Delek Group

ANNUAL REPORT 2006





IMPORTANT

This document is an unofficial translation from the Hebrew original of the 2006 annual report of Delek Group Ltd. that was submitted to the Tel-Aviv Stock Exchange and the Israeli Securities Authority on March 28, 2007.

The Hebrew version submitted to the TASE and the Israeli Securities Authority shall be the sole binding version. Investors are urged to review the full Hebrew report.

Delek Group

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Chapter A – Corporate Description

Key:

In this report, the following abbreviations have the following meanings:

Company	-	DELEK GROUP LTD.
Delek Ashkelon	-	I.P.P. Delek Ashkelon Ltd.
Gadot	-	Gadot Biochemical Industries Ltd.
Delek USA	-	Delek US Holdings Inc.
Delek Energy	-	Delek Energy Systems Ltd.
Delek Belron	-	Delek Belron International Ltd.
Delek Investments	-	Delek Investments and Properties Ltd.
Delek Refining	-	Delek Refining Inc.
Delek Israel	-	Delek The Israel Fuel Corporation Ltd.
Delek Real Estate	-	Delek Real Estate Ltd.
Delek Petroleum	-	Delek Petroleum Ltd.
Delek Infrastructure	-	Delek Infrastructure Ltd.
Delek Automotive	-	Delek Automotive Systems Ltd.
Delek Capital	-	Delek Capital Ltd.
Dankner	-	Dankner Investments Ltd.
IDE	-	IDE Technologies Ltd.
HOT	-	HOT Cable Media Systems Ltd.
Phoenix	-	Phoenix Holdings Ltd.
Menora	-	Menora Holdings Ltd.
Republic	-	Republic Companies Group Inc.
Avner Partnership	-	Avner Oil & Gas Exploration – Limited Partnership
Delek Drilling Partnership	-	Delek Drilling – Limited Partnership

Part One: Description of General Development of Company Business

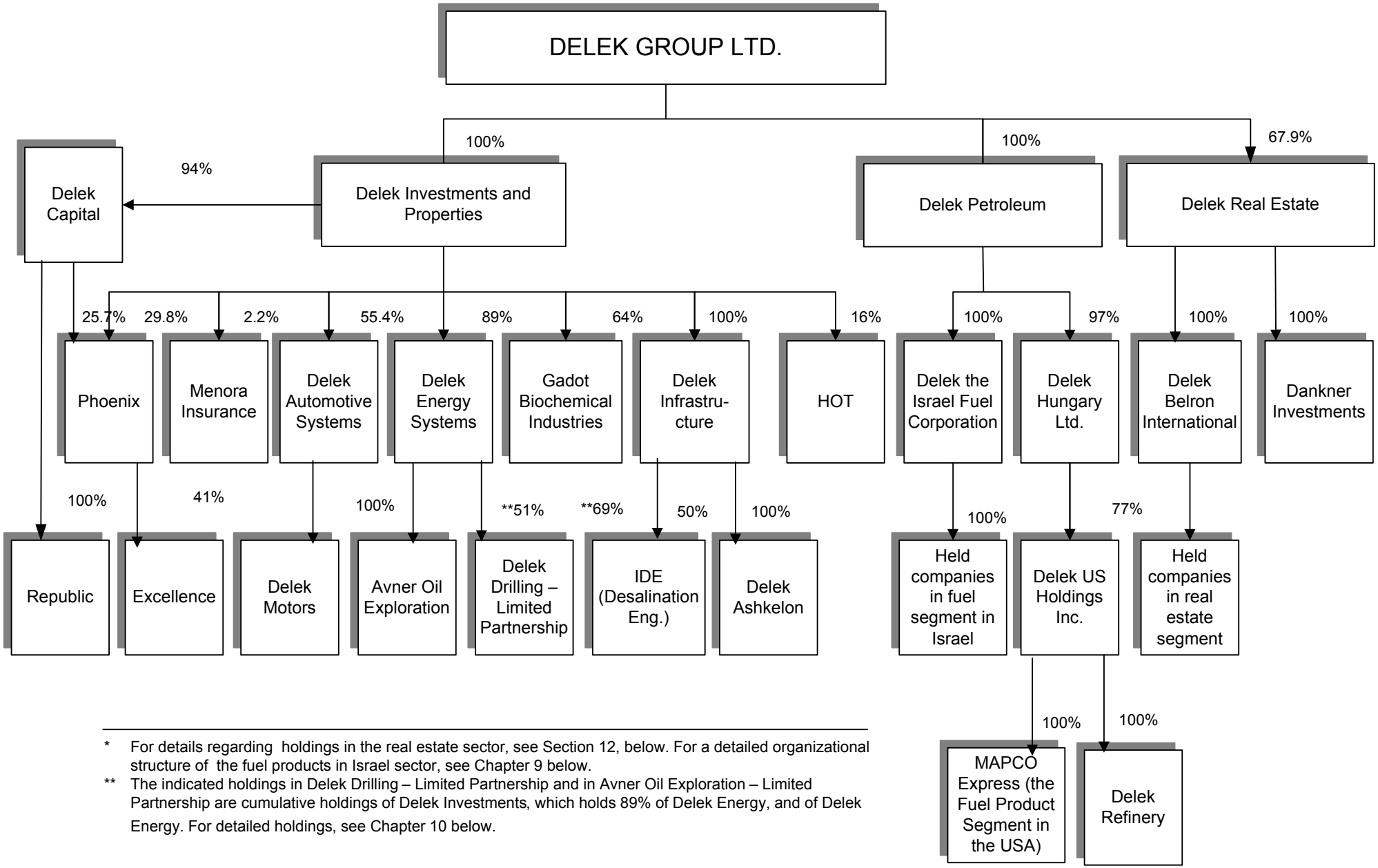
1. Company Operations and Development of its Business

1.1 Delek Group Ltd. (hereinafter "**the Company**") is a holding company which controls multiple corporations (the Company and the companies it controls will be referred to hereinafter, for the sake of convenience, as: "**The Group**" or "**Delek Group**").

1.2 The Company was incorporated on October 26, 1999 as a public company.[1]

1.3 Below is a chart of the group's major holdings as of March 28, 2006:

[1] The Company was incorporated as part of reorganization of the group in 1999, in which group operations were separated and divided into three main subsidiaries, with the Company established as a parent company. Prior to the reorganization the group operations were included under Delek The Israel Fuel Corporation Ltd. which was incorporated on December 12, 1951 and is currently, following the reorganization, responsible for the fuel product sector in Israel.



* For details regarding holdings in the real estate sector, see Section 12, below. For a detailed organizational structure of the fuel products in Israel sector, see Chapter 9 below.

** The indicated holdings in Delek Drilling – Limited Partnership and in Avner Oil Exploration – Limited Partnership are cumulative holdings of Delek Investments, which holds 89% of Delek Energy, and of Delek Energy. For detailed holdings, see Chapter 10 below.

1.4 Delek Group is one of the largest, most dynamic investment companies operating in Israel. The group is a holding company with a variety of investments in Israel and abroad, operating, *inter alia*, in the following sectors: oil refining, fuel stations, energy, real estate, automotive, finance & insurance and biochemical.

Over recent years the group's operations have expanded considerably, both in the energy sector which used to be the core of group operations at the outset, and in various other sectors. In the course of the Group's business during 2004-2007 (to the date of this report), the following material acquisitions may be noted:

The Year 2004

In 2004 the Group acquired holdings in the telecommunications and real estate sectors:

The Telecommunications Sector: In January 2004, Delek Investments acquired from Dankner Investments Ltd. (hereinafter: "Dankner") 17.99% of shares of Matav Cable Communication Systems Ltd. (hereinafter: "Matav") in exchange for $43.5 million (about NIS 193 million); and in September 2004 it exercised an option to acquire a further 2% in exchange for $4.8 million (about NIS 22 million).

The Real Estate Sector: In May 2004, Delek Real Estate entered into a transaction to acquire 87.5% of ownership and control of Dankner, in exchange for $58.5 million (about NIS 264 million). The transaction was concluded in August 2004. Since Dankner held 22% of Matav shares, the total Group holding in Matav rose to 40% of Matav shares. In November 2004 the offer to fully acquire Dankner shares was accepted, and it became a private company fully owned by Delek Real Estate.

The Year 2005

In 2005 the Group launched two new operating sectors – the oil refinery sector and the insurance & finance sector in Israel:

The Oil Refinery Sector: In April 2005, Delek Refinery acquired an oil refinery and crude oil pipelines in Texas, USA at a cost of $68.1 million after adjustments. For further details of the oil refinery sector, see section 7 below.

The Insurance & Finance Sector: In December 2005, Delek Investments acquired 25.01% of Phoenix shares in exchange for NIS 709 million, and in June 2006 Delek Investments exercised a call option to acquire a further 8.04% of Phoenix shares in exchange for NIS 222 million. In August 2006, Delek Capital entered into a transaction to acquire 28.5% of Phoenix shares in exchange for NIS 940 million. The transaction was concluded in November 2006. As of the report date, and following private placement of Phoenix shares with institutional investors, Delek Group holds 55.5% of Phoenix shares and 53.4% of its voting rights.

In March 2005 and April 2006, Delek Investments acquired 14.99% of Menora's issued capital under private placements in exchange for a total of $67.3 million. Following the above acquisitions, Delek Investments held 14.4% of Menora shares. Pursuant to instructions of the Anti-trust Supervisor, issued in conjunction with the Phoenix acquisition, Delek Group was required to sell part of its holdings in Menora no later than May-13-08, so that Delek Investments would not hold 5% or more of Menora's share capital. Consequently, Delek Investments sold in January-February 2007 12.4% of Menora shares in exchange for NIS 391 million. AS of the report date, Delek Group holds 2.2% of Menora shares. The company's cumulative profits from sale of holdings in Menora amounted to NIS 142 million.

For further details of these acquisitions, and of the insurance and finance sector in Israel, see section 14 below.

The Year 2006

In 2006 the group launched a new operating sector – the insurance sector in the USA, and in the telecommunications sector it completed the merger of the cable companies:

The Insurance Sector in the USA: In August 2006, a US corporation fully owned by Delek Capital entered into a merger agreement to acquire Republic. After the contingent conditions have been met, the acquisition closed in December 2006. The consideration for each Republic share amounted to US $20.40, and the total consideration amounted to US $298 million (NIS 1,249 million). The consideration was paid upon closing the transaction.

Republic is an insurance holding company, operating via multiple companies primarily in property, individual and commercial insurance (for small and medium enterprises) mostly in the states of

Texas, Louisiana, Oklahoma and New Mexico. For further details of the insurance sector in the USA, see section 15 below.

The Telecommunications Sector: In December 2006 the merger of the cable companies was completer, in which Matav acquired from the other cable companies all of their TV operations (multi-channel TV) and their domestic fixed telecommunications operations (telephony and internet access). Upon completion of the merger, Matav allocated shares to shareholders and rights owners in the cable companies whose operations and assets had been transferred to Matav. Matav was renamed Hot Cable Media Systems Ltd. (hereinafter: "Hot") and following the allocation, Delek Investments holds 15.9% of Hot shares. For further details of the Hot holding, see section 16.3 below.

During the period 2004-2007 (up to date of this report) the Group raised capital and debt with substantial extent. The major capital- and debt-raising operations by the Group are described in the chapters for the operating sectors, and include the following:

The Year 2004

- In 2004 Delek Petroleum issued debentures for total proceeds of NIS 250 million.
- In 2004 Delek Real Estate issued debentures to institutional investors for total proceeds of NIS 261 million.

The Year 2005

- In March 2005 the project-based fund raising procedure was completed, in which Delek Investments, Delek Drilling – Limited Partnership and Avner Oil Exploration – Limited Partnership issued, via SPC, debentures to institutional investors in the USA, amounting to $275 million.
- In May 2005 Gadot offered securities to the public, amounting to NIS 119 million.
- In June 2005 Delek Real Estate offered securities to the public for total consideration (including options exercised) of NIS 737 million.
- In 2005 the company conducted private placements of debentures and warrants with institutional investors, amounting to NIS 650 million.
- In 2005 Delek Petroleum conducted private placements of debentures for total consideration of NIS 454 million.

The Year 2006

- In May 2006, Delek USA completed a public offering and listing for trade of its shares on the New York Stock Exchange. The net proceeds from this offering amounted to $172 million (less underwriting fees, excluding issuance expenses).
- In July 2006 Delek Real Estate issued debentures to institutional investors in exchange for NIS 400 million.
- In July-August 2006 the Company raised a total of NIS 367.6 million by private placement of debentures with institutional investors.
- In November 2006 the company raised some NIS 1.1 billion by private placement of debentures with institutional investors.
- In December 2006 Delek Real Estate issued shares and warrants by private placement with institutional investors for immediate consideration amounting to NIS 128 million. In addition, Delek Real Estate has allocated shares to a third party. For details see Note 9(a)5, 6.
- In December 2006, Delek Finance US Inc, a company fully owned by Delek Capital, raised a loan of $220 million from a banking corporation.
- In December 2006 Phoenix allocated to institutional investors shares and warrants for total consideration of NIS 374 million.

January through March 28, 2007

- In February 2007 Delek Real Estate raised NIS 770.8 million by private placement of debentures to institutional investors.

- In March 2007, Phoenix raised NIS 600 million by private placement of debentures to institutional investors.

2. Sectors of Operation

2.1 The Group has Nine Sectors of Operation, as Follows:

2.1.1 **Refinery Sector** – This sector includes holding of an oil refinery and crude oil pipelines as well as marketing of fuel products in Texas, USA.

2.1.2 **Fuel Products Sector in the USA** - This sector includes sales of fuel and oil products and operation of gasoline stations combined with convenience stores in the United States.

2.1.3 **Fuel Products Sector in Israel** - This sector includes sales of fuel and oil products and operation of gasoline stations combined with convenience stores in Israel.

2.1.4 **Energy Sector** - This sector includes Group operations related to oil and gas exploration and the production of natural gas.

2.1.5 **Automotive Sector** - This sector includes the import, sales and marketing in Israel of Mazda and Ford private and commercial vehicles.

2.1.6 **Real Estate Sector** - This sector includes the development, marketing and holding of real estate in Israel and abroad.

2.1.7 **Biochemical Sector** - This sector includes the production of Fructose (sugar substitute), citric acid and salts for use in the food, pharmaceutical and detergent industries.

2.1.8 **Insurance and Finance Sector in Israel** – This sector includes a 55.5% holding in Phoenix and a 2.2% holding in Menora.

2.1.9 **Insurance Sector in the USA** – This sector includes insurance operations in the states of Texas, Louisiana, Oklahoma and New Mexico via Republic insurance company.

2.2 In addition to these sectors, The Delek Group has other operations not included on the list above. These operations include primarily a 16% holding in Hot cable company; investments in infrastructure projects (desalinization facilities and power generation facility); holdings in technology companies; and other financial holdings (see section 6 below).

Equity Investments in the Company and Transactions in its Shares

To the best of the Company's knowledge, in 2005-2006 and up to shortly prior to the date of this report, the following equity investments in the company took place:

Date	Transaction Type	% of Issued Capital	Equity Investment (NIS in millions) *
Q2 2005	Conversion of debentures into Company shares Exercise of option warrants into company shares	1.7%	47 21
Q3 2005	Conversion of debentures into Company shares Exercise of option warrants into company shares	5.8%	188 65
Q4 2005	Conversion of debentures into Company shares Exercise of option warrants into company shares	3.8%	123 54
Q1 2006	Conversion of debentures into Company shares Exercise of option warrants into company shares	0.2%	7 3
Q2 2006	Conversion of debentures into Company shares	4.9%	212
Q3 2006	Conversion of debentures into Company shares	1%	38

	Exercise of option warrants into company shares		10
Q1 2007	Conversion of debentures into Company shares Exercise of option warrants into company shares	0.2%	4 6

* With regard to debentures converted into shares, the equity investment reflects the reduced liability vs. increase in shareholders' equity. With regard to option warrants, the equity investment reflects the consideration paid.

To the best of the Company's knowledge, in 2005-2006 and up to shortly prior to the date of this report, the following material transactions by interested parties in the company took place in company shares off the stock exchange:

Date	Insider/Interested Party	Transaction Type	% of Issued Capital	Price per share	Proceeds, NIS in millions
Jan-3-2005	Yitzchak Sharon Teshuva[1]	Sale	1.45	360	50.4
Dec-14-2005	Yitzchak Sharon Teshuva[1]	Sale	2.82	602.8	184.4
Jan-10-2006	Yitzchak Sharon Teshuva[1]	Sale	2.53	675	185.6
Jan-11-2006	Yitzchak Sharon Teshuva[1]	Sale	0.29	675	21.6
Feb-28-2006	Yitzchak Sharon Teshuva[1]	Sale	2.05	667.4	150.1

1 The above transactions were made by private companies ultimately held (100%) by Mr. Yitzchak Sharon Teshuva.

4. Dividend Distribution

4.1 Dividend Distribution in the Past Two Years

Below are details of dividends declared by the company in 2005-2006 and up to shortly prior to the date of this report:

Declaration Date	Distribution Date	Dividend Per Share (NIS)	Total Dividend (NIS in millions, approx.)
8.3.2005	31.3.2005	8	78
30.3.2005	3.5.2005	2.67	26
30.5.2005	4.7.2005	4.35	43
29.8.2005	22.9.2005	9	94
28.11.2005	20.12.2005	13.3	143
29.3.2006	1.5.2006	5.57	61
30.5.2006	10.7.2006	13	150
30.8.2006	4.10.2006	21.5	250
29.11.2006	8.1.2007	7.4	86
28.3.2007	1.5.2007	8.57	100

For further details of dividend distribution, see Chapter 2 of the Board of Directors Report.

4.2 Dividend Distribution Policy

In Mar-30-05 the Company's board of directors decided on its dividend policy. Pursuant to the decision, the company would strive to distribute annually some 50% of its net annual (after tax) profit, as these may be for that year. The decision is subject to the following conditions:

A. The Board of Directors will decide from time to time on the dividend distribution; its decision will be made subject to legal provisions and its limitations.

B. The decision of the Board regarding the amount of the distribution would take into consideration the Company's financing requirements, its obligations, liquidity and investment plan as these may be from time to time.

C. The decision of the Board regarding the amount of the distribution would take ensure that it will not harm the Company's obligations to any third parties, including to its bank creditors and debenture holders.

4.3 Restrictions on Dividend Distribution

Under provisions of a credit facility with a banking corporation, the Delek Group is required to comply with certain conditions when distributing dividends exceeding 70% of the annual profit. For restrictions on dividend distribution applicable to Group companies, see explanation of the various operating sectors below.

Part Two – Other Information

5. Financial Information Regarding the Group's Operating Sectors

Below is financial information regarding the Group's operating sectors:

The Year 2006 (NIS millions)

	Refinery	Delek USA	Delek Israel	Energy	Automotive	Real Estate	Biochemical	Insurance & Finance in Israel (1)	Insurance in the USA (1)	Others and Adjustments (2)	Total
Total Revenues from External Parties	8,072	6,181	4,455	268	4,060	439	366	-	-	277	24,118
Cost of Revenues	7,389	5,467	3,958	104	3,564	278	254	-	-	210	21,217
Gross Profit	683	714	497	164	496	168	112	-	-	67	2,901
Operating Income	632	143	89	154	440	82	55	-	-	(65)	1,530
Operating Margin	8%	2%	2%	57%	11%	19%	15%	-	-	-	6%
Total Assets	1,332	1,810	2,437	1,550	1,678	5,915	409	29,938	4,202	3,172	52,444
Minority Interest in Revenues	818	626	130	94	1,814	125	126	-	-	-	3,733

(1) The sectors of Insurance & Finance in Israel and Insurance in the USA only include balance sheet information, since acquisition of control in companies operating in these sectors occurred in late 2006. For details of operating results information, see sections 14.1.1 and 15.1.1.

(2) Including other sectors, adjustments for consolidated and expenses not assigned to operating sectors.

The Year 2005 (NIS millions)

	Refinery	Delek USA	Delek Israel	Energy	Automotive	Real Estate	Biochemical	Insurance & Finance in Israel (1)	Others and Adjustments (2)	Total
Total Revenues from External Parties	4,239	4,951	4,050	184	3,868	484	375	-	182	18,333
Cost of Revenues	3,712	4,304	3,581	82	3,427	286	258	-	152	15,802
Gross Profit	527	647	469	102	441	198	117	-	30	2,531
Operating Income	501	144	46	95	380	155	68	-	(56)	1,333
Operating Margin	12%	3%	1%	52%	10%	32%	18%	-	-	7%
Total Assets	896	1,516	2,255	1,391	1,756	4,075	417	658	3,019	15,983
Minority Interest in Revenues	--	--	146	58	1,490	66	120	-	-	1,880

(1) The insurance and finance in Israel sector only includes balance sheet information. For details of operating results information, see section 14.1.1.

(2) Including other sectors, adjustments for consolidated and assets & expenses not assigned to operating sectors.

The Year 2004 (NIS millions)

	Refinery	Delek USA	Delek Israel	Energy	Automotive	Real Estate	Biochemical	Others and Adjustments (1)	Total
Total Revenues from External Parties	-	3,846	3,273	141	3,923	503	343	220	12,249
Cost of Revenues	-	3,277	2,776	59	3,457	236	232	197	10,234
Gross Profit	-	569	497	82	466	267	111	23	2,015
Operating Profit	-	70	56	79	405	242	66	(13)	905
Operating Profit Margin	-	1.8%	1.7%	56%	10.3%	48.1%	19.2%	-	7.4%
Total Assets	-	1,275	2,103	1,236	1,331	4,397	389	2,157	12,888
Minority Interest in Revenues	-	--	84	44	881	45	99	-	1,153

(1) Including other sectors, adjustments for consolidated and assets & expenses not assigned to operating sectors.

For details of major developments in financial data, see comments of the board of directors on the state of the corporation's business.

6. The General Environment and Impact of External Factors

The company is a holding and management company, which owns companies engaged in a range of operating sectors.

The Company's financial data and results are impacted by the financial results and profits of its held companies as well as by realization or sale of Company holdings. The Company's cash flow is impacted by, *inter alia*, dividends and management fees paid by its held companies; by proceeds from realizing the Company's holdings; by the Company's ability to raise foreign financing by relying, *inter alia*, on the value of its holdings; by investments made by the Group; and by dividends it distributes to its shareholders.

