



## **Makhteshim Agan Industries Ltd.**

### **Management Discussion and Analysis for the period ended September 30, 2008**

The Board of Directors of the Company is pleased to submit the Board of Directors' report of the state of the Company's affairs for the quarter ended on September 30, 2008 (the "**Quarter**"), and for the cumulative period of nine months ending on that date (the "**Report Period**"). The management discussion for the Report Period is limited in scope and should be read together with the Periodic Report for 2007.

#### **1. Brief description of the Company and its business environment**

Makhteshim Agan Industries Ltd. ("**the Company**") engages in the primary field of activity involving the development, manufacture and marketing of crop protection products. In addition, the Company has activities in other markets, none of which, in a substantial scope for the Company. As at the date of the report, the Company is the world's leading manufacturer of branded off-patent crop protection products and sells its products in more than 100 countries worldwide. The Company's success factors are, mainly, goodwill, know-how, high-level technological-chemical abilities, expertise in product registration, observance of strict standards of environmental protection, stringent quality control and an international marketing and distribution structure. Investments in consistent and ongoing development facilitate the launching of new generic products at opportune times.

The Company's business strategy and goals in the crop protection products market focus on: (1) strengthening and establishing its presence in markets in which it operates and expanding its market share in markets with a high growth potential; (2) continued growth, based on the composition of the Company's existing basket of products and the ability to launch new products; (3) continued improvement of the Company's operating capabilities, allowing for efficient production at competitive costs; and (4) growth through the acquisition of companies and products registrations, affording the Company access to new customers and markets.

Note that in this interim report, the Company is implementing Accounting Standard No. 29, "Adoption of International Financial Reporting Standards (IFRS)" (hereinafter: the "**Standard**"). For further details regarding implementation of the Standard, see notes 2, 3 and 7 of the Financial Statements for September 30, 2008.

## **Conditions of the business environment**

### **Brief overview of changes in the sector**

In the third quarter, the impact of trends in the first half of the year continued, subject to the changes that occurred as of the second half of the quarter, as set out below:

1. There was an increase in demand for the Company's products, stemming from the high level of prices, as compared with previous years, of many of the agricultural outputs. The high level of agricultural outputs prices stemmed mainly from a continued rise in the standard of living worldwide, particularly in developing markets such as China and India as a result of dietary changes in these markets. In addition, the global increase in demand for alternative fuels produced mainly from sugar cane, oilseed and corn also contributed to increase in demand for the Company's products.
2. There was an increase in the average selling prices of the Company's products. This trend had a positive effect both on the increase in the Company's revenues and on the Company's gross profit.
3. Relatively favorable weather conditions in most of the geographical regions in which the Company operates, led to extensive demand for crop protection products.
4. The Company reports its results in US Dollars ("Dollars") and therefore, the exchange rates of currencies (particularly the Euro) against the US Dollar contributed to an increase in the Company's revenues in Dollar terms, compared with the exchange rate of the Shekel against the Dollar which increased local expenses in Israel.
5. On the other hand, the high level of oil prices caused a continued increase in the prices of raw materials (which are distant derivatives of oil), and an increase in energy prices which offset some of the improvement in the Company's gross profits which was obtained due to an increase in average sale prices of the Company's products, as set out above.

Notwithstanding this, as of the second half of the third quarter, and during the period after the balance sheet date and until approval of the financial statements, there were significant changes in the above trends, including a decline in the price of agricultural outputs, a decline in oil prices and a appreciation of the Dollar with respect to the main currencies with which the Company's operates (the Euro, the Real and the Shekel). This occurred simultaneously with the financial crisis in the global markets. The changes in the agricultural output markets and in the global financial markets did not substantially affect the results of the Company's operations during the quarter or the report period, which saw continuation of high level of demand for the Company's products. In the Company's assessment, based on the market data known at present, no change is expected in the long-term trends in the market in which the Company operates, nor in the Company's operations, but the changes in trends that characterized the agricultural outputs market during the second half of the quarter, as aforesaid, together with the impacts of the financial crisis on global markets, may cause a slow-down in demand for the Company's products and a slow-down in the Company's growth rate and greater volatility of the factors that

affect the Company's results, including oil price, exchange rates, costs and availability in customers' and suppliers' credit in the various markets in which it operates.

The global uncertainty and the instability of financial markets, particularly in emerging markets, where a substantial portion of the Company's business is concentrated, could have a material impact on the Company's business in the near future.

## 2. **Results of Operations – Condensed Profit and Loss Statements**

During the third quarter of 2007, a one-time capital gain in the sum of \$13.4 million was recorded from the divestment of RiceCo LLC ("RC") which, following the first-time implementation of IFRS standards, was recorded as operating income. The following are the profit and loss statements, following deduction of the minority interest in the sum of \$7.7 million of the capital gain from the divestment of RC:

### **Statements of Profit and Loss for the Third Quarter Adjusting for Capital Gain from Sale of RiceCo LLC (\$ Millions):**

	%	7-9/2008	%	7-9/2007	Change	%
Revenues		640.1		496.9	143.2	28.8%
Gross profit	32.8%	209.9	32.5%	161.7	48.2	29.8%
R&D and SG&A expenses	19.4%	124.0	21.1%	104.9	19.1	18.2%
Operating profit (EBIT)	13.4%	85.9	11.4%	56.8	29.1	51.2%
Financing expenses	3.3%	20.9	7.4%	36.5	15.6	(42.7%)
Pre-tax profit	10.1%	64.9	4.1%	20.2	44.7	220.8%
Net profit after minority share	7.9%	50.6	3.9%	19.5	31.1	159.8%
EBITDA	17.0%	109.1	16.7%	83.0	26.1	31.4%

