



## **Makhteshim Agan Industries Ltd.**

### **MANAGEMENT DISCUSSION AND ANALYSIS FOR THE PERIOD ENDED JUNE 30, 2007**

#### **1. BRIEF PROFILE OF THE COMPANY AND ITS BUSINESS ENVIRONMENT**

MA Industries Ltd. is the world's leading manufacturers of branded off-patent crop protection products. The Company has high level technological and chemical capabilities, broad product licensing, upholds strict environmental control and quality control standards, and markets its products internationally. Ongoing investment in research and development enables the Company to launch new products regularly upon expiration of patents.

The main business focus of the Company is in the crop protection market, which includes the manufacturing, marketing and distribution of conventional crop protection products. The Company's operations in non-agro markets extend to a large number of sub-areas, none of which are material for the company and are grouped and defined as non-agro activities.

**New Registrations** – during this quarter, the Company received 41 new registrations for active ingredients, formulations and mixtures. Of special note are two new registrations: a registration of the active substance Fluazinam in New Zealand and a registration of the active substance Bifenthrin in Brazil.

#### **Summary of changes in the industry**

The positive trends of the agricultural market which were manifested in the first quarter of the year broadened and continued into the year. Key drivers were:

1. An increase in the prices of agricultural output (for example corn and soybean) caused an increase in derivative demands for the Company's products.
2. Relatively favorable weather conditions in most regions in which the Company operates gave rise to a larger than expected demand for crop protection products and contributed to a market recovery, which was affected by difficult weather conditions in 2006.
3. The Company reports its results in US Dollars (in this Report: "Dollars"), and therefore, the strengthening of currencies (particularly the Euro and the Real) against the US Dollar influenced the increase in the Company's revenues positively,

compared with the strengthening of the Shekel which increased local expenses in Israel.

The reports published so far this year by the leading companies in the industry show that sales turnover increased by approximately 10% in dollar terms in the second quarter.

## 2. RESULTS OF OPERATIONS – CONDENSED PROFIT AND LOSS STATEMENTS

### A. Profit and Loss Statements for Second Quarter:

	4-6/2007	4-6/2006	Change	%
Revenues	549.9	458.3	91.6	20.0%
Gross profit	188.7	159.7	29.0	18.2%
	34.3%	34.8%		
R&D and SG&A expenses	100.3	93.5	6.8	7.3%
	18.2%	20.4%		
Operating income	88.4	66.2	22.2	33.5%
	16.1%	14.4%		
Financing expenses	12.0	14.0	(2.0)	(14.1%)
	2.2%	3.1%		
Pre-tax profit	69.2	47.6	21.7	45.5%
	12.6%	10.4%		
Net profit	52.3	40.2	12.0	29.9%
	9.5%	8.8%		
EBITDA*	100.6	80.2	20.4	25.4%
	18.3%	17.5%		
Basic Profit per share	0.12	0.09	0.03	33.3%

### B. Profit and Loss Statements for First Half of Year:

	<b>1-6/2007</b>	<b>1-6/2006</b>	<b>Change</b>	<b>%</b>
Revenues	1,109.2	952.1	157.1	16.5%
Gross profit	386.9	337.8	49.1	14.5%
	34.9%	35.5%		
R&D and SG&A expenses	198.5	188.1	10.4	5.5%
	17.9%	19.8%		
Operating income	188.4	149.8	38.7	25.8%
	17.0%	15.7%		
Financing expenses	23.4	25.7	(2.3)	(8.8%)
	2.1%	2.7%		
Pre-tax profit	153.5	112.3	41.1	36.6%
	13.8%	11.8%		
Net profit	118.8	97.9	20.9	21.3%
	10.7%	10.3%		
EBITDA*	219.8	176.4	43.4	24.6%
	19.8%	18.5%		
Basic Profit per share	0.27	0.23	0.04	17.4%

### C. Quarterly Profit and Loss Statements:

	<b>4-6/2007</b>	<b>1-3/2007</b>	<b>10-12/2006</b>	<b>7-9/2006</b>	<b>4-6/2006</b>	<b>1-3/2006</b>
Revenues	549.9	559.3	419.0	407.6	458.3	493.9
Gross profit	188.7	198.2	131.7	137.2	159.7	178.2
	34.3%	35.4%	31.4%	33.7%	34.8%	36.1%
R&D and SG&A Expenses	100.3	98.2	121.8	93.0	93.5	94.6
	18.2%	17.6%	29.1%	22.8%	20.4%	19.2%
Operating income	88.4	100.0	9.9	44.1	66.2	83.6
	16.1%	17.9%	2.4%	10.8%	14.4%	16.9%
Financing expenses	12.0	11.4	11.4	7.2	14.0	11.7
	2.2%	2.0%	2.7%	1.8%	3.0%	2.4%
Pre-tax profit (loss)	69.2	84.2	(57.9)	30.5	47.6	64.7
	12.6%	15.1%	(13.8%)	7.5%	10.4%	13.1%
Net profit (loss)	52.3	66.6	(38.5)	24.5	40.2	57.7
	9.5%	11.9%	(9.2%)	6.0%	8.8%	11.7%
EBITDA*	100.6	119.2	(6.4)	59.6	80.2	96.3
	18.3%	21.3%	(1.5%)	14.6%	17.5%	19.5%

