

**CLAL INDUSTRIES AND INVESTMENTS LTD.**

**MANAGEMENT DISCUSSION AND ANALYSIS**

**FOR THE PERIOD JANUARY - JUNE 2001**

## **1. Description of Company**

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

CII is principally engaged in the acquisition, establishment and development of companies in various industries and takes an active role in the management of its investee companies, particularly so when it is the largest investor. The Company has access to a range of commercial opportunities, remaining constantly alert for investments with appropriate potential returns. Simultaneously, the Company aspires 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 segments, which primarily include: infrastructure industries, paper, textile, high-technology and electronics, biotechnology, communications, and management of venture capital funds.

New investments are in four principal fields of specialization: biotechnology, software, semi-conductor equipment and communication technologies.

On May 21, 2001, the Company entered into a share exchange merger agreement with a subsidiary, Clal Electronic Industries Ltd. (“CEI”) (“the merger agreement”). Under the terms of the merger agreement, the shareholders of CEI (other than the Company) will transfer all their shares to the Company, such that, subsequent to the merger, the Company will hold all of the shares of CEI. The Company’s Board of Directors has approved the rate of the share exchange, insofar as the Company will issue twelve of its shares for each share of CEI transferred to the Company (as proposed by a joint appraiser). The Company has also obtained a further opinion with respect to the reasonableness of the consideration from the Company’s perspective.

On June 20, 2001, the merger agreement was approved by shareholders in general meeting, and on July 17, 2001, the merger between the Company and CEI was completed. Upon completion of the merger, the Company now holds all the shares of CEI, which have accordingly ceased to be traded on the Stock Exchange.

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

The Company views its contribution and assistance to the community as a vital component of its visionary business plan.

## 2. *Results of operations*

- A. The loss for the second quarter amounted to NIS 64 million, as compared to net income of NIS 118 million in the corresponding period of the previous year.

The loss includes the effects of net negative non-recurring factors totaling NIS 56 million, stemming principally from a write-off made by Scitex with respect to a reduction in value of its investment in Creo (NIS 27 million), the amortization of goodwill attributable to the operations of Creo in relation to the investment of CEI in Scitex (NIS 21 million), and the write-down of the value of investments in investee companies (NIS 36 million). By contrast, the above was offset by a capital gain arising on the sale of shares in PRI (NIS 46 million). In the corresponding quarter of the previous year, there were net positive non-recurring factors totaling NIS 84 million.

The loss for the reporting period amounted to NIS 283 million, as compared to net income of NIS 163 million for the corresponding period of the previous year, and a loss of NIS 89 million for 2000 as a whole.

The decrease in current income stems principally from the transition to loss-making in ECI, as well as from the decrease in profitability of Mashav and the transition to loss-making in Polgat.

- B. We set out below a review of the operations of the principal companies in the second quarter (\*):

Nesher - The quarter saw a 26% reduction in the sale of cement as compared to the corresponding quarter of the previous year, which was due primarily to a 24% reduction in sales volume. The net income for the quarter of companies in the cement sector totaled NIS 33 million, as compared to NIS 43 million for the corresponding quarter of the previous year. The affect of the decrease in sales was partly offset by the cessation of operations of old production lines, which led to a reduction in energy costs.

ECI - ECI reported a loss in the current quarter from continuing operations, before adjustment for non-recurring expenses, of NIS 109 million, as compared to a profit from continuing operations of NIS 86 million in the corresponding period of the previous year. The loss in the second quarter is computed after accounting for a decrease in the value of assets and reorganization expenses totaling NIS 41 million. Sales for the quarter amounted to NIS 1,110 million, as compared to NIS 1,211 million in the corresponding quarter of the previous year.

ECI has reported improved operating results for most of its divisions, the first quarter having been marked by an improvement in the gross profit margin and a reduction of the pace at which money was 'burned up'.

(\*) The surveys of ECI, Scitex and Fundtech are based on published financial statements prepared in accordance with accounting principles generally accepted in the U.S.A.