### **Statements of Profit and Loss for the First Nine Months of the Year Adjusting for Capital Gain from Sale of RiceCo LLC (\$ Millions):**

	%	1-9/2008	%	1-9/2007	Change	%
Revenues		2,044.5		1,592.5	451.9	28.4%
Gross profit	34.7%	709.3	34.1%	542.8	166.5	30.7%
R&D and SG&A expenses	18.4%	376.2	20.0%	318.1	58.1	18.3%
Operating profit (EBIT)	16.3%	333.1	14.1%	224.7	108.4	48.3%
Financing expenses	4.2%	86.2	3.3%	51.9	34.3	66.2%
Pre-tax profit	12.1%	246.9	10.9%	172.8	74.1	42.9%
Net profit after minority share	10.3%	210.3	9.1%	144.2	66.1	45.8%
EBITDA	19.5%	398.8	18.5%	295.3	103.5	35.1%

**Statements of Profit and Loss for the Third Quarter (\$ Millions):**

	%	7-9/2008	%	7-9/2007	Change	%
Revenues		640.1		496.9	143.2	28.8%
Gross profit	32.8%	209.9	32.5%	161.7	48.2	29.8%
R&D and SG&A expenses	19.4%	124.0	18.4%	91.5	32.5	35.5%
Operating profit (EBIT)	13.4%	85.9	14.1%	70.2	15.6	22.3%
Financing expenses	3.3%	20.9	7.4%	36.5	(15.6)	(42.7%)
Pre-tax profit	10.1%	64.9	6.8%	33.7	31.3	92.8%
Net profit after minority share	7.9%	50.6	5.5%	27.2	23.4	86.0%
EBITDA	17.0%	109.1	18.3%	90.8	18.3	20.2%

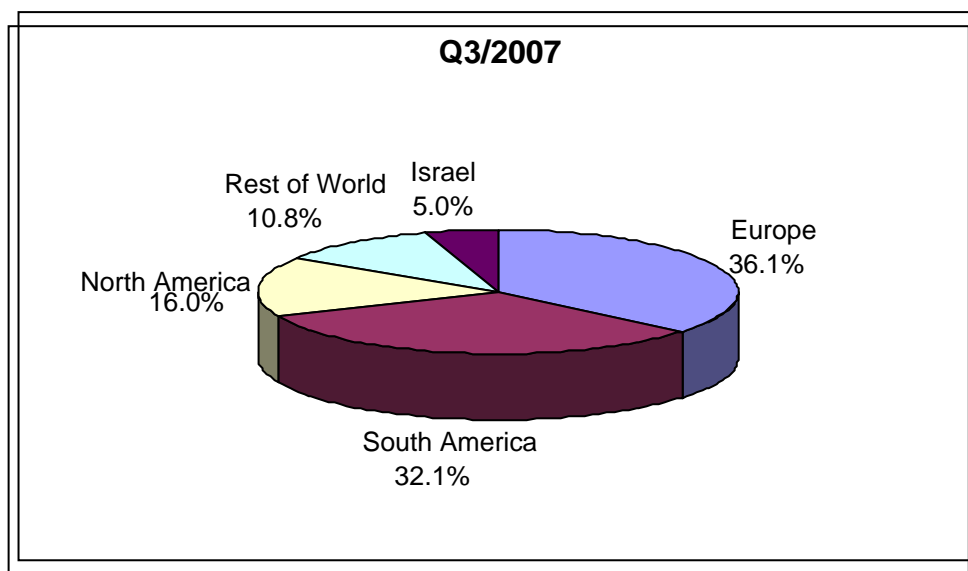
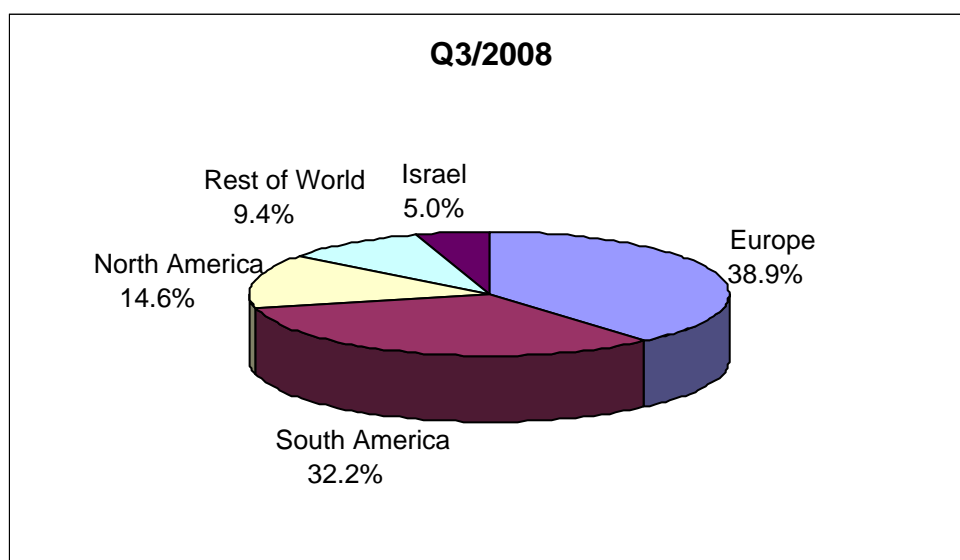
**Statements of Profit and Loss for the First Nine Months of the Year (\$ Millions):**