#### D. Condensed profitability data (US\$ millions)

##### Annual Data:

	2004	% Chg	2005	% Chg	2006	% Chg
<b>Sales</b>	1,539.7	30.8%	1,740.7	13.1%	1,778.8	2.2%
<b>EBITDA*</b>	323.7	32.7%	376.9	16.3%	229.7	(39.0%)
<b>EBIT**</b>	245.2	41.4%	281.4	14.8%	126.7	(55.0%)
<b>Net Income</b>	165.3	60.8%	204.8	23.9%	83.9	(59.0%)

##### Quarterly Data:

	4-6/2005	4-6/2006	4-6/2007	Change % 2007 V 2006
<b>Sales</b>	416.5	458.3	549.9	20.0%
<b>EBITDA*</b>	93.4	80.2	100.6	25.4%
<b>EBIT**</b>	71.3	59.2	78.1	31.9%
<b>Net Income</b>	50.1	40.2	52.3	29.9%

##### Half-Yearly Data:

	1-6/2005	1-6/2006	1-6/2007	Change % 2007 V 2006
<b>Sales</b>	933.5	952.1	1,109.2	16.5%
<b>EBITDA*</b>	212.6	176.4	219.8	24.6%
<b>EBIT**</b>	165.7	135.2	172.0	27.2%
<b>Net Income</b>	111.0	97.9	118.8	21.3%

\* EBITDA is made up of EBIT (see below) plus depreciation and amortization which are included in the statement of cash flow.

\*\* EBIT includes net profit plus tax expenses and financing expenses.

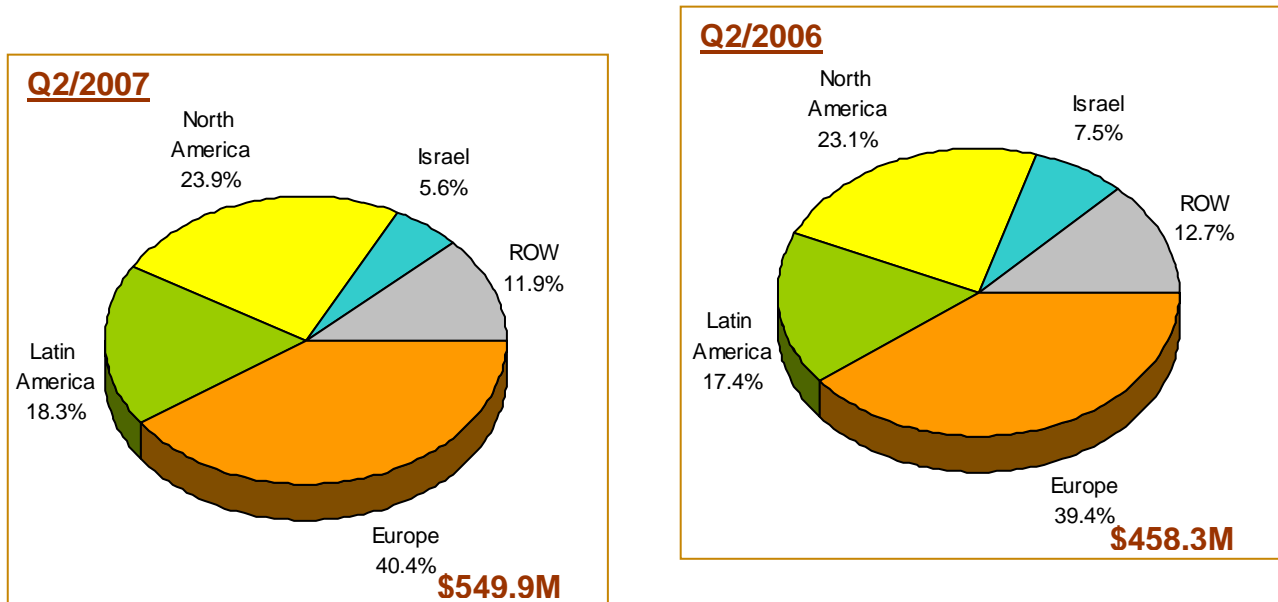
All of the data comprising these indexes (including tax expenses, depreciation expenses and financing expenses) have been reviewed or audited, as required.

### 3. ANALYSIS OF RESULTS:

#### A. Revenues by Geographical Region:

There was significant growth during the second quarter of 2007, and the Company's sales amounted to \$549.9 million, compared with \$458.3 million in the corresponding quarter last year, an increase of 20%.

Percentage of Quarterly Revenues by Region:



Quarterly Revenues by Region (\$ millions):

	<b>4-6/2007</b>	<b>%</b>	<b>4-6/2006</b>	<b>%</b>	<b>Change</b>	<b>% Change</b>
Israel	30.5	5.6%	34.4	7.5%	(3.9)	(11.3%)
North America	131.4	23.9%	105.8	23.1%	25.5	24.1%
South America	100.4	18.3%	79.7	17.4%	20.7	26.0%
Europe	222.1	40.4%	180.4	39.4%	41.7	23.1%
Rest of the world	65.5	11.9%	58.0	12.7%	7.5	13.0%
<b>Total</b>	<b>549.9</b>	<b>100.0%</b>	<b>458.3</b>	<b>100.0%</b>	<b>91.6</b>	<b>20.0%</b>

First Half of the Year Revenues by Region (\$ millions):

	<b>1-6/2007</b>	<b>%</b>	<b>1-6/2006</b>	<b>%</b>	<b>Change</b>	<b>% Change</b>
Israel	55.9	5.0%	63.6	6.7%	(7.6)	(12.0%)
North America	233.7	21.1%	206.0	21.6%	27.7	13.4%
South America	205.5	18.5%	162.9	17.1%	42.6	26.2%
Europe	490.6	44.2%	410.3	43.1%	80.3	19.6%
Rest of the world	123.5	11.1%	109.4	11.5%	14.1	12.9%
<b>Total</b>	<b>1,109.2</b>	<b>100.0%</b>	<b>952.1</b>	<b>100.0%</b>	<b>157.1</b>	<b>16.5%</b>

**In Europe** – sales in the quarter amounted to \$222.1 million, compared with \$180.4 million in the corresponding quarter in the previous year, an increase of \$41.7 million, constituting growth of 23.1%. The increase in sales stemmed mainly from: (1) High demand for the Company’s products. (2) Strengthening of the Euro, which increased the dollar value of sales. (3) First time consolidation of new companies.