Operations of companies held by the Company are impacted, *inter alia*, by the security and geo-political situation in Israel and the Middle East as well as by the economic situation in Israel and around the world. Israel's security and economic situation may also impact the willingness of foreign entities to contract business with Israeli companies.

A change of trend in the capital markets in Israel and around the world may impact the prices of securities of companies held by the Company as well as their ability to realize capital gains from the sale of such investments. This is due, *inter alia*, to potential challenges in executing private or public offerings by held companies or in finding alternative sources of financing for said companies. Furthermore, the Company and some of its held companies are sensitive to changes in interest rates, inflation and currency exchange rates as well as to changes in prices of raw materials, all of which impact the business results of said companies and the value of their assets and liabilities.

The Company and some of its held companies are limited by provisions of laws or government regulation in their business operations. These regulations include antitrust regulations; regulations concerning duty to hold tenders; regulations concerning insurance companies, provident funds and pension funds; regulations concerning price controls for goods and services; and regulation of the telecommunications sector.

The Company and some of its held companies are influenced by the "Proper Conduct of Banking Business Directives" issued by the Banking Supervisor (of the Bank of Israel – Israel's Central Bank) which includes, *inter alia*, limitations as to the scope of loans that Israeli banks may extend to "single borrowers", to the six largest borrowers and to the "largest borrower group" of the specific banking corporation (as these terms are defined in the aforementioned directives). Consequently, the extent of loans to Group companies and to the controlling shareholder of the Company may impact, under certain circumstances, the ability of Group companies to borrow additional funds from Banks in Israel.

The Company and its held companies are also influenced by government policy decisions in many areas (such as monetary policy) and by requirements of environmental protection authorities. Furthermore, a significant increase in the minimum wage in Israel; other material changes to labor laws applicable in Israel; strikes and labor unrest may also impact the financial results of the Company and its held companies.

Some the held companies have operations outside Israel; market products or services outside Israel; or have their securities traded on non-Israeli stock exchanges. Legislative and regulatory initiatives by foreign powers and exposure to currency exchange rate fluctuations can influence the results of these companies.

For details of the general environment and external factors impacting specifically the operating sectors of the Delek Group, see the individual description of each sector below.

Part Three – Business Description of the Corporation by Sector

Below are descriptions of the Company's operations in each separate sector of operations:

7. Oil Refining Sector

Refining activities of the group which include marketing of gasoline products in the United States, are concentrated under a subsidiary company, Delek US Holdings, Inc. (Hereinafter "Delek USA"). On May 9, 2006 Delek USA completed the issuing of 11,500,000 shares was listed for trading on the New York Stock Exchange. AS at the time of this report the Company holds approximately (indirectly) 77.0 percent of the shares in Delek USA. The net receipts from the IPO were $172 million (after deducting underwriting commissions and before the costs of the issue).

7.1 Refining Activities and Distribution of Petroleum Products-General

7.1.1 On April 29, 2005 Delek USA finalized an agreement for the acquisition of a refinery in the United States (hereinafter: “The Refinery”) crude oil transportation pipeline of approximately 104 km (hereinafter:" The Pipeline”). This acquisition was conducted via three subsidiaries of the subsidiary Delek Refining Inc. (hereinafter: "Delek Refining"), which was incorporated pursuant to the purchase of Refinery. The Refinery is located in Tyler, Texas and as of the date of this report possesses an output capacity of an approximate maximum 60,000 barrels of oil per day. The investment in the purchase of the Refinery and the pipeline totaled approximately $78 million (including actual inventories).

Delek Refining purchases most of its raw materials from suppliers in East and West Texas and sells the petroleum products that it produces to a variety of clients who are chiefly local.

7.1.2 As a supplement to the activities in the area of refining, in July 2006 Delek USA acquired through two subsidiaries of its subsidiary and Delek Marketing and Supply Inc. (hereinafter "Delek Marketing") a number of assets for its marketing system and its refineries from PRIDE-L.P. and its associate companies based in Abilene, Texas. The acquisition was financed by the money from the issuance of Delek USA in May 2006 and from two new credit frameworks. The gross value of the acquisition was approximately $55.1 million, not including inventory.

The assets which were acquired included two terminals for marketing petroleum products, situated in Abilene and San Angelo, Texas, 7 pipelines for transporting petroleum products with a length of approximately 114 miles, and storage containers for petroleum products with a gross capacity of approximately million barrels. The assets which were acquired also included different refining facilities situated near the terminal in Abilene, some of which are intended for Delek Refining to transmit to its Refinery in Tyler.

In the context of this acquisition Delek Marketing also acquired the marketing of petroleum products activities of the PRIDE Group including the wholesale marketing of petroleum products to clients in west Texas. Marketing of petroleum was effected through three petroleum terminals owned by the Company and including two terminals which were purchased in San Angelo and in Abilene, and the third terminal which was acquired along with the Refinery and operates in Tyler, Texas and through four additional terminals located in Aledo, Odessa and Dallas in Texas, which are owned by third parties. Delek Marketing also acquired the rights of the PRIDE Group for the purchase of up to 27,350 barrels a day of petroleum products, subject to PRIDE's existing supply contracts.

Ninety six percent of the petroleum products are supplied to Delek Marketing in accordance with two main supply agreements from the Magellan Company and the rest through swap transactions. For the details of the petroleum products purchase agreements with Magellan see also paragraph 7.11.2 below.

Delek Refining acquires in the context of these agreements petroleum products that then flow, through a network of pipelines which it owns and through a network of pipelines owned by Magellan, to the aforementioned petroleum terminals.

7.2 General Information on the Sector of Operation

7.2.1 What is Refining?

A. Oil refining is a process whereby the various components of crude oil are separated into various products such as: gasoline, diesel, and the like.

B. The refining process includes a number of principal stages, including: a separation process whereby crude oil is separated into groups of products, fractionalization processes which change the chemical composition of the materials of the separated products to obtain products possessing a higher added value, refining processes whose purpose is to purify and cleanse the products created during the separation process, and finally – finishing processes whose purpose is to make the products compatible with the standards and specifications demanded by law or pursuant to agreements with specific customers (for example: adding fuel additives). It should be noted that the crude oil market and the refined petroleum products market are marketed as commodities; that is to say that the regular marketing of the commodities and their trading is standardized.

7.2.2 General Environment and the Influence of External Factors

As a refining company, Delek Refining is exposed to trends, events and developments in the regional fuel market in which it operates in the US, that possess or may possess an influence on its activities and on the activities of its competitors, including:

A. Volatility in global fuel prices in general and in the area of operations of Delek Refining in particular – The crude oil that Delek Refining purchases is the main cost component of the petroleum products produced by the Refineries The price of crude oil is dictated by oil prices in the international markets. This price influences the price of petroleum products which are produced by Delek Refining. In 2005 and 2006 Delek Refining purchased approximately 65 percent and approximately 67 percent of the scope of the purchase of crude oil from local suppliers (in East Texas), respectively. It purchased the rest from suppliers in West Texas and from international sources.

   Among the factors that influence fuel prices are the following: changes in the global and local economic situation; the level of demand for petroleum products within and outside the United States, the global political situation in general and that of principal oil production regions in particular; the scope of crude oil production and of oil distribution operations in the United States and globally; development and marketing of gasoline substitutes; disruptions in the supply lines, local factors including market conditions, weather conditions, the output capacity levels of competing refineries, as well as US government regulations.

B. Legal Limitations, Regulatory Developments and Special Constraints applicable to the Refining Sector – Delek Refining is subject to laws, regulations and standards that are set by the competent authorities in the sector, at the federal, state and local levels, primarily in the area of environmental controls and standards. For details, see Paragraphs 7.17 and 7.16, below.

C. Economic Slowdown – Most of the Delek Refining products are intended for transportation (vehicles and planes). An economic slowdown in the US could reduce demand for flights and the scope of traffic on the roads, thereby reducing both the volume of demand for petroleum products and the refining margin (as defined in Paragraph 7.2.3 below) of the Refinery.

D. Refining Capacity – A shortage in the refining capability of distillates which are regulated by strict environmental standards, such as gasoline and diesel for transportation, could limit the maximum exploitation of the existing facilities and their expansion. Such standards could obligate Delek Refining to upgrade its existing facilities, to add new facilities, in order to have a basket of products suitable to the demand. In recent years there has been a significant growth in the demand for distillates. The growth in demand was met by an increase in the exploitation of the international refining capability and matching the level of the demand to the ever increasing strict standards for producing distillates. Historically, increases in demand led to a period of increases in profits, which led to investments which made it possible to increase production. This then led to a period of oversupply and a drop in products in the sector. Thus a rise in crude oil prices causes certain slow down of the demand for oil.

   The information in this paragraph as to the possibility of a decline in the refining capability due to the increasing exacerbation of the environmental regulations is a view of what might be

expected in the future. Realization of the aforementioned possibilities depends on the trends in the area of refining, including the rate of introduction of natural gas in the areas of activities of Delek Refining, changes in regulations, establishment of additional refineries, changes in demand or in the supply of raw materials, changes in the refining margins and increase in refining costs.

7.2.3 Changes in the Scope of Activities in the Area and their Profitability

Petroleum products like those produced by Delek Refining are traded on international markets and so the prices of Delek Refining products are prone to high daily volatility. Delek Refining therefore enters into contracts with its customers on the basis of a price formula that reflects the changes in market prices.

Results in the refining industry are influenced and measured by the difference between the price of petroleum distillates and the price of crude oil, termed the refining margin. The refining margin is the difference between the cost of the crude oil (including costs of transportation, insurance, unloading, storage, and flowing to the Refinery), and the return on the sale of the refined product mix.

The relevant refining margin for Delek Refinery is the margin called The US Gulf Coast Spread 5-3-2 (hereinafter: "**2-3-5 Spread**"), which measures the difference between the price quoted by Platt for 3/5 barrel of US Gulf Pipeline 87 Octane Conventional Gasoline and 2/5 barrel of US Gulf Coast Pipeline Heating Oil No.2, and the price of 5/5 barrel of light crude oil as quoted on the New York Mercantile Exchange for the next month's supply.

According to the data published by Bloomberg, the refining margin 2-3-5 is the average in the area of the US Gulf Coast amounted during 2006 at an average of approximately $10.16 a barrel in comparison to an average of $12.94 a barrel in 2005, fluctuating within a range of a maximum of $21.50 a barrel and a minimum of $1.07 a barrel. It should be noted that in recent years the refining was significantly lower[1]

The refining and marketing margin of Delek Refining in 2006 was approximately $11.16 a barrel compared with approximately $12.29 a barrel for the last eight months of 2005.

The Refining margin is influenced by four variables:

A. The price of crude oil.

B. The scope of the demand for petroleum products globally, in the United States and in the area of the Gulf Coast (The Gulf of Mexico) in particular.

C. Global refining capability.

D. The basket of products which are produced by the Refinery is influenced by the types of crude oil purchased by the Refinery and the facilities of the Refinery influence the refining technology (a Refinery for refined petroleum produces mainly "white" products: in 2006 92 percent of the products of the Refinery were white distillates (that is products which are not fuel oil, such as gasoline, diesel or jet fuel) and rest heavy products etc.).

   Whereas only the last factor is subject to the influence of the Refinery, and this factor is not central to determining the refining margin, as profitability in this area depends more on changes in the global than on refined petroleum.

   From the crude oil, a basket of petroleum products is refined, and the Refinery has a marginal ability to influence this basket through the quality of the processed raw material and the manufacturing processes. In the absence of the ability to significantly influence on the basket of products, considering level of demand and the price of the products, there is no significance from the point of view of the Refinery in relating to the gross profit of a single item and the Refinery is judged by the refining margin resulting from the sales of the basket of products.

   It should also be noted in this matter that the ability of the Refinery to reduce the amount of fuel oil refined by increasing the amount of "white" products is measured by the Nelson

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[1] Below are the statistics for the past ten years regarding the US Gulf Coast 5:3:2 margin, as published by Bloomberg: 2004 – approximately $6.25, 2003 – approximately $4.48, 2002 – approximately $3.1, 2000 –approximately $4.36, 1999 –approximately $1.67, 1998-approximately $2.34, 1997-approximately $3.21, 1996-approximately $2.91.

Complexity Index (hereinafter: "**Nelson Index**"); the higher the Index the greater the ability of the Refinery to produce more "white" products. And in addition, it is possible to examine the compatibility of the Refinery products to the demand in its area of activity. The rating of the Refinery at present after the completion of the projects described in Paragraph 7.16.6(D) below is 8.9 on the Nelson Index

7.2.4 Competition in the Area of Activity and the Main Success Factors

The Refinery of Delek Refining is located in the city of Tyler, in East Texas, USA.

Delek Refining operates an independent Refinery. Most of the Refinery's products are sold to various local customers in the area of East Texas. The Refinery has a great advantage in being located relatively distant from other refineries or terminals. This advantage enables Delek Refining to charge its customers the maximum while paying meticulous attention to providing efficient services based on product availability and by operating a terminal with nine lanes.

According to data published in the Oil and Gas Journal and by the U.S. Department of Energy, as at the date of this report, there are 135 petroleum refineries operating in the United States and in addition approximately 15 small refineries for asphalt, when in 1980 there were 319 refineries in the US. According to a survey conducted in 2004 and published in January 2005, by the Department of Energy Information Administration (EIA) and the Oil and Gas Journal since 1976 no new large refineries were built in the US and this in light of a growth in the use of petroleum products which were supplied mainly by an increase in the efficiency and the expansion of existing refineries. It is also noted that the last ten years in the oil refining sector in the US was characterized by many mergers and acquisitions by the large integrative companies in the field such as Arco BP merging with Amoco, Exxon merging with Mobil, Phillips merging with Tosco and Conoco, and Chevron merging with Texaco. Another example of the aforesaid trend is Valero, which owned only one Refinery in 1994 and currently owns 17 refineries in the United States.

For details in the matter of areas of competition of Delek Refining see Paragraph 7.6 below.

7.2.5 Factors Critical for Success in the Sector of Refining and Marketing

Delek Refining estimates that the key success factors in the Refinery sector are as follows:

A. Level of the refining margins

B. Selection of the optimal mix of the types of crude oil and locating supply sources

C. Availability of capital and the operational availability of refining facilities

D. The location of the Refinery - the Delek Refinery was the only one within a 115 mile radius offering a gamut of gasoline distillates.

E. Optimization of the supply and production chains.

F. The ability to meet product standards and varying regulatory demands and adapting the Refinery to meet these standards.

G. Location of the gasoline terminals.

H. The possibility of using the pipeline infrastructure for bringing the existing petroleum products into the sectors of activity, and the ability to increase the use of this pipeline infrastructure.

7.2.6 Changes in the Supply System and Raw Materials in the Activity Sector

Delek Refining purchases its crude oil from a large number of suppliers in East Texas, West Texas and from imports, and is not dependent on any single supplier.

Delek Marketing purchases petroleum products from one main supplier. For details see Paragraph 7.11.2 below.

7.2.7 Alternatives and Technological Changes which Influence Sector Activity.

In light of the increase in the price of crude oil and in matters connected to the quality of the environment and the array of energy sources, governments of the world are examining long range programs for the partial transition to alternative energy and different companies in the world are trying to develop energy alternatives to oil. As of the time of this report and until efficient and cheap energy solutions are found, Delek Refining does not predict a significant drop in demand in the area of its activities following the aforementioned alternatives, in the foreseeable future.

The information included in this paragraph is forward-looking information. This information is based on the evaluation of Delek Refining as to the rate and the ability to locate energy sources which would be an efficient alternative to oil cannot be estimated and are uncertain.

7.2.8 Barriers to Entering or Leaving the Sector

The main barriers to entry into the refining and marketing sector is the amount of capital required in order to set up new refineries and to establish oil pipelines and pipelines for petroleum products, and the meager capacity of the existing pipeline infrastructure which is found in many instances to be at full capacity make it difficulty for new competitors to enter the sector, as well as the licensing demands and the strict environmental controls. The barrier for leaving the sector which is most significant is the worth of the facilities and their purpose, and the environmental side effects on the ground on which they stand, which can limit other possible uses.

7.3 Products and Services

7.3.1 The products marketed by Delek Refining include the following petroleum products:

Gasoline – Gasoline constituted in 2005 and 2006 approximately 52.2 percent and approximately 53 percent respectively, of all the products produced by the Refinery. The Refinery produces four different types of gasoline (premium – 93 octane, regular, and medium) and also aircraft fuel.

Diesel and jet fuel – diesel and jet fuel constituted in 2005 and 2006 approximately 38.6 percent and approximately 40.2 percent, respectively, of the total petroleum distillates produced by the Refinery. Delek Refining produces diesel and jet fuel according to the military standard (JP-8), fuel for civilian jet planes, and beginning in September 2006 diesel with very low quantities of sulfur (Ultra Low Sulfur Diesel).

Petrochemical products – the Refinery produces small quantities of propane, propylene and butane.

Other products – the Refinery produces small quantities of additional products, coke, slurry oil, sulfur and other mixtures.

7.3.2 The products marketed by Delek Marketing include the following petroleum products:

Gasoline – Gasoline constituted in 2006 approximately 46 percent of all the products marketed by Delek Marketing. Delek Marketing markets two different types of gasoline (premium – 93 octane, and 87 octane).

Diesel – Diesel constituted in 2006 approximately 54 percent of all products marketed by Delek Marketing. Delek Marketing will market diesel with very low quantities of sulfur (Ultra Low Sulfur Diesel), beginning in September 2006.

Segmentation of Revenues and Profitability in Products and Services

7.3.3 Below are the amount and rate of revenues from product sales or services by Delek Refining and Delek Marketing, whose total revenues represent 10 percent or more of the Delek Group revenues.

In 2006 sale of gasoline of Delek Refining and Delek Marketing came to approximately NIS 4,278 million which constituted approximately 18% of the Delek Group sales. During the 8 months of operation in 2005 of Delek Refining resulted in gasoline sales of approximately NIS 2,231 million, which constituted approximately 11 percent of all revenues of the Delek Group in 2005.

7.3.4 The gross profit of Delek Refining and Delek Marketing in 2006 and during the last eight months of 2005 before operating expenses, amortization and deductions was approximately NIS 684 and NIS 527 million, respectively which constituted approximately 8.5% and 12.4% of the revenue in the area of operation, respectively.

7.4 Customers

Delek Refining markets its fuel products to the large fuel companies, independent refiners, fuel distributors, fuel station operators, utility and transportation companies, and independent retailers.

In 2006 the sales to the ten largest clients of Delek Refining constituted approximately 57.5 percent of net sales of Delek Refining. No single customer of Delek Refining contributed more than 10

percent of the revenue of Delek USA, even though sales to one customer came to approximately 13 percent of the sales of Delek Refining.

Delek Marketing sells its products to customers in West Texas, among them large oil companies such as Exxon Mobile, independent marketing refineries such as Murphy Oil, gasoline agents, companies in the service and transportation sectors and others.

7.5 Marketing and Distribution

The vast majority of Delek Refining's sales are conducted at the gate of the factory through the Refinery's supply terminals with 9 lanes which allow for adding a wide variety of gasoline additives, including special additives which are sold to the main oil companies which purchase fuel from the Refinery The Refinery sells coke mainly using railway cars and when needed for large or special orders by tankers. The Refinery is connected to a pipeline for the sale of propane. The rest of the products are distributed by Delek Refining through an oil pipeline (owned by a third party).

Through the activities of Delek Marketing the Company markets petroleum products through two terminals each with 2 lanes which are owned by the Company in West Texas (Abilene and San Angelo). These terminals are connected to each other as well as to a nearby air force base and to a system of pipelines owned by the Magellan Company, through 7 different pipelines owned by the Company. In addition Delek Marketing markets products through four terminals owned by a third party.

Delek Marketing is dependent on the flow infrastructure of the Magellan Company in Texas since all its products are marketed directly and indirectly (by swapping deals) using this system of pipelines.

7.6 Competition

Delek Refining operates, as stated, in the state of Texas in the USA and markets its products primarily to local customers in East and West Texas.

The refining and marketing sector is highly competitive, and includes national and international fuel companies operating in various areas related to oil, including oil exploration, production, refining and marketing of fuel products and the operation of convenience stores. Delek Refining's main competitors include other local refineries in the Texas Gulf region, operators of fuel supply terminals and Calumet Lubricants in Shreveport, Louisiana.

The main competitors to Delek Marketing are owners of other independent terminals and other fuel companies operating in the area of its operations. The competition is mostly expressed by location, price and variety of products and services being sold. The cost of transportation of the products from the fuel terminals to the final customer limits the geographic size of the market of fuel purchasers, who purchase from the fuel terminals of Delek Marketing if it is economical for them. Two main markets of Delek Marketing activities are in West Texas, in the area of Abilene and San Angelo. In the Abilene area there is direct competition from another Refinery which markets fuel products through another fuel terminal. In the area of San Angelo there is no competition for the fuel terminal of Delek Refining, the nearest competitor being 90 miles from the terminal.

The competition between Delek Refining and Delek Marketing and its competitors is influenced primarily by the price paid for raw materials, by marketing margins, Refinery efficiency and the mix of products produced by the Refinery, as well as the transportation and distribution costs. Some of Delek Refining's competitors operate larger and more complex refineries and their production costs per barrel are therefore possibly lower.

The factors which influence the competitive position of the Refinery and of the fuel terminals include:

A. The location of the Refinery and its accessibility to local customers provide it with a relative advantage for those customers located in the region of its operation.

B. Location of fuel terminals and their accessibility to local customers. Delek Refining operates as aforementioned two fuel terminals in West Texas.

C. Production capacity of the Refinery .

D. Constant attention to the quality of its products and improving the quality of its products such that they uphold the standards and specifications required under law and by customer demands.