	%	1-9/2008	%	1-9/2007	Change	%
Revenues		2,044.5		1,592.5	451.9	28.4%
Gross profit	34.7%	709.3	34.1%	542.8	166.5	30.7%
R&D and SG&A expenses	18.4%	376.2	19.1%	304.7	71.5	23.5%
Operating profit (EBIT)	16.3%	333.1	15.0%	238.1	95.0	39.9%
Financing expenses	4.2%	86.2	3.3%	51.9	34.4	66.2%
Pre-tax profit	12.1%	246.9	11.7%	186.3	60.6	32.6%
Net profit after minority share	10.3%	210.3	9.5%	152.0	58.4	38.4%
EBITDA	19.5%	398.8	19.0%	303.0	95.8	31.6%

**3. Analysis of Results of Business Operations****A. Revenues by Geographical Region**

In the third quarter of 2008, the Company's sales amounted to \$640.1 million, compared with \$496.9 million in the corresponding quarter last year, an increase of 28.8%. In the third quarter of 2008, the Company's sales of crop protection products amounted to \$587.4 million, compared with \$452.2 million in the corresponding quarter last year, an increase of 29.9%. The increase in the Company's sales stems from a continued increase in the standard of living around the world, particularly in developing areas such as China and India, as well as the increase in international demand for alternative fuel products produced from crops such as sugar cane, oilseed and corn which led to an increase in the prices of agricultural outputs. This growth was recorded in all of the geographical regions in which the Company operations, and particularly in Europe and South America. In the Company's assessment and in accordance with the trends which were described in previous quarters, part of this growth might be ascribed to advancement of sales from the fourth quarter. For a specific description of the unique trends of the principal areas of operations see below.

Breakdown of Quarterly Sales:



Breakdown of Quarterly Sales (\$ millions)

	%	<b>7-9/2008</b>	%	<b>7-9/2007</b>	Change	%
Europe	38.9%	248.8	36.1%	179.4	69.5	38.7%
South America	32.2%	206.1	32.1%	159.7	46.4	29.1%
North America	14.6%	93.3	16.0%	79.3	14.0	17.6%
Rest of the world	9.4%	60.0	10.8%	53.5	6.4	12.1%
Israel	5.0%	31.9	5.0%	25.0	6.8	27.4%
<b>Total</b>	<b>100.0%</b>	<b>640.1</b>	<b>100.0%</b>	<b>496.9</b>	<b>143.2</b>	<b>28.8%</b>

Breakdown for first Nine Months (\$ millions)

	%	<b>1-9/2008</b>	%	<b>1-9/2007</b>	Change	%
Europe	42.5%	868.7	41.8%	665.9	202.8	30.5%
South America	24.3%	497.1	22.3%	355.7	141.4	39.7%
North America	16.9%	344.7	19.7%	313.0	31.7	10.1%
Rest of the world	12.0%	244.5	11.1%	177.1	67.5	38.1%
Israel	4.4%	89.5	5.1%	80.9	8.5	10.5%
<b>Total</b>	<b>100.0%</b>	<b>2,044.5</b>	<b>100.0%</b>	<b>1,592.5</b>	<b>451.9</b>	<b>28.4%</b>

In Europe, sales in the third quarter of 2008 amounted to \$248.8 million compared with \$179.4 million in the corresponding quarter of the previous year, an increase of \$69.5 million, constituting growth of 38.7%. Apart from the affect of the general trends of this quarter as set out above, the aforesaid increase stemmed mainly from: (1) favorable weather conditions which gave rise to an increase in the Company's sales; and (2) the strengthening of the Euro which increased the dollar value of the sales.

During the first nine months, sales to Europe amounted to \$868.7 million compared with \$665.9 million during the corresponding period last year; an increase of \$202.8 million, constituting growth of 30.5%.

In South America, sales in the third quarter of 2008 amounted to \$206.1 million compared with \$159.7 million in the corresponding quarter of the previous year, an increase of \$46.4 million, constituting growth of 29.1%. Most of the increase in sales was related to Brazil. This increase stemmed from a continued increase in demand, which brought about an increase in the Company's sales.

During the first nine months, sales in South America amounted to \$497.1 million compared with \$355.7 million in the corresponding period of the previous year, an increase of \$141.4 million, constituting growth of 39.7%.

In North America, sales in the third quarter of 2008 amounted to the sum of \$93.3 million compared with \$79.3 million in the corresponding quarter of the previous year, an increase of \$14.0 million, constituting growth of 17.6%.

During the first nine months, sales to North America amounted to \$344.7 million compared with \$313.0 million during the corresponding period in the previous year; an increase of \$31.7 million, constituting growth of 10.1%. The relatively low growth rate recorded in North America stems mainly from sale of the Company's holdings in RC during the course of 2007.

In the rest of the world, sales in the third quarter of 2008 amounted to \$60.0 million compared with \$53.5 million in the corresponding quarter of the previous year, an increase of \$6.4 million, constituting growth of 12.1%.

In the first nine months, sales to the rest of the world amounted to \$244.5 million compared with \$177.0 million during the corresponding period in the previous year, an increase of \$67.5 million, constituting growth of 38.1%. The sharp rise in sales in the quarter and in the first nine months, and mainly in the first half of the year, stems, apart from the effect of the general trends, as set out above, from an increase in sales of the Company's products in the Asia Pacific region, and particularly in Australia, which was positively affected by a good agricultural season following several years of drought.

In Israel, sales in the third quarter of 2008 amounted to \$31.9 million compared with \$25.0 million in the corresponding quarter of the previous year, an increase of \$6.8 million, constituting growth of 27.4%.