As of January 1, 2001, the commercial operations of the principal divisions of ECI were transferred to five subsidiaries. The results of ECI for the quarter were affected by the costs associated with the reorganization process and by the global recession in the communications equipment market. At the end of April 2001, ECI announced a program of cost-saving measures, which included a reduction in the workforce and a decrease in the salary costs of senior management.

Scitex - Sales for the quarter amounted to NIS 276 million, an increase of 27% as compared to the corresponding quarter of the previous year. Scitex has reported a growth in operations and an improvement in the operating results of the digital printing operations and wide format printing operations, despite the current market situation. Operating income before adjustment for amortization of goodwill, amounted to NIS 17 million. After adjusting for the company's equity in the losses of Creo and a write-down with respect to a decrease in value of its investment therein, the loss for the quarter amounted to NIS 673 million (under accounting principles prevailing in Israel, in accordance with which the Company is required to consolidate the results of Scitex, the loss of Scitex for the quarter amounts to NIS 230 million).

AIPM - Net income for the second quarter of 2001 amounted to NIS 9 million, as compared to income of NIS 16 million in the corresponding quarter of the previous year. A reduction in demand, together with an erosion of selling prices, led to a 14% reduction in sales for the quarter, from NIS 127 million in the corresponding quarter of the previous year to NIS 109 million for the quarter under review. The reduction in income following the decline in sales, the increase in financing expenses, and the fall in the share of AIPM in the profits of associated companies, was offset by the results of the efficiency program implemented by AIPM, which led, in turn, to a general reduction in expenses.

Kitan - Net income for the quarter amounted to NIS 11 million, as compared to NIS 7 million for the corresponding quarter of the previous year. In spite of the economic recession, sales for the quarter increased from NIS 184 million in the corresponding quarter of the previous year to NIS 204 million for the current quarter. The increase in income is due principally to an improvement in industrial operating results.

Polgat - Sales for the quarter amounted to NIS 147 million, as compared to NIS 122 million for the corresponding quarter of the previous year. A decrease in the gross profit margin in the wake of an erosion of selling prices, together with the recording of a tax expense incurred by a Turkish subsidiary (the tax expense was derived from differences in the respective bases of measurement for tax and accounting purposes), led to a reduction in net income from NIS 0.2 million for the corresponding quarter of the previous year to a net loss of NIS 10 million for the quarter under review. During the reported period, Bagir continued its transfer of manufacturing operations to locations outside Israel, with a view to reducing significantly its level of manufacturing costs.

In addition, during the reported period, the merger between Polgat Textiles and the Turkish group, Guney Sanayi, was completed, such that Polgat now holds 45% of the ownership of the joint company, Guney-Polgat.

Barak - The increase in revenues continued, reaching NIS 157 million, as compared to NIS 127 million in the corresponding period of the previous year. As well as achieving an increase in sales together with a reduction in the level of overhead expenses and marketing expenses, Barak recorded a net profit of NIS 6 million for the current quarter (the first time the company has reported net income since the commencement of operations), as compared to a net loss of NIS 24 million for the corresponding period of the previous year. Barak's quarterly results were also affected by the decline in financing expenses (NIS 8 million) and by an increase in other expenses (NIS 13 million) in the wake of expenses relating to a tender for the provision of nationwide domestic telecommunications services being charged to operations.

Fundtech - Revenues for the quarter amounted to NIS 46 million, a level similar to that for the corresponding quarter of the previous year. A decline in income from the licensing of software, together with an increase in operating expenses, led to a quarterly loss from continuing operations of NIS 15 million, as compared to a profit of NIS 5 million for the corresponding quarter of the previous year.

In general, the quarterly results of Group companies were affected by the economic recession, the security situation and the world-wide reduction in demand for technology products. The overall effect of the factors outlined above is partly offset by reorganization and efficiency measures taken by a significant number of Group companies.