E. Selecting the optimal mix of crude oil types and locating their supply sources .

7.7 Seasonality

The demand for gasoline products is generally higher during the summer months than during the winter months, because of a seasonal rise in vehicle mobility in the summer, although the demand for diesel is higher in the winter. As a result, Delek Refining and Delek Marketing operating results are usually lower during the first and fourth quarters. Below is a table which shows the average 5:3:2 refining margin in the Gulf of Mexico region, in dollars, by quarter:

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
2006	8.13	15.38	10.29	6.76
2005	6.22	9.15	15.93	10.91

7.8 Production Capacity

7.8.1 The Refinery's maximum production capacity as of the date of this report, is approximately 60,000 barrels per day, dependent upon the type of raw material that is processed and the amount of sulfur it contains.

In 2006 Delek Refining refined 21.2 million barrels of oil and other raw materials at an average of approximately 58,128 barrels a day. During 2005 (including four months before the acquisition of the refining operations by Delek Refining) the Refinery refined approximately 18.2 million barrels of oil and other raw materials, when during the first eight months of its operations (April 29, 2005 - Dec. 31, 2005) Delek Refining refined approximately 13.1 million barrels, an average of approximately 53,150 barrels a day. In 2004 the Refinery refined approximately 18.3 million barrels (as stated, Delek Refining acquired the Refinery in April 2005, and thus the data for 2004 and the first four months of 2005 are those communicated to Delek Refining on the basis of data supplied by the previous owners).

Below is a chart showing the products which were produced by the Refinery in 2004 – 2006 (in millions of barrels) and the annual average daily output of barrels in each year:

	2004		2005		12-5/2005		2006	
	Amt.	Daily Output	Amt	Daily Output	Amt	Daily Output	Amt.	Daily Output
Gasoline	10.4	28,349	9.4	25,744	6.6	26,927	11.0	30,163
Types of Diesel	6.4	17,613	6.8	18,688	5.1	20,779	8.0	21,816
Other	1.2	3,261	1.5	4,168	1.0	3,902	16.8	4,604
Total	18.0	49,223	17.7	48,600	12.7	51,608	35.8	56,583

7.8.2 Operations of Delek Marketing began on August 1, 2006 with the purchase of Pride Group. In 2006 sales activities of Delek Marketing amounted to approximately 2.7 million barrels of refined petroleum at an average of 17,758 barrels a day according to the following breakdown:

	8/06 – 12/06	
	Amt.	Daily Output
Gasoline	1.2	8,129
Types of Diesel	1.5	9,568
Other	0.0	61
Total	2.7	17,758

7.8.3 Below is the breakdown of investments in 2005-2006 and anticipated future investments by Delek Refining in 2007, which are not connected to the environment (in millions of dollars):

	2005	2006	Forecast for 2007
Improvements	1.9	5.6	34.4

7.8.4 These investments are mainly in relation to future investments by the Group in three projects at a gross cost of $55 million. These projects are expected to reduce the costs of oil refined by the Company.

7.8.5 For the breakdown of anticipated investments connected to the environment refer to Paragraph 7.16.6 below.

7.9 Fixed Assets and Facilities

The Delek Refining facilities in Tyler, Texas are located on land covering an area of 2,643 km^2, of which 440.6 km^2 are built. Delek Refining's facilities include Refinery units, fractionalization processors, additional production units (Coker), a sulfur treatment plant, infrastructure facilities (buildings, storage tanks, pipes, etc) and service facilities (including tanker trucks). Delek Refining also owns a 104-kilometer long pipeline for the transportation of crude oil, as well as four terminals for crude oil intake and pumping stations.

In addition, as stated in Paragraph 7.1.2 above, at the end of July 2006 Delek USA acquired a number of assets for the marketing system and the Refinery from companies in the PRIDE-L.P. Group and companies associated with it based in Abilene, Texas.

The assets which were acquired include two terminals for marketing petroleum products located in Abilene and San Angelo Texas, 7 pipelines for transporting petroleum products which are 114 miles long, and storage tanks for storing petroleum products with a gross capacity of approximately a million barrels. Also included are different refining facilities situated near the Abilene terminal, such as an atmospheric facility and a vacuum facility for the refining of crude oil and additional equipment. In addition, Delek Refining holds an option for 10 years for acquiring the land on which the Abilene refining facilities are located.

7.10 Human Resources

7.10.1 Below is the breakdown of the personnel of Delek Refining for 2005-2006:

	Dec. 31.2005		Dec. 31, 2006	
Department	Refinery & Marketing	Pipeline	Refinery & Marketing	Pipeline
Management	10	1	12	1
Production	116	-	122	-
Maintenance	33	8	40	8
Finance and Purchase of Fuels	11	-	20	-
Support	19	1	20	1
Environmental Controls	9	-	10	-
Marketing and Distribution	22	-	26	-
Engineering	4	-	1	-
Total	224	10	251	10

7.10.2 Investment in Training – Delek Refining and Delek Marketing conduct safety training for all employees. Employees participate in seminars and professional training. Delek Refining and Marketing invests resources in the professional training of operation and maintenance personnel in their areas of employment, while safety training is provided to all employees pursuant to relevant laws.

7.10.3 Benefits and Characteristics of Employment Contracts – Employees of Delek Refining and Delek Marketing do not have individual contracts. As of December 31, 2006 approximately 166 of the Delek Refining employees are members of a workers union. In January 2006 the agreement with these workers was renewed for an additional three years.

7.10.4 The management of Delek Refining and Delek Marketing and a number of people in senior positions are employees of a sister company Mapco Express which organizes the operations of the Group in the areas of fuel stations and convenience stores in the United States. For details see Paragraph 8.10.7 below.

7.10.5 In addition, the Company has an incentive program for employees in which some of the employees of Delek Refining and Delek Marketing are entitled to receive options under a plan approved by the Company's the Board of Directors. For details see Paragraph 8.10.6 below.

7.11 Raw Materials and Suppliers

7.11.1 The main raw material used by Delek Refining in its area of operations is crude oil. The main raw material used by Delek Marketing is gasoline distillates. The crude oil market and its products are traded on the commodities markets and which are state of the art markets with a high level of negotiability both in spot and in futures trading, executed in an organized exchange or with large international entities. Delek Refining purchases its crude oil from various suppliers in the US.

Below is a chart showing the breakdown of crude oil which was purchased by Delek Refining between April 29, 2005 and December 31, 2006:

	% of Crude Oil Received	
Source	**2006**	**May-Dec. 2005**
Crude Oil fr. East Texas	65%	67%
Crude Oil fr. West Texas	26%	23%
Other	9%	10%
Total	100%	100%

It should be noted that the data for the first four months of 2005 and of 2004 are not from Delek Refining since that was prior to their acquisition by the Refinery.

The source of more than 90 percent of the oil processed by company is from Texas, with approximately 65 percent from East Texas in close proximity to the Refinery. The location of sources of oil and the availability of the oil enable the Company to enjoy low transportation costs.

7.11.2 Delek Marketing purchases petroleum products mainly from the Magellan Company which has supplied it, during the five months since it began its fuel marketing operations, with approximately 96 percent of the scope of products sold in the context of these operations. Delek Marketing is signed on two agreements with this supplier for the supply of up to approximately 27,350 barrels a day at advantageous conditions. According to the first agreement Delek Marketing can purchase up to 20,350 barrels a day. This agreement is valid up to December 31, 2007 and it can be, with certain conditions, extended for five additional periods of two years each. The second agreement enables Delek Marketing to purchase up to 7,000 additional barrels of petroleum products a day, and it is valid up to 2015. In the context of the second agreement it is determined also that Delek Marketing will be entitled to use the pipeline infrastructure for transporting Magellan petroleum, on the basis of the tariff set in the agreement.

7.12 Working Capital

7.12.1 Inventory Policy for Crude Oil and Finished Products

It is the policy of Delek Refining is to hold in inventory crude oil and products at a level that ensures continuous supply of oil products so as to fulfill its obligations to customers. The main factors which influence the level of inventory are as follows:

The need for a minimal inventory to fill the lower part of the tanks and pipelines.

The need to maintain a large amount of crude oil types for the refining of the various mixtures.

The situation of the crude oil market and the oil products market and the estimate of Delek Refining regarding the level of expected demand for its products and its production capacity.

Delek Refining and Marketing hold in the Refinery, in different terminals and of third party facilities an inventory of crude oil, mixtures of fuels and gasoline distillates, whose value fluctuates with the economic condition of the global economy, amount of inventory in the local and global markets and seasonal considerations. Below is the amount of inventory owned by Delek Refining and Marketing including the average price for 2005 and 2006.

	Dec, 31, 2005			Dec. 31. 2006		
	Amt. (in bbl M)	Av. Price per bbl ($)	Total Value ($M)	Amt. (in bbl M)	Av. Price per bbl ($)	Total Value ($M)
Delek Refining	1.2	61	75.5	1.3	64	82.9
Delek Marketing	-	-	-	0.1	74	6.6
Total	1.2	61	75.5	1.4	63.9	89.5

7.12.2 Credit Policy

A. Customer Credit: Delek Refining and Delek Marketing provide its customers with total credit of approximately 3-15 days (10 days is the approximate average). The average amount of credit to customers for December 31, 2005 and December 31 2006 was approximately $38 million and approximately $65 million, respectively.

B. Supplier Credit :

1. Delek Refining - 35 days of credit from its suppliers for the purchase of crude oil (EOM + 20) usually accompanied by a bank letter of credit. The amount of credit from suppliers as of Dec. 31, 2005 and December 31, 2006 totaled approximately $96 million and approximately $90 million, respectively.

2. Delek Marketing – An average of 10 days of credit from its suppliers for the purchase of Gasoline distillates. The amount of credit from suppliers as of December 31, 2006 totaled approximately $14million.

7.13 Financing

Delek Refining and Delek Marketing finance their operations through bank credit, non-bank credit, and through independent means.

7.13.1 Credit Facility

A. Delek Refining possesses a credit facility guaranteed by the assets it uses in its daily operations and its oil purchases which was raised through an American bank, at with a scope of $300 million.

This credit facility carries a predetermined interest rate and it enables Delek Refining to choose between a "basic interest" and an interest rate based on "Eurodollar". The current interest in 2006 was 1.875 percent + LIBOR. This credit facility also includes letters of credit As of the day of this report Delek Refining had letters of credit for a gross amount of credit of $152 million, and beyond that it did not use its credit facility.

B. Delek Marketing has a short term credit facility guaranteed by assets used by it in its current operations and its purchases of petroleum products, which was raised through an American bank, in the value of approximately $50 million. This credit facility carries predetermined levels of interest and it enables Delek Marketing to chose between a "basic interest" and a rate based on the prime interest rate The current interest in 2006 was LIBOR +2 .25 percent when in certain circumstance the Company borrowed sums linked to the prime interest rate. As of the date of this report the total loan balance for the short term for Delek Marketing was approximately $9.1 million.

7.13.2 Variable Interest Credit

The following is a detailed outline of the variable-interest credit that Delek Refining was granted, in accordance with the sums of current loans in 2006:

Type of loan	Change mechanism	Interest range	Average annual interest rate	Interest rate adjacent to report date	Size of loan ($M)
Refining – long-term	L+2.0%	7.04%-7.31%	7.07%	7.31%	30
Marketing – long-term	L+2.0%	7.53%	7.53%	7.56%	30
Marketing – short-term	L+2.25%	7.58%-9.0%	7.92%	7.07%	19.2

7.13.3 Loans

A sister company of Delek Refining, was given a loan by an Israeli bank in the amount of $30 million at an interest rate of LIBOR + 2.0 percent which was taken to cover the return of a previous loan which had been used to purchase the Refinery. The loan is due in May 2009.

In addition, part of the acquisition of the assets from the PRIDE Group as mentioned above in Paragraph 7.1.2 and 7.10 was financed by funds generated by the offering of Delek USA in May 2006 and by a loan taken by Delek USA in the amount of $30 million from an Israeli bank in the United States at a current interest rate of LIBOR + 2.0 percent, for a period of two years ending in June 2009.

7.13.4 Raising of Additional Funds [for discussion]

Delek Refining estimates that at this stage, with the exception of the need for renewed financing of the credit facility for a short term for the marketing operation, it has no need to raise additional funds to finance continuing operations; however, a sharp raise in the price of crude oil could increase Delek Refining's credit needs. In that case, Delek Refining estimates that it could raise these sums from bank sources and/or non-bank sources, although there is no guarantee than it could do this.

7.13.5 Credit Restrictions

Details of the main financial criteria that Delek Refining needs to uphold are as follows:

A minimal adjusted surplus of current assets less a minimum of financial obligations ("**credit margin**") through the entire period of the loan. If the credit margin is smaller than $5 million, Delek USA has undertaken to raise additional temporary capital. As of March 19, 2006 the credit margin was approximately $75 million.

In the event the credit margin is smaller than $30 million, then the following criteria shall come into effect: (1) Delek Refining must meet a rate of (Cash flows from continuing operations-EBITDA-less current investments/interest expenses + principal payment on planned loan + income tax payment) greater than the amount set in Delek Refining loan agreement and variable for the entire period of the loan; (2) There are limits on the scope of Delek Refining's investments over the course of the loan; (3) Various limitations exist regarding the distribution of dividends.

As at the date of the report, Delek Refining is in compliance with all the restrictions stated above.

Below are the details of the chief financial criteria that Delek Marketing undertakes in connection with the short term Line of Credit in the amount of approximately $50 million.

Value of shareholders' equity will be greater than approximately $43 million.

(Cash flow from continuing operations –EBITDA- less current investments)/(interest expenses + principal payment on planned loan + income tax payment) will be greater than 1.2.

The relation of the debt to the cash flow from current operations EBITDA will be smaller that 4.0.

As of the date of this report Delek Refining has met all the abovementioned credit obligations.

7.14 Liens

In order to guarantee the credit agreement, Delek Refining charged all of the inventory and payments owing from customers in favor of a consortium headed by an American bank . In order to guarantee the credit agreement, Delek Marketing charged all of the inventory and payments owing from customers in favor of a consortium headed by an American bank .

7.15 Taxation

Delek Refining and Delek Marketing are wholly owned subsidiaries of Delek USA and therefore their financial statements for tax purposes are consolidated with those of Delek USA and are subject to the tax laws that apply thereto. For details of the tax laws to which Delek USA is subject, see Note 33 to the Delek Group's financial statements.

7.16 Environment

Delek Refining is subject to laws, regulations, ordinances and permits regarding environmental controls, set by the authorized authorities in its area of operations, in the federal, state and local levels, and in particular The Environmental Protection Agency (hereinafter: "**EPA**") and the Texas Commission on Environmental Quality.

The main legislation in the area of environmental controls relating to Delek Refining's operations is with respect to the matter of air quality, quality of liquid waste, solid/toxic waste and the prevention of ground and groundwater contamination, including the following:

7.16.1 Requirements of the Federal Clean Air Act ("CAA") – a law for supervision of air quality – and related state and local regulations which supervise the allowable level of emissions of certain materials into the air, which influence the operations of refineries directly and indirectly. Licensing requirements and/or control requirements of the CAA relating to the level of emissions of certain air pollutants allowed can influence directly activities in the field of refining. The CAA indirectly influences refining operations through wide ranging regulations relating to emissions into the air of sulfur dioxide and other materials, including nitrous oxide, and other components emitted by vehicles, factories and other public transportation vehicles which use Refinery products. In addition unstable organic compounds which are emitted by refineries are heavily regulated, including compounds such as benzene. Regarding benzene it should be noted that the EPA suggests changes in the formulation of benzene which will require additional decreases in the content of benzene by 2011.

The CAA imposes strict limits on the emissions of materials, established Federal programs which require operating licenses and enable the imposition of enforcement sanction, both civil and criminal. Also the CAA determines the final period for the implementation of the standards and requirements for control based on the severity of the air pollution in a specific geographical area.

7.16.2 The Federal Clean Water Act 1972 ("**CWA**") influences the operations in the field of refining in that it imposes limits of the release of liquid waste into certain water reservoirs. Meeting the requirements for control, standards and regular reporting according to the law, is a precondition for receiving or renewing licenses which enable the releasing of polluting agents into the water. The state of Texas has similar laws and regulations which are even stricter. The Refinery today has the license required for releasing waste in compliance with the national plan for removing waste, The National Pollution Discharge Elimination System Program. The Refinery also operates according to an internal plan supervising the efforts to comply with the abovementioned laws. In addition on a Federal level the Refinery is supervised by the law to prevent oil pollution, The Oil Pollution Act, which amends the Clean Water Act. According to the law to prevent oil pollution it is required, among other things, that the owners or the operators of the facility or tanker have a contingency plan to deal with leaks of fuel and/or other dangerous materials. Delek Refining has developed and will implement such a plan in every one of its facilities to which the law applies for the prevention of petroleum pollution. In addition, in the case of an aforementioned leak, the law states that the responsible companies will carry the charges for cleaning and purification and it imposes heavy civil fines as well as criminal sanctions for breaking the law. The State of Texas has passed similar legislation for the prevention of petroleum pollution.

7.16.3 Delek Refining is also subject to the Resource Conservation and Recovery Act ("**RCRA**") which dictates the manner of dealing with, the storage and the removal of dangerous waste. The State of Texas has similar laws and regulations which are even stricter. When it is possible, RCRA material is recycled directly in a process to produce coke instead of releasing it either in or outside of the site. The TCRA sets standards and procedures for the care of dangerous solid waste. Above and beyond the procedures for dealing with the releasing and removal of waste, the RCRA deals with the influences on the environment in relation to past waste removal practices, the recycling of waste, and the control of underground storage of containers containing material requiring supervision. In addition, new laws and regulations by various supervisory bodies are constantly being enacted.

7.16.4 Under The Comprehensive Environmental Response Compensation and Liability Act **(**"CERCLA**")**, the RCRA and state laws, impose personal responsibility for the release or the possible release of hazardous substances into the environment. Those responsible include the present owners and/or operators of the site at the time of the release, and every person who organized the disposal of the hazardous waste on the site. The responsibility under CERCLA is total, retroactive and in the majority of cases it is the State who is the prosecutor. The responsibility is jointly and severally so that every side which is found responsible can be held responsible for all or part of the costs of the investigation and for the costs resulting from the cleaning-up due to the disposal of the hazardous substances. The responsibility under CERCLA is divided between all the solvent parties which could be responsible. The responsibility which is imposed on the side is determined by the cost of the investigation and the clean-up, on the amount of the hazardous substances the party disposed of on the site and the number of solvent responsible parties. The Railroad Commission of Texas (hereinafter the "**RRC**") has the authority in classification of environmental issues connected to the Refinery's pipeline. Regulations of the RRC settle the matters relating to the types of safety requirements for the transportation of liquids as well as the procedures relating to the response in instances of crude oil leaks and reporting thereof.

7.16.5 The Energy Policy Act of 2005 requires that large quantities of renewable fuel will be recycled to gasoline tanks. The final rules for the implementation of the law have not yet been published and it is possible a small Refinery which refines gasoline distillates will be exempt from these standards until 2010.

7.16.6 **Significant Investments in the Area of Environmental Controls**

A. Prior to the purchase of the Refinery and the pipeline by Delek Refining the previous owners of the facility had been involved for many years in an investigation and clean-up operations as required by the Environmental Protection authorities for disposing liquid propane which polluted the ground and the groundwater at the aforementioned site. With the purchase of the Refinery Delek Refining became responsible for the costs connected to the investigation and the continuing clean-up of the polluted area and in areas in which pollution had not yet been detected. Today Delek Refining is not aware of any pollution whatsoever of the ground or the groundwater in the area of the pipeline which requires investigation or clean-up, including the storage areas which are not being used. Basing these conclusions on the evaluation of the environment which was carried out by a third party at the time the Refinery was acquired, Delek USA recorded in its books the obligation in the amount of approximately $7.9 million to cover the costs for cleaning systems on the site of the Refinery. As of December 31, 2006 the obligation came to approximately $7.8 million. Current and future regulations in matters of environment, as well as other situations which require reporting and action, may cause significant additional expenses for investigation and cleanup. Efforts to purify the groundwater at the Refinery are expected to continue in the foreseeable future.

B. At the time the Refinery was purchased the previous owners agreed to indemnify the Company, under special conditions, for the costs which would accrue to it as a result of the certain damages to the environment. However, it is possible that this indemnity arrangement will offer sufficient protection to Delek Refining from the responsibility in the area of environmental protection, since Delek Refining does not have the right for indemnity for environmental damage of which it had knowledge at the time of the purchase.

C. It should also be noted that Delek Refining has insurance policies, (Environmental Pollution Policy), which covers claims and costs of cleaning and purification in certain cases connected to the Refinery (but do not included, inter alia, cleaning costs due to environmental damage from the past). As of today, no claims have been presented whatsoever in connection to these policies.

D. In September 2006 Delek Refining completed renovations of the facility for the removal of sulfur from diesel, by which the diesel produced by the Refinery in Tyler, Texas will meet the new standards for Ultra-Low-Sulfur-Diesel (ULSD). The production of this Ultra-Low-Sulfur-Diesel at the renovated facility began in August 2006. During the renovations the capacity of the facility was extended by 12,000 barrels a day to 22,000 barrels a day. Delek Refining plans to produce and sell this diesel for use in vehicles, heavy machinery and the like. In addition to this Delek Refining completed the construction of a new complex, which includes a facility for reclaiming 35 long tons of sulfur a day and a facility for the treatment of 75 long tons a day of process gas. The facility for the treatment of process gas will handle flows from the

new sulfur reclaiming facility, as well as flows from the existing sulfur reclaiming facility so as to significantly lower airborne emissions from the Refinery.

E. Below are details of the Refinery's investments in dealing with environmental matters and regular maintenance for 2005-2006 and a forecast for 2007 in millions of dollars.

Year	2005	2006	2007 forecast
Regular Maintenance (inc turnaround)	12.9	3.9	7.2
Environment and Regulations	4.0	65.6	48.5
Total	16.9	69.5	55.7

In 2006 costs for environmental controls began to rise due to, inter alia, the rise in the cost for the construction of facilities for the production of ULSD which were higher than expected due to the demand for such facilities after Hurricane Katrina.

In the course of 2008 Delek Refining expects to complete the project for constructing the facility for the production of gasoline sulfate. The cost for the system to construct the facility comes to $64.8 million (of this the Company expects to spend in 2008 approximately $18 million).

This information regarding Delek Refining estimates concerning the need for investments in the area of environmental controls is to be considered a forward-looking statement based on current information and estimates of Delek Refining relating to expected investments in environmental controls and which may change in the future.