In the first nine months, sales in Israel amounted to \$89.5 million compared with \$80.9 million during the corresponding period last year; an increase of \$8.5 million, constituting growth of 10.5%. The growth in sales during the quarter and in the first nine months was achieved due to an increase in sales of the Company's products.

**B. Additional areas of activity:**

During the quarter, the Company's sales from other areas of activity amounted to \$52.6 million compared with sales of \$44.7 million in the corresponding quarter last year.

In the first nine months, the Company's sales from other areas of activity amounted to \$154.0 million compared with \$144.1 million in the corresponding period in the previous year.

**C. Gross Profit:**

Gross profit in the third quarter of 2008 amounted to the sum of \$209.9 million compared with \$161.7 million in the corresponding quarter of the previous year, an increase of \$48.2 million, reflecting growth of 29.8%. In conjunction with the increase in gross profit, the Company's gross margin increased slightly to 32.8% compared with 32.5% in the corresponding quarter last year.

In the first nine months, gross profit amounted to \$709.3 million compared with \$542.8 million in the corresponding period last year, an increase of \$166.5 million constituting growth of 30.7%. In the first nine months, the Company's gross margin increased to 34.7% compared with 34.1% in the corresponding period last year.

The increase in gross profit and margin during the third quarter stemmed mainly from the following factors:

- (1) An increase in Company's sales due to the trends described above;
- (2) An increase in the average selling prices of the Company's products;
- (3) Strengthening of the Euro compared with the corresponding period last year;

The increase in gross profit was partially offset by an increase in costs stemming from the continuing increase in oil prices, resulting in an increase of raw material prices (which are distant derivatives of oil) and energy costs, and the appreciation of currencies which increased production costs.

**D. Operating Profit:**

**Operating profit** in the third quarter of 2008 amounted to \$85.9 million (13.4% of sales) compared with operating profit, adjusting for the capital gain from the sale of RC, of \$56.8 million (11.4% of sales) in the corresponding quarter last year. Including with the capital gain from the sale of RC, the operating profit in the corresponding quarter last year amounted to \$70.2 million (14.1% of sales). The increase in the operating profit this quarter

compared with the corresponding quarter last year (adjusting for the capital gain from the sale of RC), amounted to \$29.1 million, reflecting growth of 51.2%.

In the first nine months, operating profit amounted to \$333.1 million (16.3% of sales) compared with operating profit, adjusting the capital gain from the sale of RC, of \$224.7 million (14.1% of sales) during the corresponding period last year. Including the capital gain from the sale of RC, the operating profit in the corresponding period last year amounted to \$238.1 million (15.0% of sales). The increase in the operating profit during this period compared with the corresponding period last year (adjusting for the capital gain from the sale of RC), amounted to \$108.4 million, reflecting growth of 48.3%.

The increase in operating profit and margin during the quarter (adjusting for the capital gain from the sale of RC), stemmed both from the increase in gross profit and gross profit margin, and continued containment of operating expenses, a trend which continued throughout the Report Period.

Operating expenses this quarter amounted to \$124.0 million (19.4% of sales), compared with operating expenses, adjusting for a one-time capital gain from the sale of RC, of \$104.9 million (21.1% of sales) during the corresponding quarter last year. Including the capital gain from the sale of RC, operating expenses in the corresponding quarter last year amounted to \$91.5 million (18.4% of sales). The increase in operating expenses during the quarter, compared with the corresponding quarter last year, amounted to the sum of \$19.1 million and operating expenses as percentage of sales dropped to 19.4% from 21.1% in the corresponding quarter last year.

In the first nine months, operating expenses amounted to \$376.2 million (18.4% of sales) compared to operating expenses, adjusting for a one-time capital gain from the sale of RC in the sum of 318.1 million (20.0% of sales) in the corresponding period last year. Including the capital gain from the sale of RC, operating expenses in the corresponding period last year amounted to \$304.7 million (19.1% of sales). The increase in operating expenses during the period, compared with the corresponding period last year, amounted to the sum of \$58.1 million and operating expenses as percentage of sales dropped to 18.4% from 20.0% in the corresponding period last year.

This trend of continued decrease in percentage of sales of operating expenses stems mainly from continued sales growth as well as continued implementation of the Company's efficiency plan.

R&D Expenses in the third quarter of 2008 amounted to \$5.3 million compared with \$4.8 million last year – an increase of \$0.4 million. In the first nine months, R&D expenses amounted to \$17.9 million compared with \$15.1 million in the corresponding period last year, an increase of \$2.9 million.

Sales expenses in the third quarter of 2008 amounted to \$96.1 million compared with \$79.9 million in the corresponding quarter last year. The increase of \$16.2 million dollars (20.3%) stemmed mainly from an increase in variable expenses. Sales expenses as a percentage of

sales dropped to 15.0%, compared with 16.1% in the corresponding quarter last year, mainly from a significant growth in sales.

In the first nine months sales expenses amounted to \$291.9 million (14.3% of sales) compared with \$243.3 million dollars (15.3% of sales) in the corresponding quarter last year.

General and administrative expenses during the third quarter of 2008 amounted to \$22.6 million compared with \$20.8 million last year – an increase of \$1.8 million.

In the first nine months G&A expenses amounted to \$67.1 million (3.3% of sales) compared with \$60.3 million dollars (3.8% of sales) in the corresponding quarter last year. The increase in G&A expenses stemmed from the strengthening of various currencies in the Company's main areas of activity (and mainly from the strengthening of the shekel) and adjustment of the provision to doubtful debts to the Company's sales growth rate.

