

CLAL INDUSTRIES AND INVESTMENTS LTD.

**MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE PERIOD JANUARY - SEPTEMBER 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 high 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 and cardboard, 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. The Company actively encourages Group companies to ensure that their operations are community-oriented.

2. *Results of operations*

- A. The loss for the third quarter amounted to NIS 147 million, as compared to net income of NIS 39 million in the corresponding quarter of the previous year.

The loss includes the effects of net negative non-recurring factors totaling NIS 92 million, stemming principally from write-downs of investments totaling NIS 263 million (Fundtech – NIS 96 million; CEI – NIS 37 million; Tioga – NIS 24 million; Scitex – NIS 24 million; and other listed companies – NIS 45 million) and write-offs reflected in the financial statements of ECI (NIS 36 million), Creo (NIS 34 million) and Fundtech (NIS 11 million). By contrast, the above was offset by a capital gain arising on the sale of 25% of Mashav (NIS 261 million). In the corresponding quarter of the previous year, there were net positive non-recurring factors totaling NIS 4 million.

The loss for the reported period amounted to NIS 433 million, as compared to net income of NIS 204 million for the corresponding period of the previous year, and a loss of NIS 90 million for 2000 as a whole.

The decrease in current income for the quarter stems principally from the transition to loss-making in ECI, as well as from the decrease in profitability of Mashav, the decrease in the Company's share of Mashav, and the increase in the losses of venture capital funds in the wake of book adjustments to the value of investments.

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

Nesher - The quarter saw a 27% reduction in the sale of cement as compared to the corresponding quarter of the previous year, which reduction was due primarily to a 26% decrease in sales volume. The net income for the quarter of companies in the cement sector totaled NIS 35 million, as compared to NIS 48 million for the corresponding quarter of the previous year. The effect of the decrease in sales was partly offset by the cessation of operations of old production lines, which led to a reduction in costs.

ECI - ECI reported a loss in the current quarter from continuing operations, before adjustment for non-recurring expenses, of NIS 93 million, as compared to a profit from continuing operations of NIS 37 million in the corresponding period of the previous year, and a loss of NIS 114 million for the second quarter of this year. The loss for the third quarter amounted to NIS 334 million and reflected a reduction in asset value of NIS 247 million. Sales for the third quarter amounted to NIS 1,145 million, as compared to NIS 1,351 million for the corresponding quarter of the previous year and NIS 1,160 million for the second quarter of this year.

(*) 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.

At the end of April 2001, ECI announced a cost-cutting program, including a cut-back in the workforce and a reduction in the salaries of senior management, which was designed to adjust the level of expenditures to the market conditions in which the company was operating. The reduction in expenditures and the improvement in operating results of most of the divisions, as compared to the second quarter of the year, was reflected, inter alia, by positive cash flows from current operations, amounting to NIS 85 million.

As of January 1, 2001, the commercial operations of the principal divisions of ECI were transferred to five subsidiaries.

Scitex – Sales for the quarter amounted to NIS 290 million, an increase of 14% in comparison with sales for the corresponding quarter of the previous year. A change in the mix of sales, as a consequence of prevailing market conditions, led to a decrease in gross profit. Operating income, before adjustment for the amortization of goodwill, amounted to NIS 13 million, as compared to income of NIS 18 million for the corresponding quarter of the previous year. After accounting for the company's equity in the losses of Creo, which included write-downs made by Creo, the loss for the quarter amounted to NIS 178 million, as compared to a loss of NIS 73 million in the corresponding quarter of the previous year. During the course of the quarter, Scitex presented two new systems.

AIPM - Net income for the third quarter of 2001 amounted to NIS 6 million, as compared to income of NIS 17 million in the corresponding quarter of the previous year. A reduction in demand, together with an erosion of selling prices, led to a 25% reduction in sales for the quarter, from NIS 140 million in the corresponding quarter of the previous year to NIS 106 million for the quarter under review. The reduction in income following the decline in sales, and the fall in the share of AIPM in the profits of associated companies, was partly offset by the results of the efficiency program implemented by AIPM, which led, in turn, to a general reduction in expenses, and to a transition from financing expenses to financing income. In addition to the effects of the general recession, AIPM was also affected by the dumping of paper and the closing of margins as between the selling prices of pulp and paper.