The Delek Refining estimates regarding investments in environmental controls and standards are dependent upon estimates and factors regarding which there is no certainty, for example the complexity and differing interpretations of government regulations relating to the area of environmental controls, the lack of reliable data regarding the exact nature and extent of the existing contamination , or that which will be revealed in the future, the extent of required necessary clean up efforts , and the multiplicity of possible solutions with varying costs of alternative remediation requirements, the number of years that remedial and monitoring activity will be required In addition, the legislation and regulations in the area of environmental controls change and are updated regularly and the changes in them can influence the above estimate.

This information regarding the estimate by Delek Refining as to future investments is a forecast based on information and evaluations available to Delek Refining at present and is subject to change in the future due to the rate of progress of the projects, unanticipated changes in the projects and in their costs.

7.17 Restrictions and Supervision of the Activities of Delek Refining

7.17.1 Business Licenses

Delek Refining and Delek Marketing operate under many licenses , which it obtained for its operations such as various environmental protection laws which require licensing (License for the Disposal of Waste) License for operating fuel pipelines and the like.

7.17.2 Standards Covering Fuel Products

The EPA possesses the authority to enact regulations regarding production standards for refined fuels.

The EPA promulgated national regulations[8] limiting the amount of sulfur emissions permitted in transportation vehicles. These standards prescribe the average amount of sulfur allowed in gasoline distillates extracted by refineries cannot be higher than 30 ppm during a single calendar year., and that after January 1, 2006 one gallon of gasoline cannot have more that 80 ppm. During 2006 the EPA authorized a program in which context Delek Refining received an extension for the production of low sulfur gasoline which applies from June 2008 while at the same time Delek

[8] Tier 2 Motor Vehicle Emission Standards

Refining undertakes that 95 percent of the diesel for vehicular use which will be produced beginning in the third quarter of 2006 will not be higher than 15 ppm.

In compliance with the abovementioned undertaking Delek Refining began during the third quarter of 2006 to produce 100 percent low emission diesel and in the first half of 2008 Delek Refining expects to complete the construction of the facility for the production of low sulfur gasoline.

In addition the EPA issued regulations limiting the allowable emission of sulfur due to the use of On Road Diesel

Also, it should be noted that the TCEQ also issued regulations according to which beginning in October 2005 in districts in the State of Texas which lie east of Interstate 35 only low emission diesel will be allowed. Delek Refining received authorization from TCEQ that it can meet this requirement through the sale of low emission diesel which meets the criteria set in the alternative plan called Alternate Emissions Reduction Plan which was authorized by the TCEQ.

7.17.3 Other

A. Delek USA is subject to the Federal Occupational Safety and Health Act known as OSHA and other similar policy laws that regulate safety and sanitary conditions for employees, including the manner of dealing with hazardous materials.

B. Delek Refining is subject to state and federal laws in matters of wage protection, overtime, working conditions and citizenship. It should be noted that to the best of Delek Refining's knowledge, federal bills are proposed from time to time for raising minimum wage and requiring employers to provide health insurance for their workers. If such bills should be passed, they might negatively affect Delek Refining's results.

7.18 Legal Proceedings

Delek Refining and Delek Marketing are not involved in any material legal proceedings.

7.19 Business Goals and Strategies

Delek Refining examines its plans and strategic goals from time to time and updates them in conjunction with developments that occur in the fuel market, the competition and the macro-economic influences on its activities. The activities of Delek Refining are expected to concentrate in the coming years in the following activities:

7.19.1 Considering the purchase of additional refineries or other complementary assets, such as pipelines or terminals. The acquiring of additional assets. The acquiring of additional aforementioned assets may be in the area of Delek Refining operations or they may be in other areas.

7.19.2 Widening the customer base and the profitability of the Refinery. The Refinery is located in Tyler, Texas, and is the only fuel product supplier within a 115-mile (184 km) radius. Delek Refining has increased its customer list, and continues to do so. In addition, Delek Refining is acting to achieve better contractual terms with its customers.

7.19.3 Investment in facilities to improve the ability of Delek Refining to work with crude oil which is more acidic and heavier.

7.19.4 Carrying out projects which will result in better and more efficient use of its refining facilities, which will increase the production capability of the Refinery and improve the quality of the petroleum products produced at the Refinery.

The above estimates regarding the business goals and strategies are to be considered forward looking statements. Not all of the estimates are in the control of Delek Refining and the realization of the goals and the strategies are dependant also upon external factors. In addition, the risk factors detailed below in paragraph 7.20 could influence Delek Refining's ability to realize the aforesaid goals and strategies.

7.20 Risk Factors

The main risks to the operations of Delek Refining and Delek Marketing are:

7.20.1 Exposure to Price Changes in Raw Materials and Products –Delek Refining is exposed to changes in the price at which it purchases its raw materials, and the sales price of its petroleum products to its customers. Delek Refining carries out from time to time hedge transactions through derivatives in order to lessen its exposure to these risks. In this matter it should be noted that among the competitors of Delek Refining, inter alia, are multi-national companies with greater integrated capabilities significantly larger than Delek Refining, which due to their size, the integrated nature of their operations and their complex refineries, have greater abilities to withstand the vagaries of a changing market.

7.20.2 Refining Margin - Delek Refining is exposed to changes in the refining margin. When the refining margin increases, then profitability increases, however, a drop in the refining margin will cause a decrease in the profitability of Delek Refining.

7.20.3 Legislative Developments and Changes and Issues in Environmental Controls – Delek Refining is subject to various laws and regulations related to its activities in the refining sector, mainly in topics related to environmental controls. Delek Refining is therefore exposed to developments, changes and new legal requirements and the possibility that in the future material deviations will be detected or new harsh legal requirements will be added which will require financial costs.

7.20.4 Operational Risks- The refining operation is exposed to inherent risks related to the refining of fuels and supply of fuel products. These risks include, among other things, natural disasters, fires, explosions, leaks in the oil pipeline, intervention of third parties and other events that are not in Delek Refining's control, and that could disrupt the Refinery's operations, pollution and damages to the environment and to third party property, injury suits and even death. As the entire refining operation is performed at a single Refinery, each of the said risks could disrupt the Refinery's activity and cause significant damage.

7.20.5 Terror Attacks and War – Terrorist attacks in the United States as well as a war in countries which have large oil reserves could negatively influence Delek Refining's operations. As the owner of a Refinery and an oil pipeline, Delek Refining could be exposed to terrorist attacks to a greater degree. Furthermore, terrorist attacks could negatively influence global oil prices.

7.20.6 Limited pipeline infrastructure- The crude oil transportation pipeline has limited capacity, which could become insufficient if the Refinery increases its output significantly. Moreover, Delek Refining possesses no pipelines for the delivery of its fuel products, and most of its sales are performed using its own terminals. This could render it difficult to recruit new customers.

7.20.7 Delek Refining's and Delek Marketing Credit restrictions – As of March 9, 2007 Delek Refining utilized approximately $152 million of its credit facility, leaving it an additional $148 million for use. As of March 9, 2007 Delek Marketing utilized approximately $9 million of its credit facility, leaving it an additional $41 million for use. These undertakings could increase Delek Refining's sensitivity with respect to adverse financial changes, while restricting its ability to purchase crude oil and borrow additional funds.

7.20.8 Insurance – Delek Refining and Delek Marketing have insurance policies, including property policies with coverage of up to $500 million for the Refinery and oil pipeline. At the same time, Delek Refining could suffer from damages that are not insured, or which cannot be insured within its policy, or that are higher than the insured amounts in the policy. For example, the business interruption policy does not apply unless the interruption lasts longer than 45 days.

7.20.9 Dependency on Workers – Most of Delek Refining's Refinery workers, as well as 22 truck drivers, are unionized and subject to collective employment agreements. The collective agreement with the Refinery workers and the drivers was renewed in January 2006 for a period of three years. Also although these collective agreements contain provisions for prevention of strikes, there is no certainty that there will be no strikes or work stoppages. A strike or a work stoppage could potentially have adverse effects on the Delek Refining operations.

7.20.10 Important Supplier – Delek Marketing receives approximately 96 percent of its supply of petroleum products from the Magellan Company. In light of the aforementioned any interruption in the supply for any reasons whatsoever could damage the results of Delek Marketing.

7.20.11 Economic Slowdown in the global and/or local market – a slowdown in the markets could cause a decline in the purchase of fuel products and thereby could have a substantially negative effect on the scope of the orders received and on the price levels of the fuel products and as a result on the activities of Delek Refining.

7.20.12 Changes in USD Interest Rates - Delek Refining and Delek Marketing have a credit debt correct to December 31, 2006 of $79 million. They are exposed to changes in interest rates paid by Delek Refining within the context of these loans. Delek Refining and Delek Marketing manage these risks through variable interest agreements which are characteristic of the interest on most of the long term loans.

7.20.13 What follows is a summary of the risk factors that were described above according to their type (macro risks, sector risks, risks specific to the Group) which were rated, in conjunction with the estimates of the management of the Company, according to their level of influence on the business of the Company – large influence, medium influence, small influence.

	Level of Influence of Risk Factor on the Company's Operations		
	Large Influence	**Medium Influence**	**Small Influence**
Macro Risks		Economic slowdown in global or local market. Terrorist attacks and wars Insurance	Change in dollar interest rate
Sector Risks	Refining Margin Developments and changes in legislation and environmental control topics.	Exposure to changes in the prices of raw materials and products. Operational risks	
Risks Specific to Delek Refining & Marketing		Limited pipeline infrastructure Significant supplier	Credit restrictions Dependency on workers

The level of influence of the risk factors on the business of refining are formulated on the basis of estimates only. The actual levels may in fact differ.

8. Fuel Products and Convenience Stores Sector in the USA

During 2001, the Company began operating in the fuel products field in the USA through Delek USA. This field includes marketing and distribution of fuel products and lubricants, as well as initiating, setting up and operating filling stations and convenience stores. The operations are carried out by Delek USA's subsidiary – MAPCO Express (from hereon: "**MAPCO"**)**.** Operations in the USA is centered in eight neighboring states in the Southeast region of the USA (mainly in the states of Tennessee, Alabama and Virginia).

8.1 General Information on the Field of Operations

8.1.1 General Environment and Influence of Eternal Factors

A. MAPCO's operations in the fuel products field and convenience stores in the USA is exposed to trends, events and developments in the fuel economy in its operations areas, which have or are likely to have an influence upon its operations and upon its competitors, including:

Fluctuations in world fuel prices – the prices that MAPCO pays for fuel products that it purchases is derived from the global fuel market price, and so it is exposed to fuel price changes in these markets. Among the factors that influence fuel prices one can list: Changes in the state of the global and local economy; the level of demand for fuel products in and outside the USA; the world political situation in general and of the oil producing areas in particular (the Mideast, the former Soviet Union countries, West Africa and South America); the production level of crude oil and petroleum distillates in the USA and the world over; development and marketing of fuel substitutes; interruptions in the supply lines; local factors including market and weather conditions. The rise in fuel prices around the world causes a rise in prices of products sold by MAPCO, which can lead to a lowering in demand for these products, as well hurting MAPCO's profits on every product sold. In the past three years there was no essential change in the scope of demand for fuel products in similar stations (stations operated for at least a year by MAPCO), also there was no significant change in the gross profit from the sale of gasoline (see Paragraph 8.1.4 below), however, there is no guarantee that fuel price fluctuations will not cause damage in the future.

B. The economic situation – the scope if MAPCO's sales in convenience stores, just as in the marketing of fuel products, is influenced by the economic situation in its areas of operations in Southeast USA, so that a worsening of the economic situation in these areas can influence MAPCO's operations for the worse. In MAPCO's estimation, during the past three years, no essential change in the economic situation was noted in its operating areas.

8.1.2 The Activities Structure and Applicable Changes

A. As of the time of the report MAPCO's operations includes marketing products to 394 stations operated by MAPCO in eight states in Southeast USA.[1] MAPCO's operations are mainly in Tennessee (214 stations), Alabama (92 stations) and Virginia (36 stations). 237 of the stations are under MAPCO ownership and 237 are leased by it (of them 22 stations by third parties). For a detailed list of ownership and operating status of the stations, see Paragraph 8.8 below.

B. In February 2007, MAPCO signed an Agreement to purchase 107 rights in 107 filling stations and convenience stores, from the Calfree Company of Dalton, Inc., whose base is in Dalton, Georgia. Under the agreement, the ownership rights to 71 stations and leasing rights to 36 stations, will be purchased for total cost of approximately $65 million, not including inventory. The filling stations and convenience stores are located in the Southeast area of Tennessee and Georgia and operate under the brand-name of Favorite Markets, with Conoco and Shell Marathon companies' branded fuel products being sold in 124 of the stations. After completing the transaction, if and as much as it will be completed, Mapco will be holding 501 filling stations and convenience stores in the USA. The transaction is subject to suspending conditions.

C. In July 2006, MAPCO purchased the rights to 43 filling stations with convenience stores form the Fast Fuel Company in Dalton, Georgia. As part of this transaction, ownership rights were

[1] In addition, MAPCO distributes petroleum products to third parties in an additional state.

acquired in 30 stations and leasing rights in 13 stations, in return for a total sum of $46 million, excluding inventories. The purchase was financed with capital from the issue carried out in 2006, the remainder of Delek USA's cash and credit facilities. The fuel stations and convenience stores are located in North-Western Georgia and South-Eastern Tennessee – markets that lie in proximity to the regions where MAPCO currently operates.

D. In December 2005, MAPCO purchased from BP Products North America, Inc. (from hereon: "**BP**"), the rights to operate 25 filling stations with convenience stores (ownership rights in 20 stations and leasehold rights in five stations) as well as to four real estate properties zoned for filling stations and convenience stores (ownership rights to three of the properties and leasehold rights to the fourth property) in Nashville, Tennessee, USA.[1] It should be noted that the gasoline stations are currently operating and will continue to operate under the trade name "BP". The total payment on this transaction was approximately $35.5 million.

E. Additionally, as of the time of the report, MAPCO markets fuel products to more than 50 stations operated by third parties, sometimes without supply contracts.

F. MAPCO also operates convenience stores at all its filling stations integrating the sale of fuel products with convenience store operations.

G. The range of activity is influenced by the long duration of time required to license a filling station and its set up, difficulty in locating new filling stations and setting them up, regulatory limitations in the market and the competition between the fuel corporations and the retail chains in all fields of their activity.

8.1.3 The Competition Structure and Customer Characteristics in the Field.

A. MAPCO operates in the market alongside the big fuel corporations as well as the large Hypermarkets such as Walmart, whose market share is larger in comparison with MAPCO's, who also operate in this field of marketing fuel products and lubricants (see Paragraph 8.6 below).

B. MAPCO markets its products to occasional customers who come to its filling stations. Furthermore, through another subsidiary, MAPCO operates a fueling service through credit cards but this is insignificant in scope.

8.1.4 Changes in the Scope of Operations and Profitability

During the past three years, there were no essential changes in MAPCO's gross profit from the sale of fuel products or retail products. The main change in the scope of MAPCO's operations comes from the purchase of new filling stations and convenience stores as listed above. On the dates December 31, 2004, December 31, 2005 and December 31, 2006, MAPCO had 331, 349 and 394 filling stations and convenience stores, respectively.

8.1.5 Changes in the Supplier and Raw Materials Array

As detailed below in Paragraph 8.11, MAPCO has a prime supplier for fuel products and a prime supplier of retail products. During 2006, there was a fall in purchases from the fuel supplier (about 51% of the 2005, and 33% of the 2006 acquisitions), this was due to the purchase of filling stations whose fuel products are branded and bought from the big oil corporations) BP, Exxon Mobile, Shell, Conoco and Chevron).

8.1.6 Critical Success Factors

By MAPCO's estimation, the critical success factors in the field are:

1. Widespread deployment of filling stations and convenience stores in the areas of MAPCO's operations.
2. Financial stability that allows for purchasing new filling stations and convenience stores, carrying out the investments for setting up new stations and refurbishing and expanding existing ones.
3. Integrating convenience stores and retail centers at filling stations sites.
4. Ownership rights to the realty upon which the filling stations are built.

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[1] From the 25 stations and convenience stores, 21 are entirely operated by MAPCO and four are operated by third parties.

8.1.7 Entry and Exit Barriers

Key barriers to entry in this field of activity are:

1. The high costs associated with purchasing and setting up filling stations, influenced by the standards required in their construction.
2. Regulatory limitations existing in the field, including legislation and standardization in the issues of planning, construction and the environment.
3. Competition with the other oil companies and retail chains in all fields of their activities.
4. The need for a great deal of credit sources for financing fuel products inventories as well as for the convenience stores.

The main exit barrier is the existence of long-term leasehold/operating contracts with landowners.

8.2 Products and Services

The products marketed by MAPCO include primarily petroleum and lubricant products, retail products sold through convenience stores, (state) lottery tickets and money ordinances.

8.2.1 Fuel Products

In this field, MAPCO sells mostly "white products" (refined petroleum) including various types of gasoline, diesel and kerosene, as follows:

C. **Various types of gasoline** – For use by vehicles with gasoline engines and marketed mainly at filling stations.

D. **Diesel** – For large trucks and other diesel powered vehicles, as well as for heating and industry.

8.2.2 Retail Products

At the convenience stores various retail products are sold: The main ones being tobacco products, beer, soft drinks, food (including prepared food), snacks, candy and many other products.

8.2.3 Lottery Tickets

MAPCO has a license for the sale of lottery tickets in some states.

8.2.4 Money Orders

MAPCO has a license to sell money ordinances which are checks, sold in exchange for cash, and function as a substitute for personal checks.

8.3 Segmentation of Revenues by Products and Services

Below is the approximate amounts and percentages of revenues from the sale of various products and services by MAPCO, whose total proceeds represent 10% or more of the total revenues of the Delek Group over the last three years:

	The Year 2006		The Year 2005		The Year 2004	
	NIS millions	As % of Group Revenues	NIS millions	As % of Group Revenues	NIS millions	As % of Group Revenues
Fuels (including 3rd party sales)	4,717	17.9%	3,636	17.9%	2,674	18.7%

The sum of MAPCO's gross profit during the years 2006, 2005 and 2004 stood at approximately NIS 714 million, NIS 647 million and approximately NIS 570 million, respectively. They constituted approximately 12%, 13% and 14.8%, respectively, of the sum of the income from activity in the field. It should be noted that the gross profit rate from the sale of retail products is higher than that of fuel sales.

8.4 Customers

MAPCO's main customers (95%) are retail customers who buy fuel products or retail products at the filling stations and convenience stores.

In addition, MAPCO markets fuel products to about 61 stations operated by third parties. Below is a distribution of MAPCO's sales according to customer groups for the years 2004-2006:

	The Year 2006	The Year 2005	The Year 2004
Retail customers[1]	App. 95%	App. 95%	App. 95.8%
Filling stations operated by a 3rd party	App. -5%	App. 5%	App. 4.2%

8.5 Marketing and Distribution

Following below is a brief description of MAPCO's marketing methods.

Marketing in Gasoline stations – MAPCO promotes its products and services in a number of ways: Regional campaigns and discounts at specific gasoline stations and the use of sales promotions. MAPCO also advertises in the various communications media.

Purchasing agreement for branded fuels – for about 31% of MAPCO operated filling stations, MAPCO is tied by exclusive agreements with the fuel companies – Shell, Conoco-Phillips, Chevron, Exxon Mobil and BP - for the purchase of fuel products and the use of their brand names. These agreements are for a period of from one to 15 years and are at various stages of their duration. On the basis of these ties, MAPCO can benefit from the these companies' marketing efforts and brand name strength. The brand fuel purchasing agreements were signed as part of the engagements in acquiring the stations. Since it is possible to change the stations so that they will operate under the MAPCO name, their termination will not essentially influence its operations.

8.6 Competition

To the best of MAPCO's knowledge, it is one of the three companies with the largest number of filling stations in its operating areas of Memphis and Nashville (Tennessee), in Richmond (Virginia) and in northern Alabama.

MAPCO has many competitors, large filling station chains, other convenience store chains, independent local convenience stores and filling stations, mega-store chains, various retail chains and fast-food chains. MAPCO does not have precise data with regard to its market share and that of its competitors.

The competition in the filling station and convenience store field is mainly local competition by fuel stations and convenience stores in relation to rival businesses in the area. This competition is expressed mainly in the location, ease of access, price, the range of products and services offered, customer service, branded fuels, store appearance, cleanliness and safety.

Following below, is a description of the main methods by which MAPCO deals with the competition and a description of the main factors influencing its competitive position:

MAPCO is working to widen its deployment of filling stations and convenience stores in its areas of operation, as well as adjacent areas. The high concentration of MAPCO filling stations in its areas of operation allows it to be an influencing factor in the local market as well as working with a relatively small and efficient staff. Locating opportunities for initiative and acquiring additional filling stations, including opportunities to purchase chains, is carried out by MAPCO's senior management.

MAPCO is working to expand the proffered range and quality its products, in accordance with identified trends. So, MAPCO began selling readymade food products at its convenience stores in 2005, under the GrilleMarx brand, which it owns[2].

MAPCO Express invests in improving its information technology, including investments in computerization and management software.

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1 Including sales to vehicle fleets.

2 In addition, MAPCO has agreements with fast-food companies, such as Subway, for operating stores at a number of filling stations.

Most MAPCO's filling stations are located in relatively central places of its operating areas which increases customers' ease of access to its stations.

8.7 Seasonality

The demand for fuel products and other products is generally higher during summer months than in the winter. Consequently, MAPCO's operating expenses in the filling stations and convenience store field are lower in the first quarter of the year.

8.8 Fixed Assets and Facilities

8.8.1 At the time of the report, MAPCO owned 237 filling stations and convenience stores. In addition, it leases another 179 properties, mainly under long-term contracts. Of the total number of MAPCO's owned and/or leased filling stations and convenience stores, 22 filling stations and convenience stores are leased by it to third parties and 40 stations that are operated by third parties, are under their ownership or leased by them.

8.8.2 Concerning transactions for acquiring filling stations and convenience stores by MAPCO in February 2007, July 2006 and December 2005, see Paragraphs 8.1.2(b, c, d) above.