During the first half of the year, sales to Europe amounted to \$490.6 million compared with \$410.3 million during the corresponding period last year; an increase of \$80.3 million, amounting to growth of 19.6%.

**In South America** – sales in the quarter amounted to \$100.4 million compared with \$79.7 million in the corresponding quarter in the previous year, an increase of \$20.7 million, constituting growth of 26%. The increase in sales derives from an increase in demand for crop protection products, mainly in Brazil and in other countries in South America.

During the first half of the year, sales to South America amounted to \$205.5 million compared with \$162.9 million during the corresponding period last year; an increase of \$42.6 million, amounting to growth of 26.2%.

**In North America** – sales in the quarter amounted to \$131.4 million compared with \$105.8 million in the corresponding quarter in the previous year, an increase of \$25.5 million, constituting growth of 24.1%.

During the first half of the year, sales to North America amounted to \$233.7 million compared with \$206.0 million during the corresponding period last year; an increase of \$27.7 million, amounting to growth of 13.4%.

**In the rest of the world** – sales in the quarter amounted to \$65.5 million compared with \$58.0 million in the corresponding quarter in the previous year, an increase of approximately \$7.5 million, constituting growth of 13.0%.

During the first half of the year, sales to the rest of the world amounted to \$123.5 million compared with \$109.4 million during the corresponding period last year; an increase of \$14.1 million, amounting to growth of 12.9%.

**In Israel**, sales in the quarter amounted to \$30.5 million, compared with \$34.4 million in the corresponding quarter in the previous year. This was a decrease of \$3.9 million. During the first half of the year, sales to Israel amounted to \$55.9 million compared with \$63.6 million during the corresponding period last year; a decrease of \$7.6 million. The decrease stemmed from the divestment of Luxembourg Pharmaceuticals during the course of 2006.

**B. Non-Agro:**

In the second quarter of 2007, non-agro sales amounted to approximately \$51.2 million, compared with \$55.9 million in the previous year. The decrease stemmed mainly from the divestment of Luxembourg Pharmaceuticals Ltd. during the course of 2006.

**C. Gross Profit:**

Gross profit for the quarter amounted to \$188.7 million compared with \$159.7 million in the corresponding quarter of the previous year, an increase of \$29.0 million. During the first half of the year, gross profit amounted to \$386.9 million compared with \$337.8 million in the corresponding period last year, an increase of \$49.1 million.

The increase in gross profit stemmed mainly from:

- An increase in sales.
- The strengthening of currencies (in particular, the Euro and the Real) compared with the corresponding quarter in the previous year.

Gross profitability in this quarter amounted to 34.3% compared with 34.8% in the previous year. The slight erosion of profitability stemmed mainly from a high level of price erosion during the second half of 2006 (note that during the fourth quarter of 2006, gross profitability was approximately 31.4%), which stabilized during the first and second quarters of 2007.

**D. Operating Profit:**

Operating profit during the quarter amounted to \$88.4 million (16.1% of sales) compared with \$66.2 million (14.4% of sales) during the corresponding quarter in the previous year. In the first half of the year, operating profit amounted to \$188.4 million compared with \$149.8 million during the corresponding period in the previous year.

Overheads during the quarter increased by \$6.8 million and amounted to \$100.3 million compared with \$93.5 million last year, however, the percentage of overhead expenses during

the quarter, compared to sales, dropped to 18.2% compared with 20.4% during the corresponding quarter last year.

During the first half of the year, overhead expenses increased by \$10.4 million and amounted to \$198.5 million (17.9% of sales) compared with \$188.1 million last year (19.8% of sales).

***R&D expenses*** during the quarter amounted to \$4.7 million, which was similar to R&D expenses during the corresponding quarter last year, which amounted to \$5.0 million.

During the first half of the year, R&D expenses amounted to \$9.8 million, similar to last year.

***Sales expenses*** during the quarter amounted to \$78.1 million compared with \$72.9 million last year, an increase of \$5.3 million, stemming mainly from an increase in expenses as a result of a strengthening of exchange rates, mainly in Europe and Brazil.

Notwithstanding the increase in sales expenses, these expenses as a percentage of sales dropped to 14.2% this quarter, compared with 15.9% last year, as a result of continued efforts to rationalize in order to reduce costs, and of increased sales.

Sales expenses during the first half of the year amounted to \$153.9 million (13.9% of sales) compared with \$147.9 million (15.5% of sales) during the corresponding period last year.

***General and administrative expenses*** during the quarter amounted to approximately \$17.4 million (3.2% of sales) compared with \$15.6 million (3.4% of sales) last year, an increase of \$1.9 million, stemming mainly from an increase in expenses for employee options, an increase in donations and an increase in the cost of professional services such as payments to consultants with respect to changes in accounting standards (IFRS) and the reorganization scheme.