Kitan - Net income for the quarter amounted to NIS 0.5 million, as compared to NIS 7 million for the corresponding quarter of the previous year. In spite of the economic recession, and the erosion of selling prices, sales for the present quarter amounted to NIS 189 million, a level similar to that of the corresponding quarter in the previous year, reflecting an improvement in the gross profit margin. An increase in financing expenses for the quarter of NIS 7 million, as compared to the corresponding quarter of the previous year, together with an increase in selling expenses, led to a reduction in net income.

Polgat - Sales for the quarter amounted to NIS 153 million, as compared to NIS 142 million for the corresponding quarter of the previous year. An increase in the gross profit margin, despite the erosion in selling prices, together with a reduction in costs, led to a decrease in the operating loss. The loss for the quarter amounted to NIS 2.7 million, as compared to income of NIS 0.7 million in the corresponding quarter of the previous year. The transition to loss-making stemmed primarily from the increase in financing expenses, which were partly offset by a tax benefit recorded by a Turkish subsidiary. 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 177 million, as compared to NIS 149 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 operating income of NIS 18 million for the current quarter, as compared to an operating loss of NIS 9 million for the corresponding period of the previous year. Barak's net loss for the quarter, amounting to NIS 26 million, stemmed from an increase in financing expenses (a result of the devaluation during the quarter of the U.S. dollar exchange rate) of NIS 44 million.

Fundtech - Revenues for the quarter amounted to NIS 46 million, as compared to NIS 60 million in the corresponding quarter of the previous year (a decrease of 23%). A change in the sales mix (a 57% reduction in income from the licensing of software) together with an increase in operating expenses, led to a loss of NIS 19 million for the quarter, before accounting for non-recurring expenses and the amortization of goodwill, as compared to a profit of NIS 12 million for the corresponding quarter of the previous year. During the present quarter, Fundtech incurred non-recurring expenses of NIS 41 million, mainly as a result of a decline in value of marketable securities and an increase in the provision for doubtful debts.

In general, the results of Group companies, both for the third quarter in particular, and for the first three quarters of 2001 in general, were affected by the general economic recession in world markets and the domestic market, the security situation and the crisis in the capital market, especially in the technology and communications sectors. The overall effect of the factors outlined above is partly offset by reorganization and efficiency measures taken by a significant number of Group companies.

The continuing recession, both in the domestic economy and in world markets, which had, by the end of the third quarter, been exacerbated by the appalling terrorist outrages in the United States, will continue to have an adverse effect on the performance 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 nine months ended September 30		For the three months ended September 30		For the nine months ended September 30		For the three months ended September 30	
	2001	2000	2001	2000	2001	2000	2001	2000
Mashav	1,117	1,324	366	480	101	128	48	55
Kitan	593	555	189	190	21.5	19	0.5	7
ECI	3,405	3,763	1,145	1,351	(1,608)	93	(334)	28
Scitex (**)	858	1,216	290	254	(934)	399	(178)	(73)
AIPM (***)	349	610	106	140	26	70	6	17
Polgat	465	403	153	142	(10)	4	(3)	1
Barak	486	386	177	149	(59)	(92)	(26)	(21)
Fundtech	152	153	46	60	(96)	11	(63)	9

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

(**) In 2000, includes pre-printing operations, which ceased to be consolidated on March 31, 2000

(***) In 2000, includes Hogla-Kimberley operations, 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 2.99, as compared to earnings of NIS 1.45 per share in the corresponding period of the previous year and a loss of NIS 0.64 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 September 30, 2001 totaled NIS 5,937 million, as compared to NIS 7,197 million as of the end of 2000.

As of September 30, 2001, internal sources of finance (which include shareholders' and minority interests) totaled NIS 3,204 million (54% of the consolidated balance sheet total), as compared to NIS 3,784 million as of December 31, 2000 (53% of the consolidated balance sheet total).

The sale of a portion of the Company's holdings in Mashav, and a private placement of debentures in August 2001, transformed the Company's working capital position from a deficiency of working capital to positive working capital.