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

Financing expenses in the third quarter of 2008 amounted to the sum of \$20.9 million compared with \$36.5 million in the corresponding quarter last year. The increase in financing expenses in the corresponding quarter last year did not stem from the increase in the Company's ordinary financing expenses but rather, mainly from the exceptional factors set out below: (1) shekel liabilities to the Company's employees (such as severance pay, vacation pay, sick pay, etc.), are presented in the financial statements at dollar values. Due to the strengthening of the shekel during the corresponding quarter last year, a non-cash expense was recorded due to adjustment of the value of the shekel liability to the dollar value on the balance sheet; and (2) an expense for the valuation of future transactions that were not in compliance with hedging conditions under IFRS standards.

In the first nine months, financing expenses amounted to \$86.2 million, compared with \$51.9 million in the corresponding quarter last year. The increase in financing expenses during the first nine months did not stem from the increase in the Company's ordinary financing expenses but rather, mainly from the exceptional factors set out below: (1) shekel liabilities to the Company's employees (such as severance pay, vacation pay, sick pay, etc.), are presented in the financial statements at dollar values. Due to the strengthening of the shekel during the quarter compared with the corresponding period last year, a non-cash expense was recorded due to adjustment of the value of the shekel liability to the dollar value on the balance sheet; (2) one-time financing revenue in Brazil during the first quarter of 2007. Following the first time implementation of IFRS standards during the Report Period, this revenue was recorded as financing revenue whilst in the previous year, this revenue had been classified as "other revenue" in the Company's financial statements; and (3) increase in CPI prices, which increased CPI linked liabilities by a similar percentage. The main CPI-linked liabilities are NIS 2.35 billion worth of debentures raised by the Company in November 2006. The effect of the increase of the CPI was mostly offset by CPI hedging transactions effected by the Company.

#### **F. Taxes on Income:**

The tax expenses for the third quarter of 2008 amounted to \$14.4 million (constituting 22.2% of pre-tax profits) compared with \$3.0 million (constituting 8.9% of pre-tax profits) during the corresponding quarter last year.

Tax expenses in the first nine months amounted to \$34.9 million (constituting 14.1% of pre-tax profits) compared with \$27.1 million (14.6% of pre-tax profits) during the corresponding period last year.

#### **G. Net profit:**

Net profit in the third quarter of 2008 amounted to \$50.6 million (7.9% of sales) compared with net profit, less the capital gain from the sale of RC, of \$19.5 (3.9% of sales) in the corresponding quarter last year. Including the capital gain from the sale of RC, net profit in the corresponding quarter last year amounted to \$27.2 million (5.5% of sales). The net increase in net profit this quarter compared with the corresponding quarter last year amounted to \$31.1 million, constituting growth of 159.8%.

Net profit in the first nine months amounted to \$210.3 million (10.3% of sales) compared with net profit, less the capital gain from the sale of RC, of \$144.2 million (9.1% of sales) in the corresponding quarter last year. Including the capital gain from the sale of RC, the net profit in the corresponding period last year amounted to \$152.0 million (9.5% of sales). The increase in net profit in the period compared with the corresponding period last year amounted to \$66.1 million, constituting growth of 45.8%.

#### **H. EBITDA:**

EBITDA in the third quarter of 2008 amounted to \$109.1 million (17.0% of sales) compared with EBITDA, less the net profit from the sale of RC, of \$83.0 million (16.7% of sales) in the corresponding quarter last year. Including the capital gain from the sale of RC, EBITDA in the corresponding quarter last year amounted to \$90.8 million (18.3% of sales). The increase in EBITDA this quarter compared with the corresponding quarter last year (less the capital gain from the sale of RC), amounted to \$26.1 million, reflecting growth of 31.4%.

In the first nine months EBITDA amounted to \$398.8 million (19.5% of sales) compared with EBITDA, less the capital gain from the sale of RC, in the sum of \$295.3 million (18.5% of sales) during the corresponding period last year. Including the capital gain from the sale of RC, EBITDA in the corresponding period last year amounted to \$303.0 million (19.0% of sales). The increase in EBITDA in the period compared with the corresponding period last year (less the capital gain from the sale of RC), amounted to \$103.5 million, reflecting growth of 35.1%. The increase in EBITDA stems mainly from the sharp 48.3% increase in the Company's operating profit and fixed depreciation expenses.

#### 4. **Financial Condition and Liquidity**

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

The Company sells some of its customer debt, on a current basis, via securitization transactions. As part of the transition to IFRS, on January 1, 2007, the customer debt securitization balance was not written off from the trade receivables since the transaction did not meet the conditions for writing off financial assets. During the third quarter of 2007, the terms of the transaction were amended such that as of that date, the securitization transaction was in compliance with the requirements for writing off financial assets under IFRS, and therefore, the entire securitization balance in the amount of \$191.6 million was written off from the trade receivables balance which increased the cash flow from current operations for the third quarter last year by the same amount in full. In third quarter of 2008 there was a decrease of \$23.5 million in the customer debt securitization balance.

Neutralizing the affect of securitization, as aforesaid, operating cash flow in the quarter amounted to a negative cash flow of \$88.4 million compared with a positive cash flow of \$12.7 million in the corresponding quarter last year.

The operating cash flow in the quarter (neutralizing the effect of the securitization) amounted to a negative cash flow of \$111.9 million compared with a positive cash flow of \$204.3 million in the corresponding quarter last year.