C. We set out below selected data from the financial statements of the principal investee companies (in millions of shekels - rounded):

	Sales (*)				Net Income (Loss)(**)			
	For the six months ended June 30		For the three months ended June 30		For the six months ended June 30		For the three months ended June 30	
	2001	2000	2001	2000	2001	2000	2001	2000
CEI	43	40	17	21	(513)	19	(197)	-
Mashav	744	836	382	454	52	72	31	48
Kitan	400	362	204	184	21	12	11	7
AIPM (***)	233	449	109	127	20	50	9	16
Polgat (****)	299	250	147	122	(7)	3	(10)	-
Barak	306	234	157	127	(32)	(70)	6	(24)
Fundtech	101	89	46	47	(32)	2	(29)	5

(\*) Relates to sales only and does not include CII's equity in the earnings of associated companies and other income, net

(\*\*) Net income (loss) includes the effects of non-recurring factors.

(\*\*\*) The results for 2000 reflect the operations of Hogla-Kimberley, which ceased to be consolidated on March 31, 2000.

(\*\*\*\*) As of 2001, the results of operations of Polgat Textiles are consolidated with those of Guney-Polgat.

D. Earnings per share

The loss per NIS 1 share for the reported period amounted to NIS 2.02, as compared to earnings of NIS 1.16 per share in the corresponding period of the previous year and a loss of NIS 0.63 per share for the whole of 2000.

### 3. *The financial position and sources of finance*

Assets reflected in the Group's consolidated balance sheet as of June 30, 2001 totaled NIS 6,790 million, as compared to NIS 7,688 million as of the end of the corresponding quarter in the previous year and NIS 7,134 million as of the end of 2000.

As of June 30, 2001, internal sources of finance (which include shareholders' and minority interests) totaled NIS 3,273 million (48% of the consolidated balance sheet total), as compared to NIS 3,751 million as of December 31, 2000 (53% of the consolidated balance sheet total). As of June 30, 2001, the Company's working capital deficiency reached NIS 1,082 million, as compared to NIS 1,026 million as of December 31, 2000.

The sale of part of the Company's holdings in Mashav and a private placement of debentures in August 2001, led to a significant decrease in the working capital deficiency.

**4. *Principal changes in investments***

- A. In January 2001, CBI invested NIS 44 million in OralScan Laboratories Inc. ("OralScan"), in addition to NIS 2 million transferred at the end of 2000. The consideration for the investment was 9.6% of the capital of OralScan. OralScan is engaged in the development and marketing of diagnostic systems for cancerous diseases.
- B. During the period under review, CBI invested NIS 20 million in MTRE - Advanced Technologies Ltd. ("MTRE"), as part of a general investment of CBI in MTRE totaling \$6.3 million. The investment will provide CBI with 9.1% of the capital of MTRE. MTRE develops and markets a product which regulates the temperature of the human body.
- C. In May 2001, documents were signed relating to the establishment of the Infinity II Fund. The documents detail previous undertakings of the Company and CEI to invest \$25 million, in equal shares, towards the total Fund commitment of approximately \$50 million. During June 2001, only 15% of the commitment was invested. The initial capital mobilization stage was completed during July 2001. If the Infinity II Fund should undertake an investment commitment of at least \$70 million, the commitments of the Company and CEI would rise by a further \$5 million, such commitments to be divided equally between the two companies. The Company and CEI will participate in the management of the Fund.
- D. In June 2001, CBI sold its remaining holdings in Pharmaceutical Resources Inc. for NIS 51 million. The resultant net gain amounted to NIS 46 million.

**5. *Event subsequent to June 30, 2001***

- A. In August 2001, the Company sold 25% of its holdings in Mashav to CRH, a company operating in the construction materials and cement sector, for NIS 598 million. The capital gain to be reflected in the financial statements for the third quarter amounts to approximately NIS 255 million.

In addition, CRH has been granted a call option for the purchase of a further 25% of the Company's holdings in Mashav, such that, subsequent to exercise of the options, the Company and CRH will have identical holdings in Mashav. The option is exercisable at half-yearly intervals during the period commencing December 31, 2001 and ending December 31, 2003.

The parties have agreed that the exercise price of the option shall be determined by reference to the higher of, on the one hand, a company valuation of \$750 million, less the financial liabilities of Mashav as of the date of the exercise, and, on the other hand, such an amount as shall be determined by multiplying the earnings of Nesher before taxes, depreciation and financing expenses, for the twelve months preceding the date of exercise of the option, by a factor of 6.8, and adding thereto the sum of \$80 million for additional assets, and deducting therefrom the amount of the financial liabilities of Mashav as of the date of the exercise.