#### **E. Financing Expenses:**

Financing expenses in the quarter amounted to \$12.0 million, compared with \$14.0 million in the corresponding quarter last year, a decrease of \$2.0 million. During the first half of the year, financing expenses amounted to \$23.4 million compared with \$25.7 million during the corresponding period last year; a decrease of \$2.3 million.

#### **F. Other Income and Expenses:**

Other expenses amounted to \$7.2 millions this quarter, compared with \$4.7 million last year. Other expenses include mainly amortization of intangible assets of products, and expenses related to the customer portfolio securitization plan.

During the first half of the year, other expenses amounted to \$11.6 million compared with \$11.8 million last year.

#### **G. Taxes on Income:**

Tax expenses during the quarter amounted to \$13.9 million (constituting 20% of pre-tax profits) compared with \$5 million last year (10.5% of pre-tax profits). The increase in tax expenses stems mainly from: (1) an increase in pre-tax profits; (2) a decrease in taxable revenues in jurisdictions with lower tax rate than in Israel.

During the first half of the year, tax expenses amounted to \$29.8 million (constituting 19.4% of pre-tax profits) compared with \$11.6 million (constituting 10.4% of pre-tax profits).

#### **H. Net Profit:**

The net profit this quarter amounted to \$52.3 million (9.5% of sales) compared with \$40.2 million (8.8% of sales) in the previous year, an increase of \$12.0 million (29.9%).

During the first half of the year, net profit amounted to \$118.8 million (10.7% of sales) compared with \$97.9 million in the previous year (10.3% of sales), an increase of \$20.9 million (21.3%).

#### **I. EBITDA:**

EBITDA amounted to \$100.6 million this quarter (18.3% of sales) compared with \$80.2 million (17.5% of sales) last year, an increase of \$20.4 million (25.4%) stemming from an increase in operating profit.

During the first half of the year, EBITDA amounted to \$219.8 million (19.8% of sales) compared with \$176.4 million in the previous year (18.5% of sales), an increase of \$43.4 million (24.6%).

### **4. FINANCIAL CONDITION AND LIQUIDITY:**

#### **A. Operating cash flow:**

Amounted, this quarter, to the sum of \$225.0 million, compared with \$199.7 million last year. The improvement in operating cash flow stemmed mainly from an increase in collection from customers, despite a significant growth in sales in the second quarter, which brought about an increase in working capital.

During the first quarter of the year, operating cash flow amounted to \$216.9 million compared with \$195.5 million last year.

#### **B. Cash flows used in investment activities:**

Investments in fixed assets, amounted to \$8.1 million this quarter, compared with \$22.7 million in the corresponding quarter last year. Investment in product registrations and marketing rights amounted, in this quarter, to \$12.1 million, compared with \$15.9 million last year. Short-term investments in negotiable securities amounted to \$44.3 million compared with \$0.8 million last year.

In the first half of the year, investments amounted to \$114.4 million (including short term investments in negotiable securities, in the sum of \$44.3million) compared with \$90.2 million last year. Investments in product registrations and marketing rights amounted, in this quarter, to \$33.4 million, compared with \$26.0 million last year.

**C. Free Cash Flow:**

Free cash flow (operating cash flow less cash flow from investment operations) in the quarter amounted to \$161.1 million, compared with a free cash flow of \$138.4 million last year. Less short term investments, the free cash flow in the quarter amounted to \$205.4 million, compared with \$139.3 million last year.

The increase in free cash flow stems mainly from an improvement in operating cash flow and from a decrease in investments in fixed assets.

During the first quarter of the year, free cash flow amounted to \$102.5 million compared with \$105.2 million last year. Excluding short term investments, the free cash flow in the first half of the year amounted to \$146.8 compared with \$106.1million last year.

**D. Current Assets:**

Total current assets as at June 30, 2007 amounted to \$1,717.1 million, compared with \$1,243.8 million on June 30, 2006 and \$1,526.1 million on December 31, 2006.

Trade receivables – receivable balances as at June 30, 2007 amounted to \$547.2 million, compared with \$417.6 million on June 30, 2006. The increase in receivable balances stemmed from: (1) a sharp increase in sales; (2) revaluation of currencies (mainly the Euro and the Real) as against the dollar, which increased customer debt dollar balances; (3) first time consolidation of new companies.

**E. Investments in Fixed Assets:**

See Cash Flow chapter above.

**F. Cash, Current Liabilities and Long-Term Loans:**

The Company's credit (bank credit, debentures and convertible debentures) amounted, as at June 30, 2007, to \$711.8 million, of which 16.9% is short term, compared with \$382.2 million as at June 30, 2006 (of which 80.7% was short term) and \$712.2 million as at December 31, 2006 (of which 15.7% was short term).

Cash and short-term investment balances as at June 30, 2007 amounted to \$472.6 million compared with \$138.1 million on June 30 last year, and \$326.1 million as at December 31, 2006.

The increase in debt balances, and the increase in cash balances stems from the debenture placement in December 2006, which increased debit balances and cash balances accordingly.

The Company's net debt (loans to banks and debentures less cash and short-term investments) amounted, as at June 30, 2007, to \$239.2 million, compared with \$244.1 million on June 30, 2006 and \$386.2 million on December 31, 2006.

The Company has undertaken towards certain banks to meet certain covenants. As at the balance sheet date, the Company is in fulfillment of these covenants.

**G. Shareholders' Equity:**

As at June 30, 2007, amounted to \$1,265.6 million, compared with \$1,126.6 million in the corresponding period last year.