In the first nine months operating cash flow, less the effect of securitization and sale of customer debt as set out above, amounted to a negative cash flow of \$2.2 million compared with a positive cash flow of \$146.6 million in the corresponding period last year.

In the first nine months, operating cash flow was positive, amounting to \$102.0 million compared with \$338.2 million in the corresponding period last year.

The drop in operating cash flow during the quarter and the first nine months stems mainly from: (1) increased inventory as part of the Company's preparations for the fourth quarter of 2008 and the first quarter of 2009; (2) the significant growth in sales during the first nine months which brought about an increase in the Company's working capital.

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

The Company's investments (less short term investments) in the third quarter of 2008 amounted to \$27.2 million compared with \$10.7 million in the corresponding quarter last year. With a reduction of the gain from the sale of RC, as set out above, investments in the corresponding quarter last year amounted to \$28.8 million. These investments mostly include product registrations, intangible assets and investments in fixed assets. Investments in fixed assets mostly included investments in plant and equipment for upgrade and improvement of environmental standards and amounted, less investment grants, to \$18.5 million, compared with \$15.2 million in the corresponding quarter last year.

In the first nine months, investments (neutralizing short-term investments) amounted to \$96.4 million compared with \$80.9 million in the corresponding period last year.

### **C. Free cash flow:**

Neutralizing effect of securitization as set out above, free cash flow (less short term investments) in the third quarter of 2008 amounted to a negative cash flow of \$115.7 million compared with a positive cash flow of \$2.0 million in the corresponding quarter last year.

Free cash flow (less short term investments) in the third quarter of 2008 amounted to a negative cash flow of \$139.2 million compared with a positive cash flow of \$193.6 million in the corresponding quarter last year

Neutralizing the effect of securitization, free cash flow (less short term investments) in the in the first nine months amounted to a negative cash flow of \$98.6 million compared with a positive cash flow of \$65.7 million in the corresponding period last year.

In the first nine months free cash flow (less short term investments) amounted \$5.6 million compared with a positive cash flow of \$257.3 million in the corresponding period last year. The decrease in free cash flow stems from a decrease in cash flow from current operations, as set out above.

### **D. Current assets:**

Total current assets as at September 30, 2008 amounted to \$2,051.6 million, compared with \$1,750.0 million on September 30, 2007 and \$1,771.1 million on December 31, 2007.

### **E. Investments in Fixed Assets:**

See Cash Flow chapter above.

### **F. Cash, current liabilities and long-term loans:**

The Company's credit (bank credit and bonds) amounted, as of September 30, 2008, to the sum of \$935.8 million (of which 19.9% was short-term credit) compared with \$748.2 million as of September 30, 2007 (of which 15.9% was short-term credit).

Cash and short-term investment balances as of September 30, 2008 amounted to \$169.7 million compared with \$364.4 million as of September 30, 2007, and \$294.0 million as of December 31, 2007.

The Company's net debt (loans from banks and debentures less cash and short-term investments) amounted, as of September 30, 2008, to \$766.0 million compared with \$383.7 million as of September 30, 2007 and \$467.0 million as of December 31, 2007.

CPI-linked Shekel debentures are converted at the exchange rate on the balance-sheet date and are presented under long-term liabilities, where the fair value on future transactions, in the sum of approximately \$75.9 million, ascribed to such debentures, was recorded under trade payables and long-term investments.

The Company's net debt (loans from banks and debentures less cash and short-term investments) less the aforesaid hedging transactions amounted, as of September 30, 2008, to \$690.2 million compared with \$366.4 million as of September 30, 2007 and \$430.0 million as of December 31, 2007.

The increase in the net debt balance as at September 30, 2008 compared with the net debt balance as at September 30, 2007 stems mainly from the increase in working capital, payment of a dividend of \$120 million by the Company to its shareholders on April 10, 2008 and from a share buy-back in the sum of \$75 million during the Report Period.

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

**G. Shareholders' equity:**

Shareholders' equity as at September 30, 2008 amounted to \$1,357.2 million compared with \$1,330.6 million as at September 30, 2007 and \$1,337.1 million as at December 31, 2007. Shareholders' equity out of total balance sheet as at September 30, 2008 amounted to 40.8%, as at September 30, 2007 to 45.3% and as at December 31, 2007 to 44.9%.

**H. Financial ratios:**

	<b>As at September 30,</b>		<b>As at</b>
	<b>2008</b>	<b>2007</b>	<b>December 31,</b>
			<b>2007</b>
<b>Ratio of current assets to current liabilities (current ratio)</b>	1.91	2.07	2.08
<b>Ratio of current assets excluding inventory, to current liabilities (acid-test ratio)</b>	1.00	1.34	1.16
<b>Financial liabilities out of total balance sheet</b>	28.2%	25.5%	25.6%
<b>Financial liabilities out of total equity</b>	68.9%	56.2%	56.9%

## I. Sources of financing:

The Company finances its operations using independent means, debentures and bonds, securitization and sale of customers' receivables, suppliers' credit and bank credit.