8.8.3 Below is a table consolidating MAPCO's proprietary rights for filling stations as of December 31, 2006:

State	Number of MAPCO operated stations	[1]Number of 3rd party operated stations	Number of owned stations	Number of stations leased or rented	[2]Number of stations with leases of less than 3 years to run	[3]Number of stations with leases of more than 3 years to run
Tennessee	214	8	112	104	3	101
Alabama	92	45	69	39	3	36
Virginia	36	--	26	10	--	10
Arkansas	15	--	7	8	--	8
Kentucky	3	--	1	2	--	2
Louisiana	2	--	--	2	--	--
Mississippi	2	--	2	--	--	--
Georgia	30	7	20	14	--	14
Florida	--	2	--	--	--	--
Total	394	62	237	179	6	173

In most of the lease agreements, it was set that MAPCO will pay property taxes, insurance and station operating costs. Concerning those lease/rental agreement that end within three years, MAPCO estimates that it can negotiate extending the agreements to operate them under accepted terms, should it ask to do so.

8.8.4 MAPCO owns 15 trucks and transport tankers.

8.9 Intangible Assets

Delek USA has registered or submitted to the American Patent and Registered Trademarks Office, requests to register various names and trademarks for use in the fuel and retail marketing field. Delek USA owns the following trademarks registered at the American Office of Patents and Trademarks: MAPCO Express & Design, East Coast, Café Express Finest Coffee In Town, MAPCO & Design, Guaranteed Right!, MAPCO Express & Design, Fast Food & Fuel, Fleet

1 Including 40 sites that are not owned or leased by MAPCO.

2 Including options to extend the lease/rental period, as of December 31, 2006.

3 Including options to extend the lease/rental period, as of December 31, 2006.

Advantage and Delta Express. The trademarks whose registration are pending include “Grille Marx "and “MAPCO Mart”. In addition, even though MAPCO has not registered or submitted for registration, the name Discount Food Mart; it is of the opinion that under accepted state law, this name is its trademark (Common Law Trade Mark).

8.10 Human Resources

8.10.1 Below are the employee staff details for MAPCO for the years 2004 and 2005, by department:

Department	Number of Employees as of:		
	31.12.2006	31.12.2005	31.12.2004
Company Headquarters[1]	138	93	84
Regional Staff	109	79	67
Fuel Distribution	36	36	26
Central Warehouse	0	0	12
Stores and Filling Stations	2,520	2,192	2,193
Total	2,803	2,400	2,382

The growth in the number of employees for these years is a result of MAPCO’s acquiring additional filling stations and convenience stores.

Additionally, the MAPCO headquarters have grown in size as a result of new acquisitions and the Delek USA IPO on the New York Stock Exchange.

8.10.2 Except for Mr. Uzi Yamin, Delek USA’s CEO, MAPCO employees are not signed on personal employment agreements nor are they organized or members of any trade union.

8.10.3 MAPCO has a number of training programs according to the employee’s position. MAPCO holds training/continuing education for hourly laborers, store managers and regional managers. In addition, MAPCO has additional training programs, amongst them are customer service, marketing, work safety and others.

8.10.4 Most of the MAPCO employees are given the opportunity to participate in a number of programs including social benefits, medical insurance, and life insurance, which includes in its coverage among other benefits, disability insurance.

8.10.5 MAPCO has a number of employee compensation plans, commensurate with the worker's position, as follows:

1. Store and regional managers get monthly and quarterly bonuses for keeping within budget.
2. The remainder of MAPCO’s employees (except store workers) have a compensatory plan based upon their meeting targets that are set at the beginning of the year.

8.10.6 During April 2006, the Delek USA Board of Directors adopted a long-term incentive policy (from herein: “**Incentive Plan**”). Under the plan, Delek USA is allowed to grant different rights to its securities. The aforesaid rights were allocated by virtue of the incentive plan for Delek Refining’s employees (except temporary workers and those organized in a trade union), MAPCO managers (up to the regional management level) and those with positions or directors in Delek USA.

8.10.7 In December 2006, Delek USA allocated stock options to the CEO of the Delek Group, who serves as a Director in Delek USA, for the acquisition of 28,000 ordinary shares of Delek USA, each at an exercise price of $17.64 per share. In January 2007, Delek USA allocated stock options to the Chairman of the Board of Directors of the Delek Group, who serves as a Director in Delek USA, for the acquisition of 28,000 ordinary shares of Delek USA, each at an exercise price of $16 per share The eligibility for exercising the options will vest within a period of four years from their issue (one quarter of the options each year), with the last exercise date being ten years from the allocation.

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[1] It should be noted that the head offices of Mapco Express also include most of Delek Refining’s headquarters.

8.10.8 According to the employment agreement signed by Mr. Uzi Yamin, CEO of Delek USA, he has the option of acquiring 5% of Delek USA's capital stock, exercisable over a 5-year period beginning May 2004 and ending April 2009, at a realization price based on the estimate of Delek USA's valuation at the time the option was granted, on May 1, 2004, which was $80 million. At the time of the report, Mr. Yamin had realized 250,000 thousand options for Delek USA stock and holds 1,719,493 options, of which 800,396 options have matured.

8.11 Raw Materials and Suppliers

8.11.1 Fuel products and lubricant suppliers – MAPCO purchases fuel products from suppliers in its operating areas. MAPCO's main fuel supplier is Valero Marketing and Supply (from herein: "**Valero**"),[1] upon whom it is dependent as they supplied it during 2005 and 2006, with approximately 51% and 33% of its fuel needs, respectively.

In addition to Valero, MAPCO purchases fuel products from other suppliers, mainly: Conoco-Phillips, Exxon Mobil, Chevron, Shell and BP.

During 2005 and 2006, approximately 61% and 57% of the fuel transported by suppliers to the filling stations was via MAPCO's tanker fleet. The remainder of the transports were carried out by outside carriers.

8.11.2 Retail products suppliers – During 2005 and 2006, MAPCO purchased 63% and 69%, respectively, of its marketed retail products from the McLane Company, Ltd. (from herein: "**McLane**"). MAPCO's association with the McLane company began in 2005. In addition, MAPCO purchases retail products from the Pepsi Cola, Frito, Lay, Hershey, Kraft/Nabisco, Oscar Mayer and Gatorade companies as well as other companies..

For a detailed list of these agreements, see Paragraph 8.17 below.

8.12 Working Capital

8.12.1 Finished-Product Inventory Policy

MAPCO's policy is to keep on average a five-day inventory of fuel products and a 26-day inventory of retail products at each filling station / convenience store. The inventory value as of December 31, 2004, December 31, 2005 and December 31, 2006 was approximately $28 million, $34 million and $41 million, respectively.

8.12.2 Credit Policy

A. Customer Credit: It is the policy of MAPCO not to give credit to retail customers. Under certain circumstances MAPCO has given credit to its customers (mainly to car fleets and out-of-station customers), for insignificant amounts, for up to seven days. The average number of credit days during 2004-2006 was approximately five.

B. Suppliers credit: MAPCO receives credit from suppliers for a period of up to 30 days . The average number of credit days from its suppliers during 2004-2006 was between 15 and 20 days, while from some suppliers MAPCO does not get any credit whatsoever.

C. The credit that MAPCO receives from its suppliers is nearly sufficient in order to finance inventories and customer credit.

8.13 Financing

8.13.1 Credit Limits

As part of loans and credit lines that MAPCO received in April 2005, MAPCO committed to maintain financial criteria, whose main points are as follows:

A. The ratio of (Total financial debt) to (cash flows from operating activities (EBITDA – adjusted)) will be lower than 4.85 in the first two years, 4.25 in the third year, 3.75 in the fourth year, 3.25 in the fifth year, 2.75 in the sixth year.

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[1] It should be noted that Valero acquired Premcor Refining, which signed a fuel supply agreement with Delek USA – in the course of 2005.

B. The ratio of (Cash flows from operating activities (EBITDA) less current investments, to (interest expenses + the planned loan principal payment + income tax payments) will be higher than 1.2 in the first three years, 1.25 in the fourth year, 1.30 in the fifth year and from then on.

C. The ratio of (Cash flows from operating activities) plus rental fees (EBITDAR)) to (interest expenses + rental fees) will be higher than 1.90 in the first two years, 2.0 in the third year, 2.15 in the fourth year, 2.35 in the fifth year, 2.50 in the sixth year.

D. The ratio of (Total financial debt + 8 rental fee payments) to (cash flow from operating activities (EBITDA) plus rental fees) of the company will be lower than 5.60 in the first two years, 5.10 in the third year, 4.65 in the fourth year, 4.25 in the fifth year, 3.80 in the sixth year.

E. The scope of the investments in the existing assets will not exceed $12 million per annum.

F. In addition, there are certain limitations on MAPCO's dividend distribution whose main points are as follows . The total of the dividends in each fiscal year will be the lower of $1.5 million or 50% of the cash flow surplus in the preceding fiscal year, without taking into consideration advanced payments of loans taken as per the agreement, provided that the ratio mentioned in sub-section (a) above is no higher than 1:2.5 and the ratio mentioned in sub-section (b) above is higher than 1:1.25, in any event, for the period of the four fiscal quarters that preceded the date of dividend distribution.

G. Thus far, MAPCO has fulfilled all of the aforementioned conditions.

8.13.2 Liens – MAPCO Express has collateralized all its fixed assets, including real estate, inventories, cash flows from customers and credit cards.

8.13.3 Credit lines – As of March 9, 2007, MAPCO has credit lines that total approximately $120 million at a variable interest of Libor + 2.25%. As at December 31, 2005, MAPCO utilized $68 million of the aforementioned credit lines (including a letter of credit for $16 million).

8.13.4 Variable Rate Credit – Following below are the details of the variable rate loans that MAPCO received in accordance with the present loan agreements in 2006:

Type of Loan	Modifying apparatus	Interest Rate Range	Average Annual Interest Rate	Interest rate at report time	Scope of loan (in $ millions)
Long-Term Loans	L + 2.75%	7.26%- 8.2%	7.82%	8.1%	147
Revolver	L + 2.25%	6.62%-9.5%	7.77%	7.57%	59

8.13.5 Credit rating – MAPCO has short-term loans and credit lines that were rated by S&P and Moody's with a grade of B+ and B1, respectively.

8.14 Taxation

The financial statements for tax purposes, of MAPCO and its subsidiaries, are consolidated with those of Delek USA and are subject to the tax laws applying thereto.

Furthermore, MAPCO is subject to state tax laws in the various states wherein it operates (the State Income Tax and Franchise Tax). The tax rates are based upon the assets' worth, the scope of the activity and MAPCO's shareholders' equity. For the tax rates that apply to MAPCO in the USA see Note 33 of the Group's financial statements.

Delek USA is held through a wholly owned Hungarian subsidiary and consequently, the tax rates on capital gains, interest and dividends are affected by tax treaties between Israel and Hungary and the USA and Hungary.

8.15 Environment

8.15.1 MAPCO's operations are subject to the various laws, regulations and ordinances regarding environmental protection. These laws can be federal, state or regional and change from area to area. The various states issue permits for above and/or underground storage tanks on a yearly basis. At the Federal level, the Resource Conservation and Recovery Act requires that the

Environmental Protection Agency (**EPA**) formulate a comprehensive regulatory program for assessing, preventing and cleaning leaks from fuel reservoirs. The regulations issued by the EPA enable the various states to develop, manage and enforce state regulatory programs, provided that the standards they adopt are no less stringent than the federal ones. The EPA, as well as most states, have stipulated requirements for the manner of installing underground reservoirs, upgrading existing reservoirs, taking remedial steps in cases of leakage, closing underground reservoirs, saving appropriate data and saving evidence regarding financial liabilities stemming from remedial measures, and third-party compensation related to bodily or property damage caused by leakage.

8.15.2 MAPCO is party to state funds that share responsibility for rectifying certain environmental damages. In addition, MAPCO purchased an insurance policy covering certain environmental damages

8.15.3 The MAPCO operations are also subject to the Comprehensive Environmental Response, Compensation and Liability Act ("**CERCLA**"). This law imposes absolute liability on certain groups of people who are defined as accountable for discharging hazardous materials into the environment. This group of people includes the owner(s) or operator of a waste site(s), as well as the company/companies who have disposed or organized the disposal of the hazardous materials. The Company estimates that most of this cost is covered by the funds mentioned above.

8.15.4 Because of the trend in environmental issues, there could be additional and more restrictive rules that MAPCO will have to follow and probably requiring additional expenses. However, according to currently available information as to MAPCO's fulfillment of existing environmental demands, MAPCO does not expect substantial additional environment related investments in 2007.

This information regarding an assessment of MAPCO's need for additional investments for environment related items, is to be considered forward looking information. It is possible that this will not materialize in the event that essential deviations are discovered in MAPCO's operations or that new regulations might take effect that will require additional significant expenditures.

8.16 Limitations and Supervision of MAPCO operations

MAPCO operations are subject to laws and regulations including, among others, labor laws, regulations in connection with the sale of alcohol and tobacco products, minimum wages, work conditions, public access roads and additional laws, including:

8.16.1 Gasoline Station Licenses and Fuel and Oil Sales – The permit for the sale of fuels and lubricants is issued by the various states in which MAPCO operates (a Regulatory Services Permit). The permit is yearly. In addition, states also give permits for storage of fuel (above-ground and/or underground) as mentioned above in paragraph 8.15.1.

8.16.2 Lottery Permit – MAPCO is permitted to issue computerized lottery tickets as well as "Scratch-off" tickets in certain states, in accordance with licenses that it has obtained.

8.16.3 Permit to Sell Alcoholic Beverages – State or local laws restrict the hours during which certain products may be sold, the most significant of which are alcoholic beverages. State and local authorities have the power to approve, cancel, suspend or revoke applications for the issuing or renewal of licenses for the sale of alcoholic beverages or to impose various restrictions and sanctions.

8.16.4 Cigarette Sale Permit – The permit to sell cigarettes is also given by three authorities: State, county and city. This permit is yearly, while in addition, MAPCO needs to obtain permits for the sale of other tobacco products.

8.16.5 Licensing related to the operation of convenience stores – The convenience stores are subject to the various federal and state regulations governing matters involving health and sanitation, safety, fire, and planning and construction.

8.16.6 In addition, MAPCO is subject to federal and state legislation in matters related to wage protection, overtime, working conditions. and citizenship. It should be noted that, as far as MAPCO knows, the federal legislative branch occasionally considers drafting laws for raising the minimum wage and obliging employers to provide their employees with health insurance.

8.17 Material Agreements

8.17.1 As noted in Paragraph 8.1.1 above, Valero is MAPCO's key fuel supplier, from which it acquired 33% of the fuel products in 2006. MAPCO is tied to Valero by a distribution agreement until May 2008. According to MAPCO's agreement with Valero, the latter is required to supply MAPCO with a certain amount of petroleum distillates whose prices is determined by a set formula. It is possible that MAPCO will not be able to renew its supply contract at the same terms, which will affect its financial results.

8.17.2 McLane Grocery Distribution is MAPCO's principal retail product supplier, supplying it with approximately 69% of these products in 2006. The agreement was signed on January 1, 2005 for three years, with an option for an additional two years.

8.18 Legal Proceedings

MAPCO is not a party to any essential legal proceedings.

8.19 Business Objectives and Strategy

MAPCO examines its goals and strategies and updates them from time to time according to developments in the fuel market, the competition and macro-economic impacts.

MAPCO's operations in the coming years are expected to focus on the following activities:

8.19.1 The purchase of additional filling stations and convenience stores in the areas in which MAPCO is active, as well as in adjacent areas. MAPCO monitors activities at its filling stations and convenience stores. It considers the transfer of those filling stations and convenience stores, whose performances is lower than expected, to operation by third parties.

8.19.2 Increasing its retail activity and product range in the convenience stores, mainly in the area of prepared foods. As part of this move, MAPCO intends to sell premium products at its stores as well. In its opinion this will also attract a new target public to the stores. Among other things, it is MAPCO's intention to introduce prepared foods that the customer can order via a touch screen, to sell private label foods and present a larger variety of products. The range of products that will be sold at each convenience store will be determined in accordance with a unique sales strategy for the convenience store, which will take into account the store's location and customer profile.

8.19.3 MAPCO is working to strengthen its brands and as well as their recognition as leading brands in the Southeast USA, and to renovate and redesign its convenience stores, with the goal of enhancing its customers' buying experience. MAPCO has begun the branding anew of some of its convenience stores, under the name "MAPCO Mart". MAPCO believes that this move, along with a renovation and redesign of its stores, will serve to expand its customer audience. The investment outlays are significant, but will be spread over a number of years. During 2007, the investment is expected to reach approximately $19 million. This information concerning the investment costs is to be considered as forward-looking, and can change with any changes in the investment plans, regulatory impediments to receiving the allowances and required authorizations and so forth.

This information regarding business goals and strategy is to be considered forward-looking information. Not all of the estimates are under MAPCO's control and the realization of the goals and strategies is also dependent upon external forces. Similarly, see paragraph 8.20 below regarding risk factors that could have an influence on MAPCO's ability to realize goals and strategies, as aforesaid.

8.20 Risk Factors

8.20.1 MAPCO estimates that the main risk factors associated with its operations are as follows:

A. Competition – The high level of competition, including against Hypermarket chains, specifically in the fuel sector, is expressed in relatively lower margins.

B. Competition from Hypermarket Chains – development of competition in the area of marketing of fuel and oil products by hypermarket chains.

C. Volatility in Oil Prices – The influence of oil price volatility on the prices and on margins in the trade.

D. Deteriorating Profitability – The risk to declining margins due to low growth in fuel supply from the refineries in the United States and due to rising global oil prices with the difficulty of fully adjusting the fuel price to consumers.

E. Declining Cigarette Demand – A decline in the demand for cigarettes (the biggest selling retail item for MAPCO) and the difficulties of the tobacco companies in the USA that will have an impact on the marketing and prices of cigarettes. Future legislation on the subject of tobacco products, such as raising cigarette prices or increasing taxation on tobacco products is liable to negatively impact cigarette consumption.

F. Environment – The instructions of the laws, regulations and ordinances concerning the environment that apply to fuel companies, and the possibility that in the future there will be additional, ever stricter, environmental regulations, could require monetary outlays on MAPCO's part.

G. Dependence on a fuel product supplier – MAPCO purchases some 33% of its fuel products from one supplier, at a discount, pursuant to a contract that will expire in 2008. There is no certainty that MAPCO will be able to renew the agreement with this supplier or with other suppliers at preferred conditions. A change of fuel supplier, an interruption of fuel supplies, or a change in relations with the fuel supplier will have a deleterious affect upon MAPCO's situation.

H. MAPCO's credit limits – As of March 9, 2007, MAPCO has loans and letters of credit for a sum of $215 million. In addition, it can utilize a credit facility totaling approximately $52 million, subject to meeting credit limitations (see Section 8.13.1, above). These liabilities are likely to heighten MAPCO's sensitivity to negative economic changes; force it to allocate a substantial part of its [cash] flow for debt payment; limit its ability to plan, make changes and react quickly to changes in its field of activity; and curtail its ability to borrow additional funds.

I. Recession – MAPCO can be influenced by an economic downturn in the American economy which expresses itself by a decrease in the volume of fuel and fuel product sales and retail products sold at its convenience stores.

The following table is a summary of the risk factors by type (macro risks, trade risks, and special risks for the Group) that were rated according to the estimates of MAPCO's management according to the influence upon conditions relating to the Group's operations – large, medium or small influence:

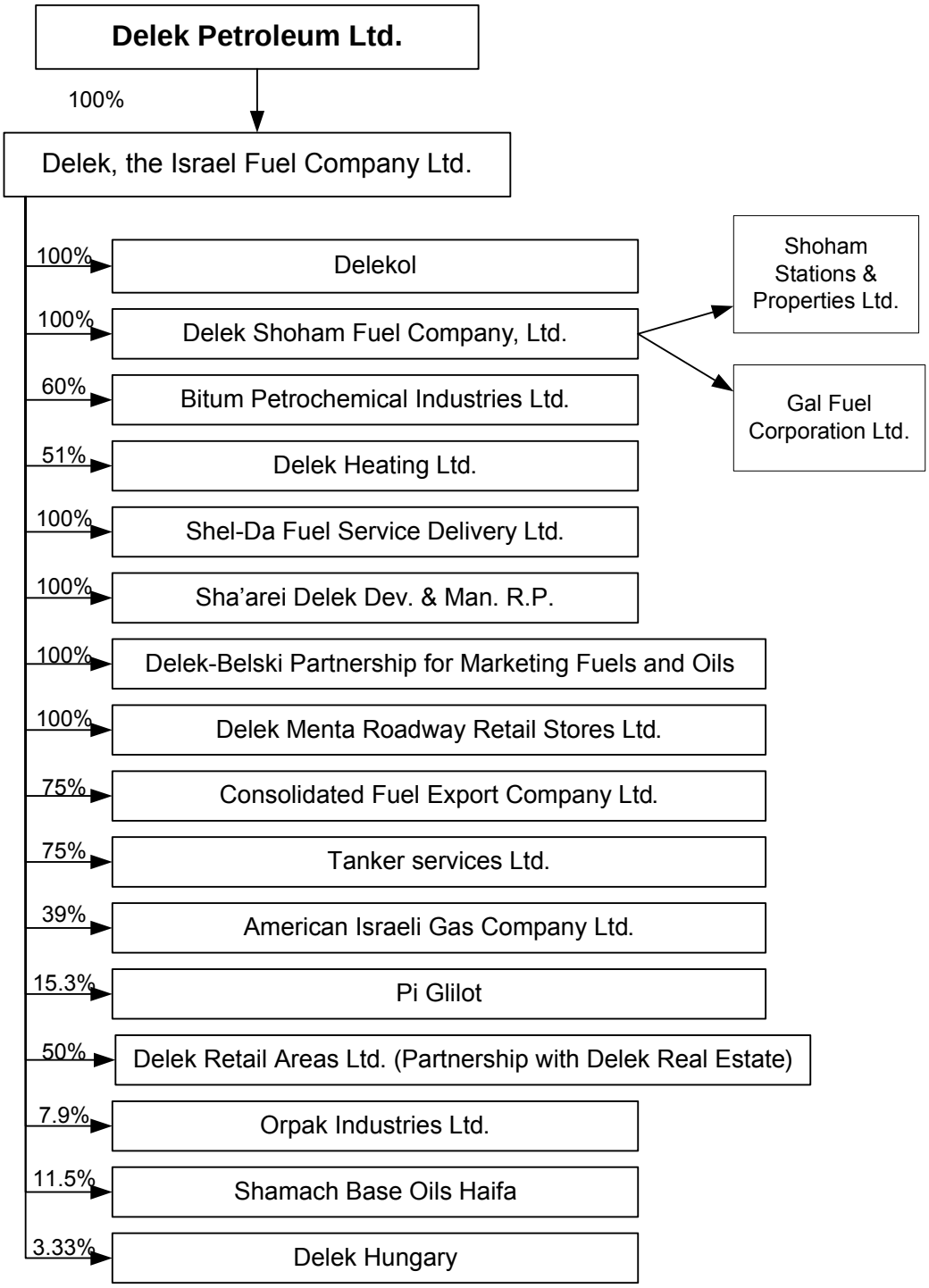
	Level of the risk factor's effect upon the Company's business		
	Considerable Influence	**Medium Influence**	**Small Influence**
Macro-level risks		• Economic slowdown	
Industry-wide risks	• Exposure to volatility in oil prices	• Competition • Lower profit margins	• Hypermarket chain competition • Lower cigarette consumption • Environment
Risks specific to MAPCO			• Dependence on a fuel product supplier • Credit Limits

The extent of the effect of the risk factors for the fuel products and convenience stores business in the USA, is based solely on an estimate. In practice, the extent of the influence will probably be different.