**H. Convertible Debentures:**

Of a series of convertible debentures issued in November 2001 and January 2002, the total sum of \$85.0 million has been converted into shares as at the date of this financial report. As at June 30, 2007, the balance of the debentures on the balance sheet amounts to \$4.9 million.

**I. Financial Ratios:**

	<b>As at</b>		
	<b>December</b>		
	<b>As at June 30,</b>		<b>31,</b>
	<b><u>2007</u></b>	<b><u>2006</u></b>	<b><u>2006</u></b>
Ratio of current assets to current liabilities (current ratio)	2.06	1.27	2.03
Ratio of current assets excluding inventory, to current liabilities (acid-test ratio)	1.34	0.69	1.22
Fixed assets (net) out of total balance sheet	17.9%	21.2%	19.5%
Financial liabilities out of total balance sheet	25.0%	16.5%	27.2%
Shareholders' equity out of total balance sheet	44.4%	48.6%	43.2%
Ratio of financial liabilities to shareholders' equity	56.2%	33.9%	62.9%

**J. Sources of Finance:**

The Company finances its operations using independent means, debentures, bank credit (short-term and long-term) and credit from suppliers. There have been no changes made to the financing agreements with banks.

## 5. EXPOSURE TO MARKET RISKS AND METHODS OF MANAGING SUCH RISKS

The Company conducts its business in a number of different currencies. Due to these activities, the Company is exposed to market risks, which mainly involve exchange rate fluctuations, partial adjustment of prices of products to reflect changes in cost of raw materials, and changes in interest rates.

The Board of Directors of the Company approved a policy of using financial derivatives to reduce the exposure to changes in exchange rates. The Company only effects such transactions via banking corporations and stock exchanges, which are obligated to meet capital adequacy requirements or to maintain a scenario-based level of collateral.

### Risk Management Officer

The Company's Market Risk Manager is the CFO, Ran Maidan. For details of his education, qualifications and experience, see under Further Particulars, under Section 26A to the periodic report published by the Company on March 12, 2007.

The following are exchange rate data for the principal trade currencies used by the Company, in comparison with the dollar, as well as LIBOR interest data:

	30/6/2007			Quarterly Average			Half-Yearly Average		
	2007	2006	Change	2007	2006	Change	2007	2006	Change
Euro	1.345	1.271	5.8%	1.348	1.256	7.3%	1.329	1.230	8.0%
Brazilian Real	1.926	2.164	11.0%	1.983	2.189	9.4%	2.046	2.193	6.7%
Shekel	4.249	4.440	(4.3%)	4.093	4.524	(9.5%)	4.157	4.601	(9.7%)
LIBOR interest for 3 months	5.36%	5.50%		5.36%	5.22%		5.36%	5.00%	

### Description of Market Risks

#### Currency Risks:

The Group's most substantial exposure is to the Euro, the Shekel and the Brazilian Real. In addition, there are lesser exposures to the UK pound, Polish zloty, the Australian dollar and the South African rand. Currency exposure deriving from foreign currency exchange rate fluctuations is constantly checked against the assets (including inventory of finished products in countries of sale), liabilities and cash flows denominated in non-US dollar currencies. It is the Company's policy is to use financial derivatives (options, swaps and forward contracts) to hedge against such exposure only when the net exposure to a certain currency is material.

During the quarter, the Company hedged most of its exposure to the Euro, the Real and the Shekel.

In November 2006, the Company completed a debenture issue in the sum of 2.35 billion shekels. The debentures are denominated in shekels, whilst the Company's operating currency is dollars. Changes in the exchange rate of the shekel against the dollar might significantly increase the Company's financing expenses. As at the date of this report, the Company has hedged most of its risk in this regard by way of swap transactions and forward contracts.

#### Exposure to CPI Linkage

As stated above, in November 2006, the Company completed a debenture issue in the sum of 2.35 billion shekels. The main portion of the debentures are linked to the consumer price index, and therefore, an increase in the consumer price index might bring about a significant increase in the Company's financing expenses. The Company partially hedges against this risk.

#### Risks in raw material prices (in source currency):

Approximately 70% of the Company's sales costs stem from raw material costs. Most of the Company's raw materials are derivatives of petroleum prices. An increase in petroleum prices can cause an increase in raw material prices.

In order to reduce exposure to fluctuations in the prices of raw materials, the Company customarily enters into long-term purchase contracts for principal materials wherever possible. In long-term production contracts, the Company tries to adjust the selling prices of its products, as far as possible, in order to reflect changes in the prices of raw materials.

The Company has not entered into any transactions to hedge against petroleum or the prices of raw materials.

#### Interest rate risks:

The Company is exposed to changes in the LIBOR interest rate on the US dollar, since most of its short- and long-term liabilities are in that currency and bear a variable LIBOR rate. The Company prepares a quarterly summary of its exposure to changes in the LIBOR rate. As at the date of publication of this report, the Company does not hedge this exposure.

### Company's Policy regarding Market Risk Management

The Company's policy is to maintain as high as possible a coefficient between the currency in which it sells its merchandise and the currency in which it purchases its raw materials.

The Company is continually examining its accounting and economic exposures 12 months in advance, in accordance with its revenue and expenditure forecasts. As at the date of this report, the Company has hedged most of its accounting exposure and some of its economic exposure in respect of the principal currencies in which it operates. For details of the Company's policies for each type of risk, see details of the risks above.

