

CLAL INDUSTRIES AND INVESTMENTS LTD.

MANAGEMENT DISCUSSION AND ANALYSIS

FOR THE PERIOD JANUARY - JUNE 2002

1. *Description of Company*

Clal Industries and Investments Ltd. (“the Company” or “CII”) 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: cement, textile, high-technology and electronics, paper and cartons, biotechnology, communications, and management of venture capital funds.

The Company’s Board of Directors has approved the basic principles of a new long term business plan which was formulated recently by management of the Company in coordination with a strategic consultant. The basic principles include, inter alia, emphasis on development of management resources, promotion of a limited number of material holdings with existing growth potential which the Company is able to influence and to develop and focus on investments in sectors with rapid growth potential including support and encouragement of long term strategic processes in the investee companies. These plans will be examined and adapted on a continuing basis and, as a result, the Company will adapt its activity through adoption of management and advanced technological tools.

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

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 58 million, as compared to a loss of NIS 68 million in the corresponding period of the previous year.

The loss includes the effects of net negative non-recurring factors totaling NIS 23 million, stemming principally from a write-off of investments in high technology and venture capital funds in the amount of NIS 34 million. By contrast, the above was offset by a capital gain arising on the sale of shares in Lasers (NIS 12 million). In the corresponding quarter of the previous year, there were net negative non-recurring factors totaling NIS 60 million.

The increase in the current loss for the reporting period as compared to the corresponding period of the previous year is derived mainly from write-off of the value of investments in venture capital funds, from a decrease in profitability of Mashav and from a decrease in profitability of Kitan. These effects were offset in part as a result of an improvement in the results of Polgat and ECI and of the transition from financing expenses to financing income.

The loss in the reporting period amounted to NIS 56 million, as compared to a loss of NIS 302 million for the corresponding period of the previous year, and a loss of NIS 711 million for 2001 as a whole.

The loss in the period includes positive net non-recurring effects in the amount of NIS 5 million which include, in addition to the effect in the second quarter, also the decrease in the provision in respect of a bank guarantee given to Barak as part of the conditions of the license (NIS 37 million) net of an efficiency measure expense in one of the Neshar facilities (NIS 10 million).

The decrease in the current loss in the reporting period stems principally from the transition from financing expenses to financing income and from an improvement in the results of ECI and of Polgat. These effects were offset in part by the write-off of the value of investments in venture capital funds, by a decrease in profitability of Mashav and by a decrease in profitability of Kitan. The net loss of ECI in the reporting period (according to generally accepted accounting principles in Israel) amounted to NIS 305 million. This loss includes a write-off in respect of decrease in value of intangible assets in the amount of NIS 257 million in the first quarter. These write-offs did not affect the financial statements of the Company, taking into account the excess of equity over proceeds in the books of the Company, which was attributed to goodwill and intangible assets written-off by ECI.

The loss per NIS 1 par value of share capital in the reporting period amounted to NIS 0.36 as compared to a loss of NIS 2.16 for the corresponding period of the previous year and a loss of NIS 4.80 in 2001 for a whole.

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

	For the six months ended June 30		For the three months ended June 30	
	2002	2001	2002	2001
	Core holdings	30	(186)	2
Venture capital investments	(61)	(59)	(51)	(41)
Biotechnology	(25)	(16)	(12)	(9)
Holdings in real estate	(5)	1	-	35
Administration	(4)	2	(1)	2
Financing	9	(44)	4	(7)
Net loss	<u>(56)</u>	<u>(302)</u>	<u>(58)</u>	<u>(68)</u>

- B. We set out below selected data from the financial statements of the principal investee companies¹ (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	
	2002	2001	2002	2001	2002	2001	2002	2001
Mashav	659	793	345	407	24	56	21	33
ECI	1,827	2,475	898	1,128	(284)	(1,395)	(36)	(172)
Scitex	570	662	280	316	(15)	(835)	(11)	(773)
AIPM	241	267	122	125	21	22	11	10
Kitan	391	427	191	218	5	22	3	12
Polgat	360	342	194	169	15	(9)	9	(11)
Barak	352	326	176	167	34	(35)	39	6
Fundtech	88	116	44	53	(37)	(36)	(20)	(33)

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

¹ Relates to financial statements of ECI, Scitex and Fundtech published according to generally accepted accounting principles in the United States.