In the Company's estimation, in the event it will require in the near future additional significant financing in order to expand its operations, then the events relating to the global financial crisis might have an affect on the financing, both due to the difficulty in the financial markets of raising significant sums and due to higher financing costs in the markets. However, as of the date of approval of the financial statements, there has been no effect on the current operations of the Company, inter alia because most of the Company's debt is in long-term debenture (no principle repayment in the next 24 months) as set out below:

	<u>Debentures</u>	<u>Long-term loans from banks</u>	<u>Total</u>
1 <sup>st</sup> year	-	-	-
2 <sup>nd</sup> year	-	8,442	8,442
3 <sup>rd</sup> year	36,607	4,273	40,880
4 <sup>th</sup> year	48,056	1,848	49,904
5 <sup>th</sup> year	48,056	1,914	49,970
6 <sup>th</sup> year	47,838	-	47,838
7 <sup>th</sup> year	11,449	-	11,449
8 <sup>th</sup> year	11,449	-	11,449
9 <sup>th</sup> year	11,326	-	11,326
10 <sup>th</sup> year			
onward	518,600	-	518,600
<b>Total</b>	<b>733,381</b>	<b>16,477</b>	<b>749,858</b>

## 5. Summary of Main Developments

- ◆ On July 20, 2008, a special annual general meeting of the shareholders of the Company was convened. The Company published an immediate report regarding the convening of a general meeting on June 11, 2007 (reference no. 2008-01-164853), the information contained in which is imported herein by reference. The Company also published an immediate report regarding the outcome of the general meeting on July 20, 2007 (reference no. 2008-01-208092), the information contained in which is imported herein by reference.
- ◆ On July 22, 2008, the Clean Air for Israel Law, 5768-2008 (the "Law") was passed by the Knesset. The purpose of the Law is to regulate air quality in Israel and to prevent pollution, inter alia by setting up a national monitoring system for measuring air pollution and setting air pollution standards. As at the date of approval of the financial statements, the Company is unable to assess the impact of the Law on its operations.
- ◆ On September 18, 2008, the Company gave notice that it is in early stage examination of the possibility of acquiring such non-Israeli firm of significant size. As at the date of approval of the financial statements, and mainly due to the financial crisis in the global markets, there has been no progress and the probability that these negotiations would result in a transaction are low. In the Company's assessment, in light of the financial crisis in the global markets,

the chances that the aforesaid negotiations mature into a transaction in the near future are very low.

- ◆ On October 28, 2008, after the balance sheet date, employees of Makhteshim Chemical Plants Ltd. filed an appeal to the National Labor Court against the ruling of the Regional Labor Court at Beer Sheva of October 7, 2008, to the effect that the declarations of a labor dispute delivered by the labor union of the Negev District on February 4, 2008 and April 22, 2008 were unfounded.
- ◆ As at the date of approval of the financial statements, the Company has acquired 15,006,783 shares of the Company at a cost of approximately \$100 million as part of a share buy-back plan which was approved by the Board of Directors on March 11, 2008.
- ◆ New Registrations - During the quarter, the Company received 40 registrations for active ingredients, formulations and mixtures.
- ◆ On November 4, 2008, after the balance sheet date, The Company's Board of Directors resolved to approve a dividend of \$50 million to the Company's shareholders. Accordingly, the dividend amount per share at the date of the above resolution \$0.11501 per share and shall be adjusted on the effective date.
- ◆ After the balance sheet date and prior to the date of approval of the financial statements, the dollar strengthened against most of the Company's operating currencies. The Company reports its results in dollars and therefore, the strengthening of the dollar against the Company's operating currencies (and particularly the Euro) caused a decrease in the Company's revenues in dollar terms. On the other hand, the strengthening of the dollar against the shekel reduced local expenses in Israel.

## 6. **Exposure to market risks and methods of managing such risks**

The Company conducts its business in a number of different currencies. Due to its activities, the Company is exposed to market risks, which mainly involve exchange rate fluctuations, partial adjustment of the prices of products to reflect changes in the cost of raw materials, changes in the rates of increase of the CPI and changes in interest rates. The Board of Directors of the Company approved a policy of using acceptable financial instruments (such as options, forward contracts and swap contracts) for the purpose of hedging exposure to exchange rate fluctuations and CPI increases. 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.

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

	30/9/2008			Nine month average			Q3 average			Rate as at October 27, 2008
	2008	2007	Change	2008	2007	Change	2008	2007	Change	
EUR/USD	1.46	1.42	3.1%	1.52	1.34	13.2%	1.50	1.37	9.4%	1.27
USD/BRL	1.91	1.84	4.1%	1.68	2.00	-15.9%	1.67	1.90	-12.1%	2.16
USD/PLN	2.35	2.66	11.7%	2.26	2.85	20.7%	2.20	2.76	20.1%	2.78
USD/ZAR	8.16	6.88	-18.8%	7.71	7.16	-7.7%	7.79	7.12	-9.3%	9.78
AUD/USD	0.83	0.88	-5.7%	0.91	0.82	10.9%	0.89	0.85	4.3%	0.67
GBP/USD	1.84	2.03	-9.4%	1.95	1.99	-1.8%	1.89	2.02	-6.4%	1.64
USD / ILS	3.42	4.01	14.8%	3.52	4.17	15.6%	3.49	4.20	16.7%	3.77
USD L 3M	4.05%	5.23%	-22.5%	2.98%	5.39%	-44.7%	2.91%	5.44%	-46.6%	3.5%

The exchange rate fluctuations for these currencies during the quarter and the first nine months are accredited to the various items in the financial statements of the Company. The net effect of changes in the exchange rates of the currencies during the period following the balance sheet date on balance sheet exposures is not substantial due to the high levels of balance sheet hedging affected by the Company, as set out above.

### **Risk Management Officer**

The Company's Market Risk Manager is the CFO, Ran Maidan.

### **Description of Market Risks**

#### Company's Policy regarding Market Risk Management

The Company's policy is to maintain as high as possible degree of correlation between the currency in which it sells its products and the currency in which it purchases its raw materials. The Company is continually examining its balance sheet and economic exposures 12 months in advance, in accordance with its revenue and expenditure forecasts. The Company hedges most of its balance sheet exposure and some of its economic exposure in accordance with its principal currencies.