### Means of supervision and policy implementation

The Company keeps internal documentation regarding the designation of financial instruments for exposures which indicate the link between the instruments and the exposure. The Board of Directors and the Finance Committee discuss the Company's exposure to market risks and the acts done by management of the Company in respect thereof, once every quarter.

There have been no substantial changes this quarter with respect to exposure to market risks, nor to the methods of managing such.

## **6. INTERNAL AUDITOR**

On July 9, 2007, the Company published an immediate report in which it gave notice of termination of the internal auditor of the Company who had held that office since November 2006, His departure is not relate to circumstances in which the public might have an interest. The Company is currently in the process of locating and appointing a suitable candidate for the position.

## **7. SUMMARY OF OTHER EVENTS IN THE COMPANY DURING THE PERIOD**

On March 13, 2007, the Company filed a draft prospectus to the Securities Authority for the purpose of listing the debentures (Series B – D) issued by it in a private placement to institutional investors on December 4, 2006, for trading, as well as a shelf prospectus. As at the date of this report, the debentures (Series B – D) have not yet been listed for trading and the Company has decided, for now, to defer the date of publication of the prospectus.

During the course of its discussions with the Securities Authority regarding the above draft prospectus, a number of matters arose relating to the following issues: The report of the Company's internal auditor and approval of the conditions of remuneration of VPs in the Company, approval of amendment of the conditions of the options in the Company, and date of approval of the conditions of office of a VP who had acted as a director of the Company. Following these discussions, on May 9, 2007, the board of directors of the Company passed

a number of resolutions relating to corporate governance in the Company. For full details of the issues discussed with the Securities Authority, and the resolutions of the board of directors with respect to corporate governance, see immediate report of June 7, 2007 (reference no. 2007-01-420299), the information contained in which is imported herein by reference.

Accounting treatment of options under the Company's Option Scheme of 2005 – On March 13, 2005, the board of directors of the Company approved an option scheme for employees of the Company, an immediate report in respect of which was published on March 14, 2005. On the basis of the transitional provisions in Standard 24 'Share-Based Payment', the Company did not apply that standard to the grants made under the option scheme, and did not record an expense in respect thereof, in accordance with the transitional provisions of the Standard which provided that it did not apply to grants made after March 15, 2005, and which had not vested prior to January 1, 2006.

With respect to the examination of the draft prospectus submitted by the Company for a listing for trading of debentures that it issued, and following a meeting with the staff of the Securities Authority on May 8, 2007, questions arose regarding the factual circumstances which led to the removal of the aforesaid grants from the application of Standard 24. In light of the above, the board of directors of the Company decided to re-examine the facts on the basis of which the grants were handled for accounting purposes, under the supervision of the Company's Audit Committee. The examination showed that the Company is not required to amend its financial statements and will not be required to record an additional expense for the options issued in the 2005 plan, due to lack of materiality. The Company published an immediate report on this matter on June 7, 2007, as set out above.

## **8. PROCESS OF APPROVAL OF FINANCIAL STATEMENTS**

The Company has a finance committee which receives a detailed presentation each quarter of the financial results from the VP Finances. Each quarter, the committee discussed the financial results before presenting them to the board of directors, and recommends that it approve the financial statements. The financial statements are approved by the board of directors, which is the organ responsible for overall review of the Company. In addition to these regular quarterly discussions, the finance committee holds additional meetings at its discretion, at which it discusses various matters arising out of the Company's financial statements in greater detail and depth. The Company's finance committee is made up of six directors, of which one is an external director. Five of the members of the committee have accounting and finance qualifications.

The members of the committee and the members of the board of directors receive the draft financial statements a few days before the meetings.

Representatives of the Company's accountants are invited to meetings of the finance committee as well as to those meetings of the board of directors at which the financial statements are discussed and approved, and they refer to and respond to questions directed to them by members of the board of directors, relating to substantial issues deriving from the data presented in the relevant financial statements. When presenting the financial statements to the board of directors, the CEO of the Company, who is also the chairman of the board of directors, Mr. Avraham Bigger, sets out the main results of the Company's operations during the period under review, and refers to substantial events that may have taken place during the period. Thereafter, Mr. Ran Maidan, VP Finances, gives a detailed presentation of the Company's financial results during the period under review, and compares it with previous periods, with the emphasis being placed on the substantial issues that arise from such. During the course of these reviews, management responds to the questions asked of it by members of the board of directors. At the end of the discussion in the board of directors, a vote is held during which the financial statements are approved.

#### **9. EFFECTS OF THE TRANSITION TO INTERNATIONAL STANDARDS (IFRS)**

In July 2006, the Israel Accounting Standards Board published Accounting Standard No. 29 on "Adoption of International Financial Reporting Standards (IFRS)" ("the Standard"). The Standard provides that companies subject to the Israeli Securities Law, 1968 that report pursuant to it will prepare their financial statements in accordance with International Financial Reporting Standards (IFRS), as from reporting periods commencing January 1, 2008. The opening balance sheet, according to IFRS, will be as at January 1, 2007 (Company's transition date to IFRS). In the first-time adoption of IFRS Standards, the provisions of IFRS Standard 1 "First-time Adoption of IFRS Standards" will be applied for transition purposes. In the financial statements prepared in accordance with IFRS Standards, in the year of first-time adoption, the Company must present comparative figures for just one year.

The Group is ready to adopt IFRS Standards and has examined those expected to have material influence on the Group as a result of the adoption of these Standards. Information on the Group's preparations for transition to reporting according to IFRS Standards, as well as a written and qualitative description of the material effects expected on the Group's consolidated financial statements as a result of the transition to IFRS, including changes that could occur as a result of this transition, are provided by the Company in its Directors' Report for the year 2006.