- C. Following is a review of the activity of the principal investee companies in the second quarter²:

Nesher - The quarter saw a 14% reduction in the sale of cement as compared to the corresponding quarter of the previous year, which was due primarily to a 9% reduction in sales volume. The net income for the quarter of companies in the cement sector totaled NIS 20 million, as compared to NIS 35 million for the corresponding quarter of the previous year and NIS 11 million (before a non-recurring expense of NIS 10 million) in the first quarter of 2002.

The decrease in sales and in profitability was derived mainly from an increase in import of cement to Israel (at inflated prices), from the crisis in the construction sector and from the security situation. The limitations to which Nesher is subject as a monopoly in the cement sector reduce its flexibility and ability to compete against import. In 2001 Nesher submitted a complaint to the Supervisor of Trade Levies in the Foreign Trade Authority in connection with the inflated imports and the Supervisor commenced an investigation in this regard. Also, Nesher acted in relation to the Supervisor of Restricted Practices in order to arrange the conditions of market competition in the cement market in light of the implications of inflated imports.

Recently, the Supervisor responsible for the inflated imports in the Ministry of Industry and Trade received Nesher's complaints regarding the inflated imports, as stated, concurrently with receipt of a commitment from part of the cement imports to fix import prices of cement in accordance with accepted prices in the Israeli market.

ECI - ECI reported a loss of NIS 36 million in the reporting quarter as compared to a loss of NIS 172 million, after adjustment for non-recurring expenses, of NIS 103 million, in the corresponding period of the previous year. Gross profits decreased by 9% only despite a sharp decrease of 29% in sales, as a result of an improvement in the rate of gross profit which reached 38.5% in the reporting quarter as compared to 30% in the corresponding period of the previous year and 37% in the first quarter of 2002. The operating loss decreased from NIS 118 million, before non-recurring expenses, in the corresponding period of the previous year to NIS 20 million in the reporting quarter.

Since 2001 ECI has been acting to adapt its activity and level of expenses to the situations in the markets in which it operates. During the last twelve months ECI has reported improvements in a number of parameters, including a continuing decrease in inventories, a decrease in the average age of outstanding due receivables as measured by days sales in receivables and improvement of liquidity. ECI's net cash balance as of June 30, 2002 is NIS 419 million as compared to a deficit of NIS 588 million as of June 30, 2001.

² Relates to financial statements of ECI, Scitex and Fundtech published according to generally accepted accounting principles in the United States.

ECI announced that it anticipates a decrease of 13% - 17% in sales in the third quarter as compared with the sales in the present quarter. Nevertheless, ECI announced that it is implementing steps to reduce to a minimum the effect of the said decrease in sales on its operating results.

During 2001 class actions were filed against ECI, part of its directors and a former employee. In May 2002 the parties to a claim signed a memorandum of understanding toward settlement of the claim.

Scitex – Sales for the quarter amounted to NIS 280 million, similar to the first quarter of the year, and a decrease of 11% compared to sales in the corresponding period of the previous year. Scitex reported a balance between operating income and operating income of NIS 5 million in the corresponding period of the previous year. The net loss decreased from NIS 59 million (before a non-recurring write-off in the amount of NIS 714 million) in the previous year to NIS 11 million in the reporting quarter. The strengthening of the Euro relative to the dollar constituted one of the principal factors responsible for the increase in the loss compared to the previous quarter of the year.

SDP, a wholly owned subsidiary, reported on its first sale of two VersaMark printing systems to a banking institution in the United States. SVN, a wholly owned subsidiary, interfaced a new printing system in the reporting quarter and Aprion Digital, held at the rate of 43%, recorded income for the first time in the reporting quarter.

AIPM – Net income for the second quarter of 2002 amounted to NIS 11 million, as compared to income of NIS 10 million in the corresponding quarter of the previous year and NIS 9 million in the first quarter of 2002. The efficiency measures implemented in all the AIPM Group companies resulted in a decrease in salary costs and other manufacturing costs. The steps implemented, together with erosion of salary costs in dollar terms and a decrease in energy prices, resulted in an increase in operating income from NIS 6 million in the previous year to NIS 9 million in the reporting quarter (highest operating income in the last six quarters).

A reduction in demand in the local market, together with an erosion of selling prices in dollar terms, led to a 2% decrease in sales for the quarter, as compared to the corresponding quarter of the previous year.

Kitan – Decrease of 4% in sales, amounting to NIS 191 million, as compared to NIS 218 million in the corresponding period of the previous year. Operating income for the quarter decreased from NIS 17 million in the previous year to NIS 8.5 million in the reporting quarter. The worsening in results is derived mainly from the recession in retail activity in the Golf Group and from the timing of the Passover holiday. These effects were offset in part as a result of an improvement in the results of Kitan Industries.