The principal causes for the reduction in the balance sheet total are attributable to the changes in the Company's investments, and stem from the Company's equity in the losses of associated companies, the write-downs in the value of investments following declines in value that were not temporary in nature, and the transition to a proportional consolidation of 75% of the assets of Mashav.

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. 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 both participate in the management of the Fund.
- C. 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.
- D. 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 21 million was reflected in the financial statements for the third quarter.
- E. 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 600 million. The net capital gain stemming from the transaction, amounting to NIS 261 million, is reflected in the financial statements for the third quarter.

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 option, 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 394 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.

- F. In August 2001, the Company made a private placement with institutions of debentures totalling approximately NIS 339 million.
- G. During the reported period, CBI invested NIS 27 million in MTRE – Advanced Technologies Ltd. (“MTRE”). The investment provides CBI with 9.7% of the capital of MTRE. MTRE develops and markets a device which regulates the temperature of the human body.

5. *Events subsequent to September 30, 2001*

- A. In October 2001, CBI invested NIS 33 million in D-Pharm as part of a capital mobilization program undertaken by that company to raise \$30 million. Subsequent to the investment, the Company's share of D-Pharm rose to 20% on a fully-diluted basis.
- B. In October 2001, the full purchase offer for the shares of Jaf-Ora was concluded, in the wake of which the shares of Jaf-Ora ceased to be traded on the Stock Exchange. The cost of the shares acquired by the Company under the purchase offer amounted to NIS 11 million. Subsequent to the acquisition, the Company's share of Jaf-Ora rose to 30.5%.
- C. During October, the Company reached an understanding with respect to the sale of its holdings in Lasers International Technologies Ltd. (“Lasers”) to a group headed by the managing director of Lasers. As consideration for the sale of its holdings, the Company is to receive \$7.25 million (“the initial consideration”). Under certain conditions, the consideration may rise to \$10.65 million. The net gain arising on the sale of the Company's holdings in Lasers, on the basis of the initial consideration, will be NIS 7 million.

Completion of the transaction is subject to all the required approvals being obtained, and to a final purchase agreement being drawn up.

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.

In August 2001, the Board of Directors approved a further plan for the allotment of up to 746,778 options convertible into a maximum of 776,778 ordinary shares of the Company (subject to adjustment). Under the terms of the plan, the options are exercisable in four equal tranches.

The plans are 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.

.....
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 September 2001

	<u>September 30</u>		<u>December 31</u>
	<u>2001</u>	<u>2000</u>	<u>2000</u>
	<u>(Unaudited)</u>		<u>(Audited)</u>
<u>Assets</u>			
Current assets	1,474	1,504	1,382
Long term deposits, loans and receivables	80	90	85
Investments	2,277	3,319	2,985
Fixed assets, other assets and deferred expenses	2,106	2,788	2,745
	<u>5,937</u>	<u>7,701</u>	<u>7,197</u>
<u>Liabilities and Shareholders' Equity</u>			
Current liabilities	1,374	2,688	2,417
Long-term liabilities	1,359	766	996
Minority interests	145	889	721
Shareholders' equity	3,059	3,358	3,063
	<u>5,937</u>	<u>7,701</u>	<u>7,197</u>

CLAL INDUSTRIES AND INVESTMENTS LTD.

SELECTED CONSOLIDATED BALANCE SHEET DATA

In millions of shekels of September 2001

	For the nine months ended September 30		For the three months ended September 31		For the year ended December 31
	2001	2000	2001	2000	2000
	(Unaudited)		(Unaudited)		(Audited)
Revenues	1,652	2,656	585	891	2,993
Costs and expenses	2,198	2,349	690	835	3,116
Income (loss) before taxes	(546)	307	(105)	56	(123)
Taxes on income	83	94	30	22	99
Income (loss) after taxes	(629)	213	(135)	34	(222)
Minority interest in losses (earnings) of subsidiaries, net	196	(9)	(12)	5	132
Net income (loss)	(433)	204	(147)	39	(90)
Earnings (loss) per NIS 1par value of share capital (in NIS)	(2.99)	1.45	(0.95)	0.28	(0.64)