Based on this assessment, the Company is estimating the effect of the transition from generally accepted accounting principles in Israel ("Israeli GAAP") as at the reporting date according to IFRS. Because of its nature, the preparation process is not yet complete, and is expected to be completed when the financial statements as of December 31, 2007 will be

filed, in which a comprehensive quantitative note will be included, audited by the independent auditor, about the effect of such transition.

Based on the status of the preparations as at the reporting date and subject to changes that could result from the continued gathering of information and its adjustment to IFRS principles, and of changes that could result from developments related to the interpretation of IFRS, presented below is an estimate of the material financial effects of the change from Israeli GAAP to IFRS on the consolidated financial position of the Company as at January 1, 2007 (the transition date). As noted, since the certification of the first financial statements in which IFRS will be applied or according to which information will be disclosed will be in the future, it is possible that the board of directors may find it appropriate to change the accounting policy on which the said information is based. Likewise, disclosure is given on the material financial effects of the transition on the Company's financial position as at June 30, 2007, if they are materially different than the effects of the transition on its financial position as at the transition date.

It is emphasized that the information presented below is not reviewed or audited.

#### Adjustments:

		Israeli GAAP	Effect of transition to IFRS Effects expressed in the adoption of new accounting principles in Israel in 2007	Other effects
		January 1, 2007		
Note	\$ thousands	\$ thousands	\$ thousands	\$ thousands
<b>Balance sheet items</b>				
		1,706		(817)
Short-term investments		486,368		195,529
Trade receivables	3	106,372		(16,759)
Other receivables and debit balances	4,8	46,125		(13,647)
Investments and other debts	4,8,10	59,738		59,738
Deferred tax assets	4,8,11	511,410	(5,291)	(10,142)
Fixed assets, net	1,7	532,755	5,291	14,884
Other assets	1,9			
Bank credit and current maturities of long-term credit	3	99,850		195,529
Other payables and credit balances	5,8	271,413		26,033
Deferred taxes	7,85,	62,147		(9,287)
Employee severance benefits	5	38,131		11,451
Put option to minority shareholders	9	-		23,774
<b>Shareholders' equity</b>				
Shareholders' equity	13	1,131,718		(11,169)
Minority interest	9	30,212		(7,556)

### **Effects expressed in the scope of the adoption of new Accounting Standards in Israel in 2007**

1. In accordance with IFRS, computer software and capitalized software development costs that do not constitute an inseparable part of the hardware related to them, are treated as an intangible asset. Therefore, with the transition to IFRS, this net book balance as at January 1, 2007 in the amount of \$5.3 million, relating to the computer software and capitalized software development costs, was reclassified from fixed assets to intangible assets. This effect was expressed in the adoption of Accounting Standard No. 27 in Israel commencing January 1, 2007.

### **Other expected effects**

2. In accordance with the exemption of IFRS 1, the Company is expected to elect to charge to retained earnings the balance of negative reserves from the translation of financial statements of investees as at the transition date, in the projected amount of \$2.3 million.
3. In accordance with IFRS, the test for derecognizing financial assets is based mainly on the transfer of risks and yields. When the risks and yields related to the ownership of the financial assets are not actually transferred, there will be no accounting derecognition. Some of the transactions of sale of receivables, for which the receivables were deducted from the balance sheet, in accordance with the practice in Israel that is based on the American standards, do not meet the criteria for derecognition according to IFRS. Therefore, with the transition to IFRS, the derecognition of receivables against an increase of short-term credit was reversed. The effect as at January 1, 2007 and as at June 30, 2007 totals \$195.5 million and \$278.6 million, respectively. After the balance sheet date, the terms of the receivable securitization transactions were changed, so that a receivable securitization meets the criteria for derecognizing the financial assets according to IFRS principles (the balance of receivables included in the securitization transaction as at December 31, 2006 and June 20, 2007 was \$175.9 million and \$275 million, respectively).
4. According to Israeli GAAP, deferred tax assets were classified as current or non-current assets, depending on the classification of the assets for which they were created. According to IFRS, deferred tax assets are classified as non-current assets even if their expected realization date is in the short-term. Therefore, with the shift to IFRS Standards, the short-term deferred tax balance as at January 1, 2007 of \$17 million, were reclassified from receivables and debit balances in current assets to deferred tax assets in non-current assets. Additionally, deferred tax assets were reclassified from investments and other debts to deferred tax assets in non-current assets of \$20 million as at January 1, 2007.