Polgat – Sales for the quarter amounted to NIS 194 million, an increase of 15%, as compared to the corresponding quarter of the previous year. The decrease in labor costs in Bagir as a result of increased manufacture outside of Israel and efficiency measures implemented in Guney Polgat resulted in an increase in gross profit from NIS 22 million in the previous year (rate of gross profit of 13%) to NIS 49 million in the reporting quarter (rate of gross profit of 25%). The increase in sales in Bagir together with the improvement in the rate of gross profit resulted in an increase in net income for the quarter which amounted to NIS 9 million as compared to a loss of NIS 11 million in the corresponding quarter of the previous year.

As a result of an agreement signed with the employees and the Histadrut, Bagir reduced the personnel in its Israel facility by 600 employees during the quarter. Toward the end of the first quarter, Polgat acquired additional shares of Guney Polgat so that after the acquisition the rate of Polgat's holding in Guney Polgat reached 51%.

Barak – Income in the second quarter amounted to NIS 176 million, similar to the income in the first quarter of the year and an increase of 5% in income as compared to the corresponding quarter of the previous year. Barak ended the quarter with a positive EBITDA of NIS 49 million as compared to NIS 36 million in the corresponding quarter of the previous year. As a result of the efficiency measures implemented in Barak, operating income amounted to NIS 37 million compared to NIS 32 million in the first quarter of the year and NIS 23 million in the corresponding quarter of the previous year. Net income amounted to NIS 39 million for the quarter as compared to NIS 6 million in the previous year as a result of an improvement in operating income together with non-recurring income as a result of acquisition of debentures of Barak.

Fundtech – Revenues for the quarter amounted to NIS 44 million, 16% lower than sales in the corresponding quarter of the previous year, mainly as a result of a decline in income from the licensing of software. Fundtech recorded an increase of 2% in income as compared to income in the first quarter of the year. The loss for the quarter amounted to NIS 18 million, similar to the first quarter of the year, as compared to a loss of NIS 33 million (including a non-recurring expense in the amount of NIS 17 million) in the second quarter of the previous year. During the second quarter, Fundtech acquired nine new customers (including one customer for the CLS system), as compared to two new customers in the first quarter, and the signing of 27 new transactions, despite the difficult situation in the markets in which Fundtech operates. Fundtech is continuing its activities toward a decrease in expenses in order to adapt them to its level of income, in order to decrease expenses by NIS 7 million per quarter as compared to the level of expenses in the reporting quarter.

In general, the quarterly results of Group companies were affected by the economic recession in world and local markets, the effect of the security situation in Israel and in the United States and the crisis in capital markets, especially in the high technology and communication sectors. The decrease in demand and increase in competition resulted in erosion of prices and decrease in profitability. The Group companies which sell outside Israel were affected mainly by the decrease in acquisition of capital instruments by companies in various sectors. The effect of these factors was moderated in part by reorganization and efficiency measures implemented in most of the Group companies.

Continuation of the recession in world and local markets may also continue to affect the results of the Group companies.

3. *Value of investments examination*

The Company examines the value of its investments in accordance with generally accepted accounting principles and relevant guidelines published by the Israel Securities Authority. In accordance with the results of its examinations, the Company recorded write-offs in respect of part of its investments for a decrease in value which is not of a temporary nature.

A material difference exists in a number of publicly traded investee companies between the amount of the investment included in the balance sheet and the market value of the investment. The Company examined the value of its investment in these companies and believes that the recoverable value of its investment therein is not less than the value of the investments therein in the Company's balance sheet.

Following is information regarding the investments in those companies:

	Amount of investment in balance sheet	Market value as of June 30, 2002	Difference between amount of investment and market value as of June 30, 2002	Market value as of August 18, 2002	Difference between amount of investment in balance sheet and market value as of August 18, 2002
NIS millions					
ECI	511	221	290	151	360
Scitex	268	96	172	88	180
AIPM	220	171	49	154	66
Polgat	142	52	90	55	87
Fundtech	122	89	33	81	41
	<u>1,263</u>	<u>629</u>	<u>634</u>	<u>529</u>	<u>734</u>

The Company believes that these companies possess existing growth potential and that the Company is capable of exerting a material influence on them. The Company's share holdings in these companies constitutes a long term investment and the Company presents its investments therein according to the equity method. The companies themselves examine the need to write-off decreases in the value of their assets and, insofar as necessary, implement write-offs which are reflected in the financial statements of the Company.