9. Fuel Products Sector in Israel

The Company's operations in the fuel products sector in Israel are conducted through Delek, the Israeli Fuel Company, Ltd. (Delek Israel) which is a wholly owned subsidiary of the Company. Delek Israel is active in the fuel products sector in Israel including the marketing and distribution of fuels and oils and is a developer of gasoline stations and convenience stores (adjacent to the gasoline stations).

Following below is the main structure of holdings of the Group in the Israeli Fuel Products sector:



9.1 General Information on the Sector

9.1.1 Structure of the Area of Activity

There are four main fuel companies in Israel: Paz, Delek Israel, Sonol Israel Ltd and Dor-Alon Energy Israel Ltd. These companies hold about 859 public fuel stations in Israel as well as engage in direct marketing of fuel and oil products to consumers outside the gasoline stations (hereinafter: "**Direct Marketing**"). In addition, there are other fuel companies that together hold 97 public fuel stations and perform direct marketing activities.

The fuel activity in Israel includes the marketing of fuel and oil products to fuel stations and their operation, direct marketing and operation of convenience stores which sell various products in the fuel station/convenience store outlets. Delek Israel also operates an electronic refueling control system ("**Dalkan**"), which enables companies with large fleets of vehicles to refuel more efficiently. In some of the fuel stations/convenience store outlets Delek Israel leases out areas for commercial purposes to third parties (hereinafter: "**Retail Areas**").

At the end of 2006, Delek Israel had 227 public fuel stations, 35 convenience stores and 27 retail outlets. At the end of 2005 Delek Israel had 225 public fuel stations, 35 convenience stores, 35 convenience stores and 25 Retail Areas. At the end of 2004, Delek Israel had 223 public fuel stations, 30 convenience stores and 23 retail outlets.

Out of the total number of fuel stations to which Delek Israel markets its products, 34 stations are owned by Delek, 149 stations are sub-leased or rented and 44 stations are operated by other companies with which Delek has agreements fore the supply of fuel products and lubricants.

Delek Israel operates 117 fuel stations, of which 45are operated by other companies for Delek Israel and 65 are operated by companies not on behalf of Delek Israel.

Import, purchase, transportation and storage of fuel products

Fuel companies are entitled to import crude oil and crude oil products to Israel. As at the reporting date, crude oil is imported to Israel by the Israeli oil refineries, undergoes distillation and refining and the distilled products are sold to fuel stations at controlled prices called "ex-works prices at oil refinery". Delek Israel does not import crude oil[1], however in 1999 it began importing fuel products (primarily benzene and diesel oil). The Delek Israel's decision to import fuel products is affected by the economic advisability of fuel imports (the offered ex-works price vis-à-vis fuel prices at the refinery).

Most of the petroleum products (as opposed to crude oil) are unloaded in the Ashkelon unloading port through EAPC[2].

The oil products are stored in terminals operated by Petroleum and Energy Infrastructures (PEI), the oil refineries and the fuel companies. Oil is conveyed to the storage and supply terminals through pipes owned by Fuel Products Line[3] (hereinafter: FPL). The pipeline that conveys oil to the storage and supply terminals of Delek Israel in Haifa is usually that owned by the oil refineries. The prices of infrastructure services (unloading, storage and conveyance) of oil products were determined in the Control of Prices of Commodities and Services Order (Infrastructure Rates in the Fuel Economy) 1995 (hereinafter: “Control of infrastructure Prices Order”).

Conveyance, supply and transportation

Petroleum products that were distilled in the oil refineries in Haifa or Ashdod as well as the imported crude oil products are conveyed through a national distillate pipeline, which is primarily owned by FPL, to the different storage facilities. The main storage and supply sites of Delek Israel are located in Haifa (owned by Delek Israel) and in Ashdod (in the Pi Glilot facility). The petroleum products are transported from the supply facilities mentioned above by means of road tankers.

As at the reporting date, 75% of the distillates transported by Delek Israel is conducted through Shal-Del Services for Fuel Transportation Ltd. (hereinafter: "Shal-Del"), a fully owned subsidiary of

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1 Delek Israel holds emergency fuel oil, diesel and jet fuel reserves on behalf of the State, pursuant to the provisions of the State Economy Arrangements Regulations (Amendments to Legislation to Achieve the Objectives of the 2001Budget) (Holding reserves and security reserves of fuel), 2001. For additional details, see section 9.17.1, below.

2 A company owned by the State of Israel (50%) and a third party.

3 A fully-owned subsidiary of PEI.

Delek Israel. Additional transportation of fuels (about 25%) is conducted by sub-contractors hired by Delek Israel or by customers which transport the fuels through their own fleet of tankers.

The marketing of petroleum products

As of the reporting date, there are 30 oil companies registered with the Fuel Administration, which are licensed to purchase petroleum products directly from the oil refineries. Delek Israel estimates that additional entities operate in this market (companies, agents, distributors, retail customers), purchasing petroleum products from the licensed fuel companies and marketing them to customers.

9.1.2 Material Changes in the Area of Operation

A. Privatization of Oil refineries Ltd. (ORL) – Pursuant to resolution of the Ministerial Committee on Privatization, ORL was split into two oil refineries (in Ashdod and in Haifa), which were sold by the State. The oil refinery in Ashdod was acquired on September 28, 2006 by Paz, while the controlling stake in ORL was sold on February 19, 2007 to a company owned by the Ofer-Federman Group.

   The Ministerial Committee's resolution prescribed that the Control of the Prices of Commodities and Services (maximum ex-works prices for fuel products at ORL's refinery) Order, 5753-1992 would be amended so that after the split of ORL and the privatization of ORA, control of ex-works prices of oil distillates at the refinery will be removed, except for control of the prices of distillates of which more than 50% of consumption in the local market is sold by one of the two refineries while less than 15% of consumption in the local is sold by the other refinery. As of the reporting date, the following products are still under price control: low-sulfur diesel for transportation, LPG, bitumen and fuel oil.

B. The Pi Glilot Tender (storage and supply activities) – in June 2005 an agreement was signed between the Government of Israel, the fuel companies: Paz Petrol, Sonol Israel and Delek Israel (hereinafter jointly entitled- "the **Fuel Companies**") and Pi Glilot, for the dissolution of the partnership in Pi Glilot. Pursuant to this agreement, Pi Glilot shall sell its existing activity (storage and supply of fuel products). The sale shall be effected by way of a tender, under which companies that own refining operations in Israel will not be able to take part in the tender. For additional detailed, see section 9.13.2, below.

9.1.3 Restrictions, Legislation and Regulation

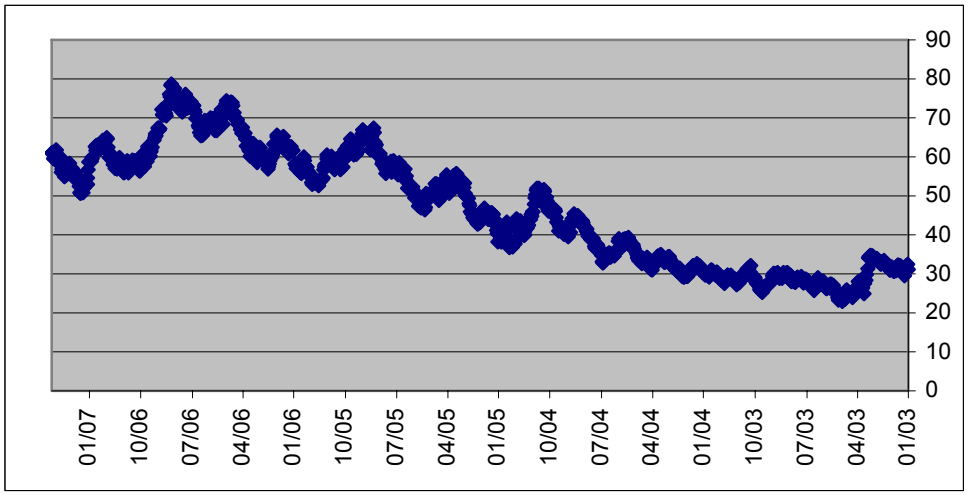
The activity of the fuel companies is subject to different legislation and regulation limitations. For details see sections 9.16 and 9.17, below.

9.1.4 Changes in the Scope of Operation and its Profitability

In 2004 and 2005 there was a consistent rise in crude oil prices which came to a halt in the second half of 2006. However, since the start of 2007, oil prices have been rising again. A decline in crude oil prices entails a decline in the prices of oil products sold by Delek Israel, which has an adverse impact on the gross profitability of Delek Israel.

In 2006 this operation suffered from a decline in gross profit margins, primarily due to the increase in the prices of oil distillates, as a result of which the prices of petroleum products ex-works at ORL increased, while the marketing margin, which is determined by the Government of Israel (in the controlled products) (see section 9.17.2(b), below) remained fixed except for insignificant adjustments.

Below is a graph illustrating the volatility of global crude oil prices from January 2003 to the date of publication of this prospectus (Brent crude oil in USD per barrel):



9.1.5 Developments in Markets and Client Breakdown

Delek Israel's activity is affected by various developments in its target markets, *inter alia*, economic developments in the Israel and global petroleum prices. Set forth below are significant developments in these markets and client breakdown:

Development of fuel stations into retail areas – in recent years there is a growing trend by fuel companies, including Delek Israel, to develop and expand their fuel stations into retail centers that offer, in addition to petroleum products and lubricants, a variety of services, such as convenience stores, restaurants and cafés, cash wash services and more.

Expanding self-service fill-ups – As of April 2006 fuel companies were required to install self-service benzene fill-up pumps in their public fuel stations. Although the selling price of benzene products is lower in the self-service pumps, employment costs decline as fewer fuel stations attendants are needed. The expansion of self service is an integral part of the company's policy to branch out its convenience store operation. See also Section 9.17.2(b), below.

An increase in the number of corporate vehicle fleets – in recent years there has been an increase in the number of customers with vehicle fleets that enter into agreements with fuel companies for the supply of petroleum products. The number of customers with large vehicle fleets and their proportion in the total number of customers in Delek Israel's public fuel stations has grown in recent years. The marketing and sale of petroleum products for vehicle fleets is carried out through the Dalkan refueling control system, which allows for efficient refueling and automated billing. The competition between the four largest fuel companies (Paz, Delek Israel, Sonol and Dor Alon) has led to increased discounts for customers with vehicle fleets.

9.1.6 The Key Success Factors in this Field are:

A. A nationwide chain of fuel stations.

B. Financial strength which enables Delek Israel to invest in the construction of new fuel stations under company ownership and to renovate and expand existing stations.

C. Setting up a chain of convenience stores and Retail Areas.

D. The ability to provide credit to customers, including credit to corporate vehicle fleets that refuel using the Dalkan automated refueling system.

E. Real estate rights in properties with fuel stations.

F. The terms of agreements with fuel station operators.

G. The availability of raw materials and products and the ability to store them efficiently.

H. Competitive prices in the tenders of significant institutional clients.

I. State-of-the-art marketing and logistic systems.

J. A developed control and collection system.

K. A significant branding of Delek Israel's products compared to its competitors.

L. High quality of the services provided to customers.

M. In the direct marketing branded products (such as lubricants, sealing and insulation products), the significant success factors are reputation, know-how and professionalism, quality control systems and human capital.

9.1.7 Changes in Supply and Raw Materials

There are two oil refineries that operate in Israel – one in Haifa and the other in Ashdod, which up to ORL's privatization, were owned by the State. Since the privatization of ORL, instead of one major supplier the Company has two local suppliers of petroleum products (ORL and ORA), while the remaining products of Delek Israel are imported. For additional details, see section 9.11.5, below.

9.1.8 Main Entry and Exit Barriers in the Fuel Market

The main entry barriers are:

A. The high costs involved in locating and setting up fuel stations, which are affected by high standards required in the construction of fuel stations, or the construction of facilities and the purchase and development of the know-how necessary to enter the field of direct marketing;

B. The long period of time (3-5 years) required for obtaining a license for the construction and operation of fuel stations.

C. Existing regulatory restrictions in this sector, including legislation and regulation in the areas of planning construction and the environment.

D. The competition with long-standing fuel companies in every field of operation.

E. The need for substantial financing sources in the purchasing of petroleum products in bulk, providing credit to customers with vehicle fleets, etc.

The main exit barriers are the leasing/operating agreements with land owners.

9.1.9 Substitutes to Existing Products and Changes Therein

In 2003, the Israeli Government approved Amendment No.3 to National Outline Plan No. 18, which permits the use of LPG for the fueling of vehicles in fuel stations ("automotive LPG"). Delek Israel estimates that as of the reporting date, the number of vehicles in Israel suited for automotive LPG is negligible.

9.1.10 Structure of the Competition and Changes Therein

There are four large competitors in this market (including Delek Israel): Paz Petrol which holds 26% of the country's fuel stations, Delek Israel with 24%, Sonol Israel with 22% and Dor Alon with 17% of all fuel stations[1]. In the opinion of Delek Israel opinion, each one of its three competitors has a nationwide chain of fuel stations and the capability for providing services to corporate vehicle fleets.

In addition, there are numerous smaller companies that together operate, as at the reporting date, about 11% of the fuel stations in Israel.

The competition for private consumers is mainly reflected in prices, the scope of services and sale of related products in fuel stations.

The competition for customers with vehicle fleets is reflected in prices, terms of credit and the provision of value-added services (such as provision of fuel consumption analysis reports through electronic media, car wash services, etc.).

Fuel companies also compete for locations of new fuel stations, as demand for fuel stations in potentially lucrative locations leads to increased rent fees or higher selling prices payable to real estate owners, which erodes the profitability of fuel companies.

The competition in the direct marketing segment has also aggravated, as reflected in price discounts, favorable terms of credit for customers and higher quality of services. The competition is

[1] These data are taken from the sites of the large fuel companies as well as from the Fuel Administration as at the reporting date.

mainly among the largest four companies. There are numerous small and medium size companies that operate in this segment.

9.2 Products and Services

The products marketed by Delek Israel mainly include fuel products as well as retail products sold in convenience stores:

9.2.1 Fuel Products

A. Oil distillates ("white products")

Various gasoline products – a fuel which is used in vehicles with a petrol engine and sold via fuel stations

Diesel fuel – mainly used for fueling vehicles with diesel engine as well as for heating and industry.

Oil – mainly used as a raw material for the petrochemical industry in which it is used for the manufacture of other products.

Kerosene – mainly used for commercial and residential heating.

Liquefied Petroleum Gas (LPG) – a material used by the petrochemical industry and for industrial and residential use.

B. Residues ("Black Products")

Fuel oil – Used as a fuel for industry, ships and the generation of electricity.

Bitumen (tar) – Used mainly as a raw material in the manufacture of asphalt and as a sealant. Bitumen is mainly sold to contractors in road infrastructure.

C. Industrial products

Delek Israel sells oils and byproducts for automobiles and for industry from its own production and from imports. These products are sold to factories, fuel stations, garages, shopping organizations and other entities. Delek Israel also sells insulation and sealing products for buildings and infrastructure.

9.2.2 Retail Products

In its convenience stores with the "Menta" brand name, Delek Israel markets a selection of retail products such as food products (sandwiches, pastries, snacks, etc.), beverages, cigarettes and other products. In addition, most of its fuel stations sell car-related accessories and foodstuffs. Most of the Menta stores operate 7 days a week, 24 hours a day. The number of Delek Israel's convenience stores as at December 31, 2004, 2005 and 2006, was 30, 35 and 35, respectively.

All Menta stores are operated by Delek Israel, which plans to expand the nationwide distribution of these stores in additional fuel stations. Delek Israel also plans to increase the variety of products and services to be offered at some of the convenience stores.

9.3 Breakdown of Revenues

The table below presents the amount and proportion of Delek Israel's income in total Group revenues, divided to product or service groups the total revenues from which account for at least 10% of the revenues of the Delek Group in the last three years (net of excise taxes):

	2006		2005		2004	
	NIS millions	% of Company's Revenues	NIS millions	% of Company's Revenues	NIS millions	% of Company's Revenues
Fuels and lubricants	4,399	18.2%	3,994	21.7%	3,224	26.3%

The gross profit generated by petroleum products in the years 2004, 2005 and 2006 aggregates NIS 496 million, NIS 469 million and NIS 497 million, respectively.

9.4 Customers

9.4.1 Delek Israel's customers can be classified into groups as follows:

A. Fuel station and convenience store customers, that can be divided into two main groups:

1. Fuel station and convenience store private customers that buy fuel products, lubricants or retail products at the fuel stations and convenience stores operated by Delek Israel.

2. Corporate customers, including vehicle fleets that subscribe to the Dalkan automated service, tender customers and fuel stations associated with Delek Israel under operating contracts and supply contracts for the purchase of fuel and oil.

B. The direct marketing customers: these include institutional clients including entities that are required to perform tenders, business clients such as industrial companies, watercrafts and transportation companies, infrastructure contractors, kibbutzim, moshavim (cooperative settlements), construction companies, quarries, etc. Most of the agreements with the direct marketing customers are for short and fixed periods.

Since the maximum margin for petroleum products is a fixed amount (due to the government's price control), which is not affected by fluctuations in the prices of gasoline/excise tax, and the same applies to uncontrolled products, there is no built-in remuneration for financing costs and credit risks in times of customers' credit growth due to a rise in fuel price and an increase in excise tax.

9.4.2 Below is a breakdown of sales in the Retail Areas (including excise and VAT) in the years 2004-2006 by type of customers whose total revenues constitute 10% or more of Delek Group revenues (in thousand of NIS and % of total Delek Group revenues):

	2006		2005		2004	
Type of customers	**NIS thousands**	**% of Revenues**	**NIS thousands**	**% of Revenues**	**NIS thousands**	**% of Revenues**
Corporate (incl. tenders, Dalkan and operating / supply stations)	2,847,465	10.8%	2,471,185	12.1%	2,127,527	14.9%

9.5 Marketing and Distribution

Set forth below is a brief description of the Company's marketing methods.

9.5.1 Marketing at Fuel Stations

Marketing to the public – Delek Israel promotes its products and services in number of ways: discounts, national or station-specific sales and by using sales promoters (for example, handing out newspapers free of charge or at discounted prices to customers buying fuel at certain prices or car wash at discounted price), and advertising through various media. In addition, Delek Israel invests in the maintenance and upgrading of its fuel stations and the services provided therein, the renovation of old stations and improvement of their exterior, as well as expands the variety of services offered by service stations. Delek Israel also cooperates with other companies (such as insurance companies) in the joint advertising and promotion of their products.

Marketing of the refueling control system ("Dalkan") – Delek Israel employs in-house marketing staff as well as hires sales promoters to add new customers to the Dalkan automated refueling and billing service, In addition, Delek Israel participates in tenders published by companies with large vehicle fleets that seek collective arrangements for the fueling service.

In addition, Delek Israel operates a regional fueling service through an electronic card ("the stations owner card"), which allows small private companies to obtain credit and discounts on the purchase of fuel at fuel stations adjacent to their business.

9.5.2 Expanding the Nationwide Chain of Fuel Stations, Convenience Stores and Retail Areas

A. Delek Israel employs a development manager to identify potential locations and entities interested in partnering up with the Company for the purpose of setting up fuel stations. In the next two years Delek Israel plans to reach a nationwide chain of more than 100 convenience stores, that is, to set up over 70 additional stores (whether operated by the Company or

through franchise. This information is forward looking, and it may not materialize, inter alia, due to difficulties in obtaining the necessary licenses for establishing Retail Areas (in order to set up a retail outlet Delek Israel is sometimes required to change the municipal building plans which applies to Retail Areas, to obtain building permits, and more), regulatory changes that might impede the construction of additional outlets, more lucrative investment opportunities, heightened competition among convenience stores, an economic recession that would weaken sales in convenience stores and more.

B. In 2004, Delek Israel, in cooperation with Delek Real Estate, established Delek Retail Areas Ltd. (hereinafter: "**Delek Retail Areas**"), a private company jointly owned by Delek Israel and Delek Real Estate (50% each). Delek Retail Areas is engaged in identifying and purchasing fuel stations, land for the development, planning and construction of fuel stations and convenience stores adjacent to commercial centers. As at the report date, Delek Retail Areas acquired eight land areas on which it intends to operate in this manner (two already have active fuel stations and commercial centers, three will begin operating by May 2007 and three are in planning stages).

9.5.3 Marketing and Distribution in the Direct Marketing Segment

Under the direct marketing activity, Delek Israel operates a marketing and sales system, either itself or through subsidiaries and investee companies. The transportation of petroleum products in the direct marketing segment is mainly conducted through the subsidiary Shal-Del, while additional transportations are conducted by the customers, through sub-contractors hired by Delek Israel.

9.5.4 Exclusive Agreements

Delek Israel has an exclusive representation agreement, immaterial to the Company, with International Exxon Mobile for the marketing of its lubricants in Israel. The agreement is effective through December 2009 and can be cancelled under such terms and conditions as acceptable in similar agreements.