During the vesting period and in the period subsequent to any exercise of the option, the parties will engage in joint management of Mashav. In the event that the option is not exercised, CRH will have proportionate representation on the Board of Directors of Mashav, and will also enjoy certain minority rights.

Shortly before implementation of the transaction, Mashav paid a dividend of NIS 393 million. In addition, shortly before implementation of the transaction, the Company acquired from Mashav, certain real estate assets which are not used for the purposes of Mashav's principal operations, together with certain financial assets, for a consideration of NIS 146 million.

- B. In July 2001, K.B.A. Townbuilders Group Ltd. disposed of its rights in a real estate asset. As a result of the disposal, a net gain of NIS 19 million will be reflected in the financial statements for the third quarter.
- C. In August 2001, the Company made a private placement with institutions of debentures totalling approximately NIS 339 million.

**6. *Analysis of exposure to market risks and the management thereof***

There are no changes to report.

**7. *Contingent liability***

In the Accountants' Review Letter, reference is made to the current legal proceedings against an investee company, ECI (see Note 4E of the financial statements).

**8. *Options granted to senior employees***

The Company's Board of Directors and the Company in general meeting have approved a plan for the allotment to the Company's General Manager and to a number of other senior employees, of up to 1,298,322 options convertible into a maximum of 1,298,322 ordinary shares of the Company (subject to adjustment). Under the terms of the plan, the options are exercisable in four equal tranches.

The plan is intended to foster a long-term relationship with the senior employees of the Company, by allowing them to participate in the Company's equity, and thus in the benefits of the initiatives, development and management carried out by the Company.

We wish to express our gratitude to the managers and employees of the Group for their contribution to the Group's progress and development.

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**LEON RECANATI**  
Chairman of the Board

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**MEIR SHANNIE**  
General Manager

# CLAL INDUSTRIES AND INVESTMENTS LTD.

## SELECTED CONSOLIDATED BALANCE SHEET DATA

In millions of shekels of JUNE 2001

	<b>June 30</b>		<b>December 31</b>
	<b>2001</b>	<b>2000</b>	<b>2000</b>
	<b>(Unaudited)</b>		<b>(Audited)</b>
<u>Assets</u>			
Current assets	1,440	1,629	1,370
Long term deposits, loans and receivables	73	93	84
Investments	2,593	3,165	2,959
Fixed assets, other assets and deferred expenses	2,684	2,801	2,721
	<u>6,790</u>	<u>7,688</u>	<u>7,134</u>
<u>Liabilities and Shareholders' Equity</u>			
Current liabilities	2,522	2,686	2,396
Long-term liabilities	995	795	987
Minority interests	495	909	715
Shareholders' equity	2,778	3,298	3,036
	<u>6,790</u>	<u>7,688</u>	<u>7,134</u>

## CLAL INDUSTRIES AND INVESTMENTS LTD.

### SELECTED CONSOLIDATED BALANCE SHEET DATA

In millions of shekels of JUNE 2001

	<b>For the six months ended June 30</b>		<b>For the three months ended March 31</b>		<b>For the year ended December 31</b>
	<b>2001</b>	<b>2000</b>	<b>2001</b>	<b>2000</b>	<b>2000</b>
	<b>(Unaudited)</b>		<b>(Unaudited)</b>		<b>(Audited)</b>
Revenues	1,058	1,749	612	931	2,967
Costs and expenses	1,494	1,500	722	762	3,089
Income (loss) before taxes	(436)	249	(110)	169	(122)
Taxes on income	53	73	28	54	98
Income (loss) after taxes	(489)	176	(138)	115	(220)
Minority interest in losses (earnings) of subsidiaries, net	206	(13)	74	3	131
Net income (loss)	<u>(283)</u>	<u>163</u>	<u>(64)</u>	<u>118</u>	<u>(89)</u>
Earnings (loss) per NIS 1par value of share capital (in NIS)	<u>(2.02)</u>	<u>1.16</u>	<u>(0.46)</u>	<u>0.85</u>	<u>(0.63)</u>