In March 2002, the Company received a valuation of ECI from an independent outside estimator which estimated the value of ECI at US\$ 644 million – US\$ 845 million (reflecting a range of the value of the Company's equity in ECI of NIS 445 million – NIS 584 million). In light of the description in section 2C above and in Note 4A to the financial statements regarding ECI, the Company believes that the cumulative weight of the circumstances does not reflect a result according to which a material negative change exists in the value of ECI as from the date of the valuation. Accordingly, according to the Company, the value of the Company's investment in ECI exceeds its recoverable realization value.

4. *Financial position and financing sources*

The deficiency in working capital in the consolidated balance sheet amounted to NIS 76 million. Short term liquid assets in the consolidated balance sheet amounted to NIS 286 million as of balance sheet date and are included in short term investments and cash and cash equivalents. The quick ratio in the consolidated balance sheet is 0.54 (December 31, 2001 – 0.49). The principal sources of cash are derived from operating activities in the amount of NIS 156 million, receipt of long term loans in the amount of NIS 196 million and issuance of debentures in the amount of NIS 109 million. The cash sources were utilized mainly for repayment of short term credit in the amount of NIS 106 million, investment in companies in the amount of NIS 120 million, investment in deposits and long term and short term loans in the amount of NIS 172 million and investment in fixed assets in the amount of NIS 48 million.

The Company's shareholders' equity as of June 30, 2002 amounted to NIS 2,973 million, as compared to NIS 3,007 million as of December 31, 2001. Minority interests amounted to NIS 108 million, as compared to NIS 132 million as of December 31, 2001. Concurrently with the sources, the shareholders' equity of the Company decreased by 1% and minority interests decreased by 18%, which constituted together the financing sources of 52% of the Group's assets.

The long term outside financing sources of the Group amounted to NIS 1,350 million as of the end of the quarter, as compared to NIS 1,090 million as of December 31, 2001, of which 31% are repayable in the coming year.

The balance of the net liability of the Company and its wholly owned corporate subsidiaries as of June 30, 2002 amounted to NIS 806 million, as compared to NIS 905 million as of December 31, 2001.

5. *Principal changes in investments*

- A. In February 2002 the Company acquired addition shares of ECI in consideration for NIS 17 million. After the acquisition and a private issuance of shares by ECI, the Company's rate of holding in ECI reached 14.5%.
- B. During the period under review, the Company acquired additional shares of Fundtech in consideration for NIS 11 million. After the acquisition, the Company's rate of holding in Fundtech reached 32.5%.
- C. In April 2002, an agreement was finalized for sale of the Company's holdings in Lasers to a group headed by the general manager of Lasers. In consideration for sale of its holdings, the Company received US\$ 7 million ("the preliminary consideration") and under certain circumstances the consideration may reach US\$ 9.5 million. The net gain from sale of the Company's holding in Lasers, taking into account the preliminary consideration, amounted to NIS 12 million.
- D. During the period under review, the Company invested NIS 22 million in Negevtech in the framework of a round of fundraising in the amount of US\$ 24 million by Negevtech. After the investment, the Company's rate of holding in Negevtech reached 24%.
- E. During June 2002 the Company acquired marketable debentures of Ormat in consideration for NIS 17 million. The debentures are convertible to shares of Ormat.
- F. Also, during the period under review, the Company invested, directly and indirectly (through wholly owned subsidiaries) as follows (in millions of shekels):

	For the six months ended June 30, 2002	For the three months ended June 30, 2002
Core holdings	12	5
Venture capital investments	39	17
Biotechnology	17	13
Other real investments	3	3
	<u>71</u>	<u>38</u>

6. Event subsequent to June 30, 2002

During the period from June 30, 2002 until the date of approval of the financial statements, the Company invested the amount of NIS 7 million, directly and indirectly, in various wholly owned subsidiaries.