In addition, Delek Israel has supply agreements with fuel stations for the exclusive supply of fuel products during the period of the engagement.

9.6 Competition

9.6.1 According to data published by the Fuel Administration, there are 30 fuel companies registered in Israel, which are licensed to acquire petroleum products from ORL. Together, the four companies hold the largest market share in Israel. As stated in section 9.1.10 above, Delek Israel estimates that it is the second largest fuel marketing company in Israel. Its main competitors are Paz Petrol which, pursuant to a prospectus published in November 27, 2006, markets petroleum products to 257 fuel stations (26% of the total number of fuel stations), Sonol Israel which, according to Company's estimates, markets to 215 stations (22%) and Dor Alon which, according to Company's estimates, markets to 160 stations (17%). According to the Dor Alon-Sonol verdict[1], Delek Israel has 24% of fuel stations, Paz has 27% of total fuel stations, Sonol 23% and Dor Alon 17%.

9.6.2 The Israeli petroleum market is characterized by fierce competition in all the areas of operations of Delek Israel, as follows:

Expanding the nationwide chain of fuel stations, whether by identifying new locations and setting up new stations or through agreements with long-standing fuel stations whose operating/supply contracts have expired.

A. Marketing to end consumers and increasing sales in fuel stations. This competition is reflected in the erosion of marketing margins, discounts and sales promotions, the range of services offered in fuel stations and convenience stores.

B. The entry of fuel companies and retail companies into retail activity in the premises of the fuel stations.

C. The competition in the direct marketing segment has become aggressive, both due to the factors driving competition in the petroleum market in general and due to issues that are unique to this segment. Since the bulk of supply is carried out directly to the customer,

[1] AA 3398/06 The Anti-Trust Authority vs. Dor Alon Energy Israel (1988) Ltd. et al.

independent of the physical location of the marketer (i.e. the fuel station), there is a fierce competition among companies for every customers, and no relative advantage to anyone. The competition in the direct marketing segment stems, in part, from the fact that some of the petroleum products are generic, with limited importance as to their origin and/or quality, as well as from the low transfer costs (both for the customers and the fuel companies) and the terms of engagement with clients under tenders or short-term agreements.

9.6.3 Set forth below are the ways in which Delek Israel confronts competition and the factors affecting its competitive status.

A. Delek Israel is working to expand the nationwide chain of its fuel stations and estimates that a wide distribution of stations across the country increases their accessibility and provides it with an advantage vis-à-vis private customers and customers using the Dalkan automated refueling system, to whom a wide distribution of fuel stations is especially important.

B. The Company is introducing unique petroleum products (such as the "Dragon" fuel, which includes additives that improve the engine's efficiency) while working to enhance the high-quality reputation of its fuel products.

C. Expanding the marketing of additional products and services in fuel stations on the basis of existing infrastructures.

D. Improving the design, atmosphere and service in fuel stations.

E. Improving the stations' operating structure.

F. Ability to provide credit to customers.

G. A developed and monitored marketing system, with a high-level control mechanism.

H. Ability to manufacture and supply large quantities when necessary (in the direct marketing segment).

9.7 Seasonality

In general, Delek Israel is not affected by seasonality. At the same time, in recent years there was an increase in the sale of fuels in fuel station during the summer which, the Company believes to stem, among others, from a rise in travels by car to vacation sites and the use of air conditioning, which increases petrol consumption. On the other hand, during holidays the petrol consumption in the business sector and in industry declines.

The effect of seasonality does not apply to most of the direct marketing products. However, sales of diesel oil and oil for domestic heating as well as to industrial companies increase during the winter that is, in the first and fourth quarter of each calendar year. In addition, Bitum's thermal insulation products are seasonal both with respect to sealing and insulation and are mostly used in the spring, summer and autumn, while in the winter (the second half of the fourth quarter and the first quarter) demand for these products drops, as due to weather conditions, it is difficult to effectively utilize most of the insulation products.

9.8 Production Capacity

The maximum production capacity for lubricants at the Delkol plant is 40,000 tons a year. The current annual production capacity of lubricants is 17,000 tons. The maximum production capacity for chemical products at the "Bitum" thermal insulation plant is 21,000 tons a year. The current annual production capacity of chemical products is 14,500 tons.

9.9 Fixed Assets and Facilities

9.9.1 Delek Israel owns 34 fuel stations (including 8 stations in joint ownership with third parties and Delek Retail Areas) and 149 stations that are leased or rented under long-term agreements in a nationwide distribution, a plant that supplies fuel oil in Ashdod, a bitumen production plant and a plant for the manufacture and mixing of lubricants in Lod.

Delek Israel operates 117 fuel stations, 45 stations are operated by third parties on behalf of the Company under operating agreements and 65 stations are operated by third parties under supply

agreements. All the Company's fuel stations carry the Delek Israel logo and sell its products exclusively.

All the "Menta" convenience stores are operated by Delek Israel, which purchases the inventories, and bears the risk involved in the operation of convenience stores. In the future, Delek Israel may examine the possibility of operating its convenience stores through franchises.

Listed hereunder are Delek Israel's fuel stations, classified according to real estate rights in the land and terms of operation, as of the reporting date.

Type of station	Self operation	Operation by Delek-appointed operator	Operation by contractor (supply)	Total
Ownership and ILA lease	20	13	1	34
Handicapped	11	3	10	24
Rent under three years	26	17	4	43
Rent above three years	60	12	6	82
No proprietary rights (supply)	--	--	44	44
Total	117	45	65	227

9.9.2 Delek Israel's fixed assets include buildings and equipment in most of the public fuel stations in which it has proprietary rights. In addition, it has equipment installed in all the stations in which it has no proprietary rights or for which it has short-term lease agreements. The Company's equipment in its stations includes all the facilities necessary for operating these stations including tanks, pipes, pumps, computer and communication systems, office equipment, electricity systems and generators, fire extinguishers and toilets for the public. Delek Israel also has vehicles and trucks for the transportation of fuel and oil products.

9.9.3 The Company's fixed assets in the direct marketing segment includes the equipment in its inner fuel stations, including infrastructure, tanks, pipelines, pumps and designated tanks in customers' premises.

In addition, Ionex has a petrol supply plant in Ashdod, which it leases to Ashdod Port Ltd. pursuant to an agreement in effect until December 31, 2007. Ionex also owns three barges for fueling ships in the ports of Haifa and Ashdod.

Delkol has a plant in the city of Lod, the total area of which is 50,000 m2, of which 30,000 m^2 are owned by Delkol and the rest is leased from ILA. [The plant includes lubricant mixing facilities, packaging facilities, lubricant renewal facilities, facilities for the manufacture and recycling of solvents, a central plant for sewage treatment, warehouses and laboratories as well as various buildings and office].

The Bitum plant is situated in the industrial zone of Haifa Bay covering an area of 11,000 m^2, most of which is owned by the Group (Delek Israel, Delek Investments) and part is leased from the Israel National Fund (in January 4, 2004, the leasing fees were capitalized for a period of 46 years). The plant includes industrial buildings, including production plants, offices, warehouses, facilities and sheds.

9.10 Intangible Assets

Delek Israel operates under several well-known, protected labels: "Delek", "Gal", "Menta", "Delkol" and "Dalkan Delek". In addition, the Company is selling products from other labels, such as "Delek Dragon" (petrol), Desko and Mapco export lubricants, and has an exclusive franchise for the import and marketing of Exxon Mobile's lubricants and other branded products in the field of tar insulation: BTI, Multigag and Mastigum. Delek Israel has a registered trade mark for the Bitum name. The Company has registered trade marks for the Mastigum and Flexigum products in the Ukraine and Eastern Europe.

9.11 Human Capital

9.11.1 As of the reporting date, Delek Israel employs 1394 persons as follows:

Department	Number of Employees
Management/headquarters	106
Production	45
Operations	117
Fuel stations	129
Sales & Marketing	997
Total	1,394

The number of employees at Delek Israel has not changed significantly over the last three years

9.11.2 Most of the workers at Delek Israel are employed under personal employment contracts and are not subject to any collective work agreement, except for 117 employees in the two subsidiaries. Delek Israel pays bonuses to its employees in line with their performance and subject to the approval of the board of directors.

9.11.3 Delek Israel only employs road tanker drivers that hold a license for the transport of hazardous substances. In addition, company employees that work in fuel stations or that come into contact with petroleum products undergo extensive training on fire extinguishing and prevention of environmental hazards.

9.11.4 In July 2005, as part of the approval of the employment conditions of the new CEO of Delek Israel, Delek's Board of Directors approved, among other things, the granting of stock options representing 5% of the issued and outstanding share capital of Delek, at no consideration, to the CEO of Delek Israel. The CEO of Delek is entitled to exercise the options over a period of 5 years from the date of commencement of employment, at terms and exercise price as determined in a detailed agreement to be signed by the parties. The terms of the option were formulated as at the date of approval of the financial statements.

9.11.5 **Raw Materials and Suppliers of Petroleum Products and Lubricants**

A. The main petroleum products used by Delek Israel

The main petroleum products used by Delek Israel are oil distillates produced from crude oil which is purchased and trade on global stock markets. The bulk of oil distillates are acquired from the Haifa and Ashdod oil refineries and the rest are imported from overseas suppliers. Oil distillates prices are exposed to fluctuations in currency exchange rates and in global commodity markets.

The main raw material used by Delkol in the manufacture of lubricants is base oil, which is purchased from Haifa Base Oils Ltd. (in which Delek Israel holds 11.5%) as well as from overseas suppliers, as well as additives that are purchased from various suppliers in Israel and abroad. In addition, Delkol imports lubricants and finished products from overseas suppliers (Exxon Mobile). The main raw materials used by Delkol in the manufacture of chemicals are petroleum products, which are purchased from overseas suppliers and undergo distillation and additional processing at the Delkol plant.

The main raw materials used by the Bitum plant are bitumen and polymers. Bitum purchases the bitumen from Delek Israel and the felts and polymers from several local or overseas suppliers.

In the years 2006, 2005 and 2004, Delek Israel purchased 80.4%, 86.0% and 84.6%, respectively, of the petrol and diesel oil products it sold from ORL, pursuant to an annual purchase agreement. The remaining products were imported from overseas suppliers (mainly Vitol and Glencore).

B. Agreements with major suppliers

1. Local suppliers

Until the privatization of Ashdod Oil Refineries, the supplier of the Company's petroleum products was ORL. The products were purchased from ORL in accordance with a fixed agreement.

As of January 1, 2007, the acquisition of petroleum products from the oil refineries in Ashdod is subject to the terms of a purchase agreement dated February 20, 2007 between Delek Israel and Ashdod Oil Refineries Ltd. (hereinafter – "ORA"). Pursuant to said agreement, the purchase of petroleum products from ORA is carried out in monthly orders. The selling prices of these products have been established in the agreement and are calculated according to a price formula derived from fuel prices in the Mediterranean basin. The purchase of products from Haifa refineries is carried out according in the same manner. Delek Israel is dependent upon its local suppliers.

2. Imports of petroleum products

From time to time Delek Israel imports petroleum products from global petroleum suppliers, in cases where the cost of imported petroleum products is cheaper than the local supply. At the reporting date, Delek Israel has two framework agreements for the purchase of petroleum products from two international suppliers: Vitol Energy S.A. and Glencore Energy UK Ltd. which account for the bulk of Delek's imports. The import price for international trade companies is determined by a formula which is based on local rates.

The aforementioned framework agreements include, *inter alia*, an undertaking by Delek Israel to purchase certain quantities of petroleum products, occasionally with an option for certain changes in the quantities and price.

Additional imports are carried out in spot transactions. Delek Israel enters into such transactions in cases where the quantities purchased under the aforesaid framework agreement do not meet the Company's supply needs on that month. Spot transactions are an acceptable trading practice in this market, and the terms of these transactions correspond to the terms of the framework agreements.

9.12 Working Capital

9.12.1 **Raw Material Inventory Policy** – Delek Israel inventory policy is to hold base oils for an average of up to 60 days.

9.12.2 **Finished Product and Emergency Inventory Policy** – Delek Israel is obligated by the Emergency Regulation to hold an emergency supply of gasoline and diesel fuels for the state. Most of the costs and financing are covered by the State.

9.12.3 **Operations Inventory** – It is the policy of Delek Israel to hold in inventory fuel supplies for an average 30 days and oil and retail products for an average of 60-90 days.

9.12.4 **Credit Policy**

A. Customer Credit: Delek Israel provides credit to its customers for a period ranging between Net + 5 days (end of the month plus 5 days) and Net + 90 days –depending on the product and customer. The average period of credit to customers in the years 2006, 2005 and 2004 was about 58 days, 60 days and 60 days, respectively. The average annual volume of credit to customers in the years 2006, 2005 and 2004was NIS 1,253, NIS 1,200 and NIS 1,150 million, respectively.

B. Supplier Credit: Delek Israel receives credit from its suppliers abroad for 30 days. Delek Israel pays ORL in the middle of the months for products purchased and receives advanced payment interest of 30 days. Payment of excise taxes (which is a significant amount of the cost of fuel) is done ten days after it has received it, according to the law.

C. Working Capital Deficit: The differences between the amount of credit given to customers and received from suppliers and tax authorities (Delek pays the government before it receives the

money from the customer) forces Delek to take short term loans. As at Dec-31-2006, Delek Israel had positive working capital of NIS 34 million. As at Dec-31-2005 and Dec-31-2004, Delek Israel had a working capital deficit of NIS 60 million and NIS 160 million, respectively. It is Delek Israel's policy to reduce the deficit by cutting the period of credit given to customers.

9.13 Investments

9.13.1 Delek USA - Delek Israel holds 3.33% of the share capital of Delek Hungary, which hold 77% of Delek USA. For additional details on the activity of Delek USA in the field of oil refining, petroleum products and fuel stations in the USA, see sections 7 and 8 to the report.

9.13.2 The American-Israeli Gas Company Ltd (hereinafter – "Amisragas") – Delek Israel has a 39% effective minority interest in Amisragas, which is a associated company engaged in the marketing of gas to industry, commerce, agriculture, hotels and for domestic use. Amisragas' remaining shares are held by Mr. Raphael Paradis indirectly through companies under his control. Three of the eight directors in Amisragas represent Delek Israel. Apart from the acquisition of LPG and its supply to Amisragas, Delek Israel does not have any agreements with Amisragas.

9.13.3 Pi Glilot – Delek Israel has a 15.3% holdings in Pi Glilot Oil & Pipe Terminals Ltd. (hereinafter – "**Pi Glilot**"), a mixed company as the term is defined in the Government Companies Law, together with Paz, Sonol and Sonefco Bank Street Corporation (hereinafter: "**Sonefco**") and the State of Israel (21.5%, 13.2% and 50%, respectively). Pi Glilot owns the real estate rights in storage and supply facilities of petroleum products in Jerusalem (an area of 76,000 m^2), in Beer Sheva (an area of 87,000 m^2) and in Ashdod (320,000 m^2). These facilities contain tans farms where the different petroleum products are stored. As of the reporting date, Pi Glilot is engaged in the paid storage and supply of petroleum products to gas companies. The maximum prices paid to Pi Glilot for the storage and supply services are prescribed in the Control of Prices of Commodities and Services Order (Infrastructure Rates in the Fuel Economy) (Temporary Order), 1995.

In addition, Pi Glilot owns real estate rights in the Pi Glilot site in Ramat Hasharon, covering about 170,000m^2, which used to include a storage and supply terminal. As of the reporting date, The Israel Land Administration is promoting a municipal building plan under which the area, including the Pi Glilot site, will be developed for housing, commerce and employment purposes. In the opinion of Delek Israel, which is based on actuarial assessment, if the changes to land use designation, as aforementioned, are completed, the value of this property may increase. This is forward-looking information, based on actuarial evaluations, the assumption that said municipal building plan will be accepted, the demand for real estate on the site and others, and it may not materialize.

Pursuant to a district court ruling dated June 11, 2002, in 2004 Pi Glilot ceased all business activity concerning the supply of petroleum products from the Pi Glilot site on Ramat Hasharon. At present, Pi Glilot is providing storage and supply services to the fuel companies from its three remaining sites. However, under an agreement between the shareholders in Pi Glilot and an agreed-upon order that was approved by the Antitrust Tribunal, Pi Glilot is earmarked for voluntary dissolution and the cessation of all activities.

The privatization of Pi Glilot

In May 18, 2005, the Government of Israel's Ministerial Committee for Privatization has passed a resolution on the privatization of Pi Glilot is several stages. The resolution laid down principles for the sale of Pi Glilot's operation in the three supply terminal in Jerusalem, Beer Sheva and Ashdod as a going concern, each terminal separately or the three of them jointly. The Ashdod terminal and the Jerusalem terminal were designated to be sold to two different companies. The sale of the operation is subject to the sale of all three terminals, as stated above. The proceeds from the sale of Pi Glilot's assets will be used to repay its debts to different banks. After the sale of the three terminals and a number of additional assets, Pi Glilot shall be voluntarily dissolved and its real estate in the Pi Glilot site in Ramat Hasharon will be transferred to the ownership of the shareholders in Pi Glilot according to their proportionate holdings in Pi Glilot.

In the wake of the ministerial committee's resolution, on June 26, 2005, an agreement, which was amended on July 18, 2006, was signed between all the shareholders of Pi Glilot, for the sale of Pi Glilot's assets and its voluntary dissolution in a procedure conducted by an external committee, which will include a representative of the Government of Israel and an objective representative of the fuel companies. The principals of this agreement are as follows:

A. Pi Glilot will sell its existing operation in the three supply terminals and in additional assets, except for the real estate in the Pi Glilot site (hereinafter – "Pi Glilot Real Estate"). The proceeds of these sales will be used to repay Pi Glilot's debts to its creditors.

B. Pi Glilot will then be dissolved and the rights in the Pi Glilot Real Estate will be transferred to its shareholders, in line with their proportionate holdings in Pi Glilot. Delek Israel's share in Pi Glilot is, as aforesaid, 15.3%.

C. Under the sale of these terminals, arrangements will be made in relation to Pi Glilot employees, in order to enable their employment, insofar as possible, by the companies that acquire the terminals.

D. The main provisions of the agreement relating to the sale of the assets and the dissolution of Pi Glilot, will become effective only upon the fulfillment of several preliminary conditions (within 60 days), as follows: (1) applying to the court for approval of an agreed-upon order to which the Antitrust Commissioner, the fuel companies and Pi Glilot had consented; (2) receipt of creditors' agreement; (3) receipt of an agreed-upon version of the resolutions of the board of directors and general meeting of Pi Glilot; (4) delivery of Pi Glilot's proposal on the matter of the allocation of activities and assets to each of the supply terminals earmarked for sale, as well as a list of the additional assets offered for sale and the details of all the rights and obligations relating thereto.

Along with the above agreement, the fuel companies and Pi Glilot provided their consent to an agreed-upon order pursuant to section 50b of the Antitrust Law (hereinafter - "the **Agreed-Upon Order**") with respect to the cessation of any joint activity of the fuel companies and Pi Glilot. This order was approved by the Antitrust Tribunal.

On November 8, 2006, the creditor banks (hereinafter – "**the Banks**") of Pi Glilot gave their consent to the privatization of the company, whereupon the last suspending condition for the privatization of Pi Glilot was fulfilled. The banks' consent was given following the consent of Pi Glilot's shareholders to provide guarantees, as per their proportionate holdings, in favor of the banks, in an aggregate amount of NIS 100 million, in case the proceeds from the privatization of Pi Glilot do not cover its debts to the banks.

On December 7, 2006, the procedure for the sale of Pi Glilot's terminals was published, pursuant to which the sale of the terminals will be conducted in an egalitarian procedure by way of competition between the offerers (and not by way of a tender) in several stages and according to schedule[1].

Delek Israel has submitted its application for the acquisition of Pi Glilot's operations and terminals (except for the terminal in Ramat Hasharon, which will be divided between the shareholders of Pi Glilot in proportion to their holdings therein), pursuant to the provisions of the procedure. Delek Israel's application has not yet been approved, and a date has not been determined for the submission of a price proposal by the approved applicants.

9.13.4 RoadChef – On March 1, 2007, Delek Belron (a wholly-owned Delek Real Estate subsidiary) entered into an agreement for the acquisition of all the share capital of a British company that holds 29 Motorway Service Areas in the UK, under the RoadChef brand. These include filling stations operated by the acquired company, 15 hotels (consisting of 600 rooms), restaurants, stores and coffee stalls operated by the acquired company through franchise holders (such as: Costa Coffee, Pizza Hut, Wimpy, Burger King), convenience stores and recreation and entertainment areas – all with an overall constructed area of 60,000 square meters, on 240 hectares of land.

The acquisition of shares will be made through a foreign subsidiary that was established for the acquisition, of which 25% are held by Delek Israel and 75% by Delek Real Estate. Subject to obtaining third party approval (necessary for changing control over the acquired company), Delek Israel will acquire 25% of the shares from the sellers upon closing, while also assuming 25% of the rights and liabilities, pursuant to the acquisition agreement. The significance, in the event that the approvals are obtained, is that upon closing, Delek Belron will acquire 75% of the shares from the sellers, while Delek Israel will acquire 25% of the shares from the sellers, at identical terms and with no mutual guarantees between the companies. For further details regarding the said investment, see Section 12.9.5, below.

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[1] For additional details see procedure of Pi Glilot's sale on www.gca.gov.il

9.14 Financing

9.14.1 Following below is the average interest rate on loans from bank and non-bank sources that were in effect in 2006 and are not intended for an exclusive purpose by Delek Israel:

		Average Interest Rate	
		Short-Term Loans	**Long-Term Loans**
Bank Sources	Shekel (non-linked)	5.2%	---
	CPI Linked	---	---
	FX Linked	---	5.%5.
Non-Bank Sources	CPI Linked Debentures	---	5.2%
	USD Linked Debentures	6.3%	---
	Non-linked Shekel Traded Securities	5.3%	---

9.14.2 Credit Limitations – Delek Israel has provided irrevocable obligations to a number of banks in Israel (hereinafter: "**The Banks**"), where:

The equity on the consolidated balance sheet of Delek Group cannot fall below NIS 680 million.