5. According to Israeli GAAP, employee severance benefits, net, are recognized based on the assumption that the employees will reach retirement age and will be entitled to full severance pay, without considering discount rates, salary increase rates in the future and future exits. Likewise, accrued vacation and sick pay were computed based on estimates of utilization and redemption, respectively. On the transition date to IFRS, all the net long-term liabilities for post-employment employee benefits and other benefit plans were measured according to the provisions of IAS 19 regarding employee benefits. Retirement benefits from a defined benefit plan are measured, inter alia, based on actuarial estimates and discounted amounts. The Company is expected to elect the corridor method to record actuarial gains or losses, and in accordance with the exemption of IFRS 1, the Company is expected to zero out the said effect as at the transition date. The difference as at January 1, 2007, which is expected to total \$25.1 million, was charged to retained earnings (net of tax). The effect of the transition to IFRS is expected to be expressed in an increase in the long-term liability for employee benefits of \$11.5 million as at January 1, 2007, in an increase in accrued vacation and sick pay of \$22.2 million as at January 1, 2007.
6. Expenses for share-based payments of \$2.4 million for the period from March 15, 2007 to December 31, 2006, which were charged in the financial statements to capital reserves, in conformity with Israeli GAAP, were reclassified to retained earnings.
7. According to Israeli GAAP, properties leased from the Israel Lands Administration ("ILA") are classified as fixed assets and are not depreciated. According to international standards, in cases in which these properties are not deemed properties owned by the Group, the lease payments are classified as deferred expenses and are amortized over the lease period, including the option to extend the lease period, if on the date of the lease agreement it was reasonably certain that the option will be exercised. Consequently, as at January 1, 2007, an increase in long-term investments is expected to be recorded in the amount of \$3.7 million, and a decrease in fixed assets of \$10.1 million, a decrease in the provision for tax of \$1.7 million and a decrease in retained earnings of \$4.7 million. A decrease in the provision for tax of \$1.7 million and a decrease in retained earnings of \$4.7 million.
8. According to Israeli GAAP, the results of derivative instruments treated for accounting purposes as a hedge are charged concurrently with the results of the hedged item in the financial statements. According to IFRS, all financial instruments are classified in the balance sheet as assets or liabilities, and they are measured at fair value. Changes in the fair value of the derivative instruments would be charged mainly to the statement of income, in accordance with the designated use of the instrument. In order to apply hedge accounting, certain documentation and effectiveness requirements must be met, which are more stringent and comprehensive than the requirements of Israeli GAAP. As at the preparation date of the financial statements, the Company did not meet the requirements for applying hedge accounting according to IFRS. Therefore, the effect of the transition to IFRS as at January 1, 2007 is expected to be expressed in an increase in other receivables of \$0.1 million, an increase in other payables of \$3.8 million, a decrease in deferred tax liability of \$0.7 million and a decrease in retained earnings of \$3.0 million. After the balance sheet, the Company made

preparations to apply hedge accounting that will meet the IFRS documentation and effectiveness requirements.

9. According to Israeli GAAP, put options that were issued to the Group by the minority shareholders are not expressed in the financial statements. According to IFRS, when the minority shareholders hold put options, their share in the net assets of the subsidiary will be reclassified from minority interest to financial liabilities in the consolidated balance sheet. This financial liability will be measured at the present value of the exercise price of the option. The revaluation of the financial liability for the time element is expressed in financing expenses, and the Company includes all of the subsidiary's earnings in its income (does not allocate to the minority its share in the earnings of the subsidiary, except for a situation of a dividend distribution to the majority, in which the dividend is recorded as financing expenses), whereas other changes in the liability will be charged against the goodwill balance in respect of the subsidiary. Consequently, as at January 1, 2007, the other assets item is expected to increase by \$16.2 million, the liability for the minority's put option will increase by \$23.8 million and the minority interest will decrease by \$7.6 million.
10. According to Israeli GAAP, investments in put options on an investment in another company are not expressed as a separate financial asset. According to IFRS, when a group holds put options, these holdings are recorded in the balance sheet at fair value: changes in the fair value are recognized in the statement of income. Consequently, an increase in long-term investments of \$2.5 million is expected, as well as an increase in deferred tax liabilities of \$0.6 million and an increase in retained earnings of \$1.9 million.
11. According to Israeli GAAP, intercompany transactions are eliminated in the consolidated financial statements, and deferred tax is recorded according to the tax rate of the selling company, for the timing differences on the recognition date of the income between the financial statements and the tax basis. According to IFRS, deferred tax on intercompany transactions in the consolidated financial statements will be recorded at the tax rate of the purchasing company. Consequently, the retained earnings balance as at January 1, 2007 and as at June 30, 2007 is expected to increase by \$20.7 million and \$26 million, respectively.
12. Additional reclassifications made in accordance with IFRS provisions:
  1. According to Israeli GAAP, minority interest of \$22.7 million as at January 1, 2007, are reclassified in a separate item between long-term liabilities and shareholders' equity. According to IFRS, minority interest in subsidiaries is classified as a separate element in the Company's shareholders' equity.
  2. Other income (expenses), net, were reclassified to other operating income and financing income (expenses), net, as follows:
    - Amortization of intangible rights in the purchase of products was reclassified to selling expenses.
    - Expenses for the securitization of receivables were reclassified to financing expenses.

3. The revaluation of the monetary balances in foreign currency other than the dollar was reclassified from sales and cost of sales to financing expenses, and the results of transactions in derivative financial instruments were reclassified from sales and cost of sales to financing expenses.

**13. Effect of the said expected adjustments on shareholders' equity:**

	<u>January 1, 2007</u>	
	<b>Effects expressed in the adoption of new accounting principles in Israel in 2007</b>	<b>Other effects</b>
	<u>\$ thousands</u>	<u>\$ thousands</u>
Fixed assets		(4,763)
Derivatives		(2,976)
Call/put options		1,908
Employee benefits		
Options		(25,148)
Deferred taxes		20,907
Reclassification of reserves to retained earnings		1,561
Total adjustment of retained earnings balance		(9,607)
Intangible assets		(1,096)
Capital reserve from employee options		(2,412)
Capital reserve from translation differences		2,346
Other reserves		(399)
Total adjustments of reserves and retained earnings		(11,169)
Minority interest		22,656
Total shareholders' equity adjustments		11,488

Avraham Bigger  
Chairman of the Board & CEO

Ra'anan Cohen  
Director

August 13, 2007, Tel Aviv