7. Analysis of exposure to market risks and the management thereof

Further to the report for the period January – March 2002 in which details were presented regarding the exposure to market risks and the management thereof, following is an update as of June 30, 2002:

A. Consolidated linkage bases (in millions of shekels adjusted to June 2002)

	<u>Linked to the CPI</u>	<u>Linked to the dollar</u>	<u>Linked to other foreign currency</u>	<u>Not linked</u>	<u>Non- monetary balances</u>	<u>Total</u>
<u>As of June 30, 2002</u>						
Current assets	70	224	109	413	702	1,518
Non-current assets	56	94	-	5	4,264	4,419
Current liabilities	(316)	(315)	(140)	(820)	(3)	(1,594)
Non-current liabilities	(818)	(41)	(8)	(61)	(442)	(1,370)
Total net balance sheet balance	<u>(1,008)</u>	<u>(38)</u>	<u>(39)</u>	<u>(463)</u>	<u>4,521</u>	<u>2,973</u>
<u>As of June 30, 2001</u>						
Current assets	80	236	87	332	723	1,458
Non-current assets	44	74	-	9	4,376	4,503
Current liabilities	(242)	(197)	(90)	(1,025)	(16)	(1,570)
Non-current liabilities	(769)	(38)	(8)	(65)	(504)	(1,384)
Total net balance sheet balance	<u>(887)</u>	<u>75</u>	<u>(11)</u>	<u>(749)</u>	<u>4,579</u>	<u>3,007</u>

B. Events after December 31, 2001

The material events in the area of market risks in the period from December 31, 2001 until the date of approval of the financial statements are: an increase in the exchange rate of the dollar of approximately 5%, an increase in the consumer price index of approximately 7% and an increase in interest which resulted in an increase in the Group's financing costs. Also, additional decreases were evident in stock exchange prices of a number of the Company's marketable investments.

8. *Options granted to senior employees*

In March 2002, the Company's Board of Directors approved the addition of two employees to the option plans from August 2001. The said employees were granted 154,287 options which are convertible to a maximum of 154,287 shares.

In May 2002, the Company's Board of Directors approved the allocation to a senior employee of 146,735 options which are convertible to a maximum of 146,735 shares.

In April 2002, the Company's Board of Directors approved the amendment of the condition of the Company's options plans from January 2001. According to the amendment, the exercise prices of the options were changed.

9. *Indemnification*

In April 2002, the General Meeting of the Shareholders of the Company approved the grant of letters of indemnification according to which the Company committed to indemnify its senior employees. The total indemnification payable by the Company will not exceed 25% of its shareholders' equity in the year of the actual payment.

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

.....
LEON RECANATI
Chairman of the Board

.....
MEIR SHANNIE
General Manager

CLAL INDUSTRIES AND INVESTMENTS LTD.

SELECTED CONSOLIDATED BALANCE SHEET DATA

In millions of shekels of JUNE 2002

	<u>June 30</u>		<u>December 31</u>
	<u>2002</u>	<u>2001</u>	<u>2001</u>
	<u>(Unaudited)</u>		<u>(Audited)</u>
<u>Assets</u>			
Current assets	1,518	1,535	1,458
Long term deposits, loans and receivables	59	78	47
Investments	2,246	2,765	2,283
Fixed assets, other assets and deferred expenses	<u>2,114</u>	<u>2,861</u>	<u>2,173</u>
	<u>5,937</u>	<u>7,239</u>	<u>5,961</u>
<u>Liabilities and Shareholders' Equity</u>			
Current liabilities	1,594	2,689	1,570
Long-term liabilities	1,262	1,060	1,252
Minority interests	108	528	132
Shareholders' equity	<u>2,973</u>	<u>2,962</u>	<u>3,007</u>
	<u>5,937</u>	<u>7,239</u>	<u>5,961</u>

CLAL INDUSTRIES AND INVESTMENTS LTD.

SELECTED CONSOLIDATED STATEMENTS OF OPERATIONS DATA

In millions of shekels of JUNE 2002

	For the six months ended June 30		For the three months ended March 31		For the year ended December 31
	2002	2001	2002	2001	2001
	(Unaudited)		(Unaudited)		(Audited)
Revenues	1,288	1,352	631	701	2,680
Costs and expenses	1,317	1,818	667	818	3,504
Loss before taxes	(29)	(466)	(36)	(117)	(824)
Taxes on income	20	56	16	30	121
Loss after taxes	(49)	(522)	(52)	(147)	(945)
Minority interest in losses (earnings) of subsidiaries, net	(7)	220	(6)	79	234
Net loss	<u>(56)</u>	<u>(302)</u>	<u>(58)</u>	<u>(68)</u>	<u>(711)</u>
Loss per NIS 1 par value of share capital (in NIS)	<u>(0.36)</u>	<u>(2.16)</u>	<u>(0.37)</u>	<u>(0.49)</u>	<u>(4.80)</u>