The following are details of the policies implemented for each risk. Note that as at the date of approval of the financial statements, there have been no significant changes in the Company's risk management policy.

#### Currency Risks:

The Group's most substantial exposure is to the Euro, the Shekel and the Brazilian Real. In addition, there is lesser exposure to other currencies such as the UK Pound, Polish Zloty, Australian Dollar and 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. The Company uses financial derivatives (such as options, forward contracts and

swap contracts) to hedge against such exposure only when the net exposure to a certain currency is material.

As at the date of the financial statements, the Company hedged most of its exposure to the Euro, Real and Shekel.

Crop protection product sales depend directly on agricultural seasons and on the cyclical nature of crop growth, and therefore, the Company's revenues and its exposure to various currencies are not evenly distributed over the year. Countries in the northern hemisphere have similar agricultural seasons and therefore, in those countries, the highest sales are usually in the first half of the calendar year. During this period, the Company has substantial exposures to the Euro, the Zloty and the Pound. In the southern hemisphere, the seasons are opposite, and most of the local sales (except in Australia) are made in the second half of the year. In these months, most of the Company's exposure is in the Brazilian Real. The Company has more sales in the markets in the northern hemisphere and therefore the Company's sales in the first half of the year are higher than its sales in the second half of the year.

In November 2006, the Company completed a bond issue in the sum of NIS 2.35 billion. The main portion of the bonds is linked to the consumer price index, and therefore, an increase in the consumer price index as well as fluctuations in Shekel rates may bring about a significant exposure to the Company's operating currency, which is the dollar. As at the date of approval of the financial statements, the Company hedged most of its exposure resulting from the issue of the Debentures, as aforesaid, in swap transactions and forward contracts.

#### Exposure to CPI linkage:

The main portion of the above bonds is 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. As at the date of approval of the financial statements, the Company has hedged most of its exposure to this risk on an ongoing basis in CPI hedging transactions.

#### Risks relating to 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 distant derivatives of oil prices. Therefore, an increase in oil prices can cause an increase in the price of raw materials.

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

As at the date of approval of the financial statements, the Company has not entered into any transactions to hedge against oil or the prices of raw materials.

#### Interest risks

The Company is exposed to changes in the LIBOR interest rate on the US dollar, since the Company has liabilities in that currency which 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 approval of the financial statements, the Company has not hedged against this exposure.

#### Means of supervision of market risk management policy and method of implementation thereof

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 actions undertaken by management of the Company in respect thereof, once every quarter. The Company's management examines the control procedures on an ongoing basis, and updates them in accordance with the scope of operations and the risk derived from the operations.

#### 7. Critical Accounting Estimates

As at the date of approval of the financial statements, there have been no substantial changes with respect to critical accounting estimates that the Company uses for the purposes of the financial statements.

#### 8. International Financial Reporting Standards (IFRS)

In July 2006, the Israeli Accounting Standards Institute published Accounting Standard No. 29 – "Adoption of International Financial Reporting Standards (IFRS)" (hereinafter in this section: the "Standard"). The Standard provides that entities subject to the Securities Law, 5728-1968 and which are required to submit reports in accordance with the regulations promulgated under that Law, are to draw up their financial statements in accordance with the IFRS for the periods, for periods commencing January 1, 2008. Initial adoption of IFRS standards is to be implemented for the first time on January 1, 2007 (the "**Transitional Period**").

For the purpose of the transition, the Company implemented the provisions of International Financial Reporting Standard 1 (IFRS1) in its financial statements for the third quarter of 2008, and presented an opening balance for January 1, 2007, a balance for December 31, 2007 and a statement of profit and loss for the year ending on that date, drafted in accordance with IFRS standards. Likewise, the Company presented relevant adjustments in the financial statements for March 31, 2008, June 30, 2008 and September 30, 2008 between reporting in accordance with the acceptable accounting rules employed in Israel.

Since the Company's being an industrial company, the effects of implementation of IFRS standards on its results, and particularly on the balance sheet and statement of profit and loss for 2007, are not material.

For further details regarding the effect of the transition to IFRS standards on the Company, see Notes 2, 3 and 7 to the financial statements.

#### 9. 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 CFO. Each quarter, the committee discusses the financial results before presenting them to the Board of Directors and recommends that it approves the financial statements. The financial statements are approved by the board of directors, which is the organ

responsible for the overall control 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 from the Company's financial statements, in greater detail and depth. The Company's finance committee is made up of 6 directors, of which one is an external director. All the committee members have accounting and financial qualifications.

The members of the committee and members of the Board of Directors receive the draft financial statements a few days before convening the meetings.

Representatives of the Company's auditors 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 regarding 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, CFO, 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 questions brought up by members of the Board of Directors. At the end of the discussion by the Board of Directors, a vote is held, during which the financial statements are approved.

10. **Matters referred to by the Company's auditors in their opinion on the financial statements**

In October 2007, a monetary claim was filed with the District Court at Beer Sheva against Makhteshim Chemical Plants Ltd., a subsidiary of the Company, together with an application to approve the claim as a class action under the Class Actions Law, 5766-2006, by three residents of the town of Wadi El Na'im, claiming damage to their health caused, allegedly, by Makhteshim's factory at Ramat Hovav, based on various grounds relating to air pollution. For additional details in this regard see Note 6 to the financial statements.

_____	_____	_____
Avraham Bigger	Raanan Cohen	Ran Maidan
Chairman of the Board of Directors and CEO	Director	CFO