemption return of about 4.7% and 4.9%, respectively.

- The communication services segment:

  In April 2006, the Company and the Sky Fund ("the Fund") signed an agreement whereby the Company and the Fund will invest in Barak as follows:

  1. The Fund, the Company and Clalcom Ltd. ("Clalcom"), a subsidiary of the Company which announced its intention to participate in the investment in Barak, will invest a total of $ 15 million in Barak's share capital, of which $ 10 million will be invested by the Fund, $ 3.2 million will be invested by the Company and $ 1.8 million will be invested by Clalcom. In addition, an amount of $ 20 million will be invested in convertible debentures, of which $ 10 million will be invested by the Fund, approximately $ 6.4 million will be invested by the Company and approximately $ 3.6 million will be invested by Clalcom.

  2. The convertible debentures will be redeemed in one payment at the end of five years from the date of their issuance, will bear annual interest of 5.5%, to be paid on a quarterly basis, and will be convertible into Ordinary shares of Barak at any time until they are redeemed for a price reflecting a company valuation of Barak of $ 47 million, subject to adjustments. If the Company converts the debentures into shares, the Fund and Clalcom will also be committed to convert their debentures. Furthermore, in the event of a merger between Barak and Netvision Ltd. ("Netvision"), which is controlled by Discount Investments Corporation Ltd., a member of the IDB Group, the Company, the Fund and Clalcom will convert the debentures into shares upon the completion of such merger, if and when it is executed. There is no certainty that such a merger will indeed be effected.

  3. If, by the end of the third year from the date of completing the transaction, a merger agreement is not signed between Barak and Netvision, the Fund will have a put option for selling its holdings in Barak to the Company by the end of the fifth year, with no return on its investment. On the other hand, the Company will have a call option for the purchase of the Fund's holdings in Barak for a price reflecting a cumulative annual return of 30% of the Fund's investment in Barak (in this context, the Fund will be obligated to vote in the same way as the Company regarding the merger between Barak and Netvision, if and when it is effected). The exercise of the call option, if and when it is carried out, will be subject to the approvals required by any law and based on Barak's articles of association.

**NOTE 7:- EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE (Cont.)**

There is no guarantee that said transaction will be executed. The completion of the transaction is contingent upon a series of prerequisites, including, among other things, obtaining the approvals required by any law as well as raising an additional amount of $ 30 million in order to allow the early redemption of the outstanding debenture principal of Barak, totaling approximately $ 65 million.

Subsequent to the investment in the share capital of Barak, the Fund will hold 21% of Barak's share capital whereas the Company will hold 66%, directly and through Clalcom (61% on a fully diluted basis). The Company is not expected to derive any significant gains or losses should the transaction be finalized.

- Dividend:

On May 21, 2006, the Company declared a dividend in the amount of approximately NIS 108 million, representing NIS 0.6863 per NIS 1 par value. The dividend will be paid on July 3, 2006, the record date determined to be June 18, 2006 and the ex day June 19, 2006. The dividend is presented in a separate line item in the statement of changes in shareholders' equity as "dividend declared subsequent to balance sheet date".

**APPENDIX TO INTERIM CONSOLIDSATED FINANCIAL STATEMENTS**

## Details of Investments[1] by the Company and its Wholly Owned Headquarter Companies as of March 31, 2006

| Listed companies | Ownership | Amount of investment in reported NIS in millions |
|---|---|---|
| ECI Telecom Ltd. | 13% | 377 |
| Scailex Corporation Ltd. | 25% | 310 |
| American Israeli Paper Mills Ltd. | 38% | 220 |
| Saifun Semiconductors Ltd. | 10% | 181 |
| Fundtech Ltd. | 36% | 129 |
| Beit Shemesh Engine Holdings (1997) Ltd. | 36% | 35 |
| Nova Measuring Instruments Ltd. | 18% | 20 |
| ECTel Ltd. | 6% | 14 |
| Gold Bond Group Ltd. | 18% | 11 |
| Other companies | | 3 |
| | | 1,300 |
| **Private companies** | | |
| Mashav Initiating and Development Ltd. | 75% | 884 |
| Kitan Consolidated Ltd.[2] | 100% | 207 |
| Clal Biotechnology Industries Ltd. | 81% | 94 |
| Barak I.T.C. (1995) - International Telecommunications Services Corp. Ltd. | 52.5% | 83 |
| Jaf-Ora Ltd. | 30% | 69 |
| F.B.R. Infinity Ventures (Israel) Venture | 39% | 58 |
| Power Paper Ltd. | 15% | 45 |
| K.B.A. Townbuilders Group Ltd. | 53% | 40 |
| Clalcom Ltd. | 72% | 32 |
| Cargal Ltd. | 27% | 27 |
| Infinity Israel Venture Capital Fund | 31% | 19 |
| Clal Venture Capital Fund, Limited Partnership | 67% | 16 |
| Millenium Materials Technologies Fund II L.P. | 13% | 14 |
| Nanomotion Ltd. | 15% | 12 |
| Scailex Vision Tel-Aviv Ltd. | 7% | 11 |
| Jordan Valley Semiconductors Ltd. | 45% | 8 |
| Orsus Solution Limited | 16% | 7 |
| FBR Infinity II China | 22% | 8 |
| Infinity I Annex Fund L.P. | 34% | 6 |
| Millennium Materials Technologies Funds, L.P. | 50% | 5 |
| Identify Software Ltd. | 1% | 5 |
| CosmoCom Inc. | 5% | 5 |
| Aternity Networks Inc. | 5% | 5 |
| Other private companies | | (1) |
| | | 1,659 |

1 The list of investments includes investments (including investments in share capital and extended loans) whose amount in the books exceeds NIS 5 million.

2 Presented net of offset of a loan placed in favor of the Company by Kitan Consolidated Ltd.

## APPENDIX TO INTERIM CONSOLIDSATED FINANCIAL STATEMENTS

| | Ownership | Amount of investment in reported NIS in millions |
|---|---|---|
| | | 2,959 |
| With the deduction of investments in subsidiaries | | (1,366) |
| With the addition of investments of subsidiaries | | 242 |
| Investments in affiliates and other companies | | 1,835 |

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