The profit from Delek Group operations has to be greater than financing expenses for all non-recourse loans that were given to the Delek Group companies with the addition of finance expenses for the purchase of emergency inventory of fuels plus 140% of the other financing expenses of the Delek Group.

If these terms and conditions are not fulfilled, the banks can sue to receive other guarantees or to reduce the amount of credit given to Delek Israel. The obligations to each bank are in effect for each period where the debt to that bank is not less than $50 million (and for some banks, $50 million or 60% of the open credit approved by the bank – the lower of the two).

As of the date of this report, Delek Israel is upholding its obligations.

9.14.1 **Liens**

In order to secure the debt to the banks, Delek Israel issued debentures to the banks collateralizing without limit, all of the inventory, proceeds and rights as defined in the debenture agreement. Moreover, Delek Israel has guaranteed all the debenture issues of Delek Petroleum from institutional entities and the proceeds obtained from the Delek Petroleum debenture issues were made available as a loan at identical terms to Delek Israel.

Delek Israel is obligated to a number of banks not to collateralize its fixed assets in any form without getting prior, written approval from the banks (with the exception which can be used as collateral in favor of the entities who have financed the assets' purchase).

In January, 2004, through the flotation of debentures by the parent company (Delek Petroleum), Delek Israel guaranteed in a permanent primary guarantee, without limit to amount, all of its rights in the loans of Delek Israel, to Delek Group.

Delek Petroleum also placed a lien on 25% of its share capital in Delek Israel in favor of Israel Discount Bank Ltd., in order to secure a loan taken by Delek Petroleum from Discount Bank.

9.14.2 **Credit Facilities**

Delek Israel's credit facilities from the banks at the date of this report total NIS 1,500 million, of which NIS 520 million has been utilized by Delek Israel.

9.14.3 **Credit Rating**

Delek Israel does not have a credit rating. However, the unsecured debentures floated by Delek Petroleum (Parent company) which also holds Delek USA, were given an A+ rating by the Israeli Ma'alot ratings agency.

9.14.4 Variable Interest Rate Credit

Following below are details of the variable interest rate credit that Delek Israel received in 2006:

Track	Interest Rate Range (2006)	Interest Rate in Proximity to Date of Report
Index linked	4.9-%5.3%	5.2%
Shekel	5.2%-%5.5	5.2%
Dollar	6.9-%7.2%	7.1%
On-call	5.25.-%5%	5.2%

9.15 Taxation

Aside from the regular corporate taxes (see additional details in note 33 of the financial statements) there is the Fuel Excise Law of 1958 and the Fuel Excise Law of 1980 both of which have a set tax on the fuel products detailed in the law which is updated every three months according to the CPI. In January, 2005 the authorities issued an order that they were raising the excise tax on gasoline and kerosene and will equalize the excise taxes of diesel fuel to gasoline over a period from 2005 until 2009. Excise tax component in fuels prices is highly significant. Petroleum companies are charged with excise tax directly upon issuing the fuel, with a 10 days credit, whereas the number of credit days granted by Delek Israel to its customers is significantly higher, especially on diesel fuel.

Delek Israel and its consolidated companies have losses (primarily capital losses) for tax purposes of NIS 50 million. A tax asset was not included in the consolidated balance sheet to reflect these business and capital losses, as it does not appear they will be utilized in the near future.

9.16 Environment

Delek Israel's operations, primarily in commercial and fueling activities are regulated under various laws, regulations and orders regarding environmental controls. Delek Israel acts constantly to minimize and prevent possible damaged to the environment and invests considerable resources in environmental controls. Delek Israel increased its investments in this area ever since water regulations (prevention of water pollution) (gasoline stations) 1997 were regulated, including comprehensive orders aimed at regulating this issue and prevent soil and water pollution. A trend of increased enforcement of environmental laws is evident in recent years. See section 9.16.7, below for details of pending indictment in this matter.

The laws, regulations and orders regarding environmental controls, applied to Delek Israel and effects thereof are as follows:

9.16.1 The Cleanliness Preservation Law

The Cleanliness Preservation Law, 1984 ("**Cleanliness Preservation Law**") places criminal responsibility on whoever throws waste (including petrol) in the public domain and or dirties the public domain. The Cleanliness Preservation Law grants authority to water law authorities and water regulations to levy fines, issue an order requiring the polluter to revert the condition or charge the offender with double expenses for reverting the condition.

9.16.2 The Water Law and Regulations

The Water Law, 1959 – (hereinafter: "**The Water Law**") charges with responsibility for polluting water sources. The Water Law grants state agencies extended authority, including authority to demand termination of the pollution, reverting the condition, levy fines and charge expenses.

Water Regulations (to prevent pollution of water) (gasoline stations) 1997 ("**Water Regulations"**) regulated by force of the Water Law include comprehensive orders aimed at regulating this area and prevent soil, water or air pollution.

The Water Regulations include, *inter alia*, orders obliging service station owners to install various protection means, including construction of sealed floor surrounded with a drainage system, maintain regular inspections, address and report leaks immediately and adapt old gasoline stations to the current standards.

As at the date of this report, it is not yet decided if a company which supplies petrol and maintains gasoline stations is regards as a supervisor or monitor of the station, therefore, Delek Israel may be considered as a station operator, which according to the regulations also assumes responsibility for stations operated by third parties on behalf of Delek Israel, or according to supply agreements.

Most of Delek's gasoline stations are located in areas that are at high risk from groundwater pollution. As at the this date, several gasoline stations were found to have soil and groundwater contamination due to past contamination and leaking fuel infrastructures. At these stations, experts are conducting soil surveys and monitoring drilling for the groundwater in order to characterize the nature of the contamination.

Once it has a clear picture of the nature of the contamination, the company will begin rehabilitating the soil and water with customary technologies, in conjunction with the Water Commission and the Ministry of the Environment.

The cost estimate for cleaning up soil and water contamination depends on its size and severity.

9.16.3 Monitoring Means in Old Gasoline Stations

Under the Water Regulations, Delek Israel is required to install monitoring means in all gasoline stations built before 1997 ("**Old Stations**") to detect oil leaks into the grounds of the gasoline station. Delek Israel installed the required monitoring means in the Old Stations.

9.16.4 Impermeability Tests

The Water Regulations require performance of regular impermeability tests (once every five years) of the pipes and tanks at all gasoline stations. As at the date of this report, tests were completed in the majority of Delek gasoline stations and the remaining tests are expected to be completed by 2010. Cost of these tests is immaterial to Delek Israel and will not affect its results significantly, unless soil or water pollution is detected.

9.16.5 Additional Environmental Requirements

A. In November 2005, the Ministry of the Environment published framework terms for gasoline stations. These terms enable the Authorities, under certain conditions, to carry out additional station infrastructure improvements that are not included in the water regulations published in 1997, e.g. sealing under the dispensers, installation of overfilling limiters and the installation of means for preventing cathode protection spillovers. The total cost of fulfilling these demands is approx. NIS 150 thousand per station.

   As of the report date, the company has received 10 demands for implementation. Part of these demands are under work, while for others, Delek Israel is preparing to conduct the work required in accordance with the timetables set out in the performance requirements

B. Delek Israel has been notified by the Ministry of Environment that they are considering the possibility of obligating operating gasoline stations to install vapors retrieval systems from vehicles petrol tanks into the station tanks during the fueling process. In parallel, there is a proposal to install similar equipment in the vehicles. Decision on the preferred method was not made as yet. If the gasoline stations operators will have to install the equipment, Delek Israel and/or station owners will have to allocate significant investments in this equipment.

9.16.6 Treatment of Soil and Water Pollution

Delek Israel received a demand from the Ministry of Environment to conduct soil and water survey tests in twenty four gasoline stations. These stations are at different stages of testing and treatment. Estimated cost of these tests and treatment in 2007 is estimated at NIS 11M, over the years 2007-2009.

9.16.7 Criminal Claims Related to Environmental Control

Failure to comply to the orders of the Water Law, and Water Regulations may consist a criminal offense, involving a one year prison sentence or a fine of up to NIS 350K, and heavier penalties in the event of an ongoing offense. Two lawsuits concerning environmental issues have been filed against Delek Israel and its managers.

9.16.8 Water Reservoirs and Soil Rehabilitation Fund

The Association of Oil Companies, of which Delek Israel is a member, is conducting talks with the related government offices with the purpose of setting up a fund that will cover the costs of locating

and repairing soil and water pollution resulting from past operations of gasoline stations and/or past leaks from gasoline stations.

In March 2005, the Knesset was presented with a draft law aimed at financing detection, location and treatment operations of gasoline stations. According to the draft law, the aforementioned fund's expenses will be covered by the fuel companies, such that every oil company will transfer NIS 0.01 for each liter of gasoline it sells to a fueling station, and NIS 0.005 for each liter of diesel oil that it sells. The aforementioned draft law includes a proposal that the control order (which sets the maximum price for 95 or 96 octane gas) be amended, such that the maximum fuel price will be supplemented with a "rehabilitation increment" of NIS 0.01 per liter. According to the proposal, a fuel company that complies with the provisions of the law, should it be passed by the Knesset, will be entitled, under certain conditions, to be reimbursed by the fund for expenses it incurs during implementation of the gasoline station treatment program, and will also be exempt from responsibility for the contamination.

It is not possible for Delek Israel to assess whether the draft law will pass or not and when. If this proposal passes as a law, the law may hedge the required costs of the company to comply with the related Environmental Control law orders.

This information is forward-looking information, and there is no certainty that the proposed law, in its current version or otherwise will be approved.

9.16.9 Intensified Enforcement of Diluted Fuels Sales Prevention

In early 2005, The Knesset approved the first reading of a vehicles operation law proposal (engines and petrol) (amendment No. 3) (intensified enforcement against sales of petrol which fails to comply with the standard requirements) – 2005. This law proposal aims at minimized the occurrence of sale and delivery of gasoline blended with diesel fuel, kerosene, heavy fuel and other substances, priced and taxed at significantly lower rates than gasoline.

This law proposal obligates every gasoline station operator to conduct six annual tests at list to verify product quality by an authorized laboratory. The proposed law increases the sanctions on non-standard oil products significantly, including administrative closure orders, publication of names of gasoline stations which sell non-standard products and significantly higher fines.

9.16.10 Fuel Distribution Facility

The Ministry of Environment has demanded of Delek that it install in its distribution facility in Haifa, a vapors retrieval system to treat gasoline vapors collected from petrol tanks of stations when these tanks are being filled. The installation and operation of the system is expected to be completed by March 2007.

9.16.11 Bottom Filling System

According to regulations of the Ministry of Transportation Delek Israel is required to install a bottom filling facility in its distribution facility and in petrol tankers in order to prevent environmental pollution during the filling of these tankers. As at the date of this report, Delek has completed the installation at its distribution facility in all its tankers.

9.16.12 Fuel Oil Distribution Facility in Ashdod

Ionex (a Delek Israel subsidiary – 75%) operates a fuel oil distribution facility that it leases from Ashdod Port Company until Dec-31-2007. Due to demands from the Ministry of the Environment, land surveys were conducted at the site and no unusual findings were identified. Consequently, no special removal, land treatment or ground water treatment activities are required. Nevertheless, demands were raised to make special investments in preventing future contamination. These investments are expected to be significant, although pursuant to the Ionex agreement with Ashdod Port, Ionex is not obligated to cover these costs.

9.16.13 Hazardous Materials

According to the Hazardous Materials Law, 5763-1993 "the Hazardous Materials Law"), oil distillates are defined as hazardous materials. The Hazardous Materials Law stipulates the duty to possess a Toxic Permit issued by the supervisor who is authorized to do so by the minister of the environment. Delek Israel has the aforementioned permission to maintain hazardous materials according to the definitions specified in its permit, and trade in fuels without storage.

9.16.14 Expected Significant Costs of and Investments in Environmental Control

Delek Israel's investments and costs during the years 2004, 2005 and 2006 amounted to NIS 2.3, 3.3 and 2.7 million respectively in complying with legal orders and requirements of authorities in environmental control area (excluding investments in building new gasoline stations according to the stipulations of the environmental control law.

Since the old gasoline stations of Delek Israel (about 134 stations) were built according to standards preceding the application of the Water Regulations, and since accumulated knowledge indicates that the required standards of that period cannot ensure prevention of damage to the soil and/or the water, Delek Israel cannot estimate which of its old stations polluted the soil or the water surrounding the stations. If such pollution, unknown at the date of this report, are detected, Delek Israel, estimates that it will be required to allocate significant investments to that end.

Detailed estimated costs and investments during the next few years is as follows (in NIS thousands):

	2007	2008	2009
Expected Significant Costs	3,700	4,800	4,600
Expected Significant Investments	3,000	3,000	3,000
Total	6,700	7,800	7,600

This information on the estimated costs and investments is to be considered forward looking information that might not be realized in the future if Delek Israel is found to be in breach of regulations or if new regulations issued by the Ministry of Environment will come into force obliging Delek Israel to allocate additional funds.

9.16.15 Operation of Delek Israel in internal gasoline stations located in customers' premises, within the direct marketing segment is also subject to the stipulations of the Water Regulations, as details in section 9.16.3, above. The gasoline station operator is held responsible for implementing the stipulations of the water regulations, as defined by these regulations. The court may rule, if the matter is brought up for its ruling, that in view of the current conditions of the agreement between the company and the owner of the internal station, that the company is also considered to be a "station operator". See section 9.17 above for details of the responsibility of a "station operator".

9.16.16 The subsidiary DELKOL, removes industrial waste according to the stipulations of the Environmental Control laws. In addition, operation related to infrastructure and sealant products is subject to comprehensive control, aimed at preventing adverse effect on the environment. A trend of intensified law enforcement in this area, in recent years, has mainly affected investments required to build and maintain bitumen tanks, requiring constant heating.

9.17 Limitations and Supervision of Delek Automotive Operations

Below is a description of the main limitations and supervision that apply to Delek Israel, in addition to the supervision concerning environmental quality described above:

9.17.1 Legislation Specific to the Fuel Industry:

A. The Arrangements in the State Economy Law (legislation amendments for achieving the budget and economic policy goals for fiscal year 2001), 5761-2001 (hereinafter: "the State Economy Law") – this law stipulates that a fuel company will register with the registry before it begins its activity and will continue to operate as long as it is registered in the registry run by the Fuel Administration' director. Delek Israel has been registered in the Fuel Administration Register since the year of its establishment. It should be further noted that the Arrangements Law stipulates that a fuel company must maintain, at its own expense, a stock of fuels, as will be determined by the National Infrastructure minister in consultation with the defense and finance ministers, and that by virtue of the Arrangements Law, the state has promulgated regulations[1] that establish this matter. In November 2002, the Supreme Court approved an

[1] The State Economy Arrangements regulations (legislative amendments for achieving budget and economic policy goals for the 2001 fiscal year) (holding stock and defense stock of fuel), 5761-2001.

arrangement obligating maintaining an security inventory. However, the State can change the present status and require maintaining a civilian inventory.

B. Fuel Industry Law (encourage interest in competition), 5754-1994 - The law stipulates limitations on the opening of new gasoline stations near stations marketing the products of the same fuel company or operated by the same operator. The provisions of the law are in effect until the end of June 2008.

C. Fuel Industry Law (forbidding the sale of fuel to specific gasoline stations), 5765-2005 – This law, forbids the sale and supply of fuel to gasoline stations unless they are on the list that the fuel Administration manages.

D. Supervision over Infrastructure Service Tariffs – Infrastructure services provided to the various fuel companies, include, among other things, unloading, pumping, storage and distribution of fuel products. Delek Israel has been issued with such a production license, which it renews each year are provided, as of the report's date, to all recognized fuel companies at tariffs set by the supervision ordinance on prices for commodities and services (temporary order) (infrastructure tariffs in the Fuel Industry) 5756-1995 (hereinafter: "**Infrastructure Tariff Ordinance**"). This ordinance comes to ensure the collection of the maximum price for the various infrastructure services.

E. Excise Taxes – According to the Excise Tax Law, no person shall manufacture fuel nor deal with its sale unless he has received a license for such from the Director of Customs and Excise Tax. Delek Israel has been issued with such a production license, which it renews each year. The excise is applied to fuel at the time it is issued at the distribution installations or when it is released from customs in the case of import. As a result of this, only companies holding such a manufacturing license may purchase petroleum distillates from the Israel Refineries or import them.

The Excise Tax Ordinance on Fuel (applying the Excise Tax), 5764-2004 (hereinafter: The "**Excise Tax Ordinance**") states the specific rates of the Excise Tax for each fuel product. During January 2005, the Excise Tax on Fuel Ordinance went into effect (Amendment 3 and temporary order), 5764-2004, and the Excise Tax on Fuel Ordinance (exemption), 5765-2004, according to which, the Excise Tax rate on diesel fuel and kerosene will be raised to be equal to that applied to gasoline, progressively from 2005 till 2009. In the Company's estimation, based on past experience, the aforesaid change may have a negative effect upon its business results, mainly because of the gap between the payment of the Excise Tax in cash by the Company and the time elapsed until it is collected from the consumer.

9.17.2 Price Controls

A. Supply of Fuel Products by ORL to the Fuel Companies - ORL was previously declared a monopoly in the refinement of crude oil in Israel. Some of the prices of fuels sold by ORL are set by the Commodities and Services Control (maximum prices for fuel products sold by ORL) Order, 1992 (hereinafter: "**ORL Price Order**"), which sets the maximum prices for various fuel products ex-works at ORL (see Section 9.1.2, above). The ORL ex-works price is updated on the first of every month according to the external price of the petroleum product with a surcharge or deduction a sum set by the Fuel Administration director. As of now, after privatization of the oil refineries, the price update mechanism has not changed.

B. Price to the Consumer – Commodity and Services Control Order (Maximum Prices at Gasoline stations) 5762-2002 – According to this regulation, the maximum price for 95 and 96 octane gasoline sold at a self service pump is fixed, as are the date and methods of its update.

9.17.3 Essential enterprise – Delek Israel and the filling stations have been declared Essential Enterprises as approved by the Ministry of Industry, Trade and Labor. According to this approval, during an emergency, the Company's vehicle fleet and the filling and distribution installations are mobilized to the good of the National Economy Emergency System in order to regularly supply fuels and gas.

9.17.4 Weights and Measures Ordinance of 1947- (hereinafter: "Weights Ordinance") - The Weights and Measures Ordinance stipulates standards for weights and states that the liter is the way to measure volumes.

The Weights Ordinance stipulates a number of offenses amongst them the refusal to cooperate with the inspector, the owning for the purpose of use, of faulty or non-checked equipment or such without a certificate of approval from the inspector, or are false instruments.

By virtue of the Weights Ordinance, regulations were set that stipulate, among other things; how liquid fuel pumps are to be inspected and calibrated, the obligation to place a calibration seal on the pumps after they are inspected and calibrated by the inspector.

Also, the regulations issued under the Weights Regulations specifies certain specifications for equipment that measures fuel in tankers, including setting a calibration seal upon such instruments.

The Weights Ordinance prohibits the use of said equipment, unless they have been calibrated and sealed in accordance with the Weights regulations

9.17.5 Operational Licenses for Operating Gasoline Stations:

The licensing process for new gasoline stations is a long and complicated one that requires large investments and obtaining many approvals and licenses from multiple authorities. This process is regulated under many laws which bestow licensing powers to various governmental authorities. Below are the main ones:

A. Planning and Building Law 5725-1965 (hereinafter: "The Planning Law") and the Regulations issued hereunder – By virtue of this law, the National Planning Council approved a "National Plan for Gasoline stations" stipulating the criterion and conditions for the building of filling stations. According the Planning Law and the regulations hereunder, any use of land - for the building of any structure, or use of any structure – needs approval. Quite often, the construction of a filling station requires a change in the permitted use the land

During the first half of 2006, amendment 4 of TMA 18 went into effect. Its aim was to match the filling stations to the needs of Israel's population while assuring proper service to consumers and strict prevention of transportation, safety, visual and environmental damage. Most of the change is that local Planning and Building Commissions are authorized to approve construction of a filling station in any "built-up area" including areas zoned for residential, office, commercial or other uses, while today this authority is limited to industrial zones or those integrating industrial and commercial zones. Another change in the plan is the possibility of establishing "mini" stations while in the existing TMA this is not possible. "Mini" stations require a smaller capital investment than that required now for public filling stations. The Mini filling station is one that can serve up to four vehicles at one time, whose weight are less than four tons each. No structure will be allowed to be built there other than roofing over the filling pumps.

B. Planning and Building Law 5728-1968 (hereinafter: "Licensing of Business Law"), the regulations and ordinances that derive by virtue of the law:

1. Licensing of Business Law (Businesses that require Licensing) 1995 – according to this ordinance, filling stations are businesses that need a license according to the law. The licensing authority is the local authority in whose jurisdiction the filling station is located. In order to operate the filling station, one needs to receive, among other things, approval from the following main authorities: The Israel Police, The Ministry for Environmental Protection, Ministry of Industry, Trade and Labor, the Fire-fighting Service and the relevant Planning and Building Commission.

2. Licensing and Business (the Storage of Fuel), 5736-1976 (hereinafter: "Fuel Storage Ordinances") – The ordinances instituted by virtue of the Business License Law, stipulates detailed instructions regarding the issuance of a business license for a filling station. The ordinances stipulate, among other things, the safety conditions and storage of fuel in order to receive a license.

3. Licensing of Business (sanitation conditions at gasoline stations), 5730-1969 – These regulations stipulate, among other things, instructions regarding the sanitary conditions and facilities at filling stations.

4. Business Licensing Regulations (Hazardous Plants), 5763-1993 – according to these regulations, a business that stores, produces, processes or sells hazardous materials must have a special license to do so, and must comply with the safety provisions stipulated in the law or by virtue thereof.

C. Commodities and Services (Garages and Vehicle Related Factories) Order, 5730-1970 – The order which was issued under Commodities and Services Law, 5718-1957, forbids the opening of a gasoline station or operating one without a proper license from the Division of Vehicles and Maintenance Services, the Ministry of Transportation.

9.17.6 Most of Delek Israel's public filling stations and convenience stores have received business licenses or temporary permits. Concerning other filling stations and convenience stores, Delek Israel or the station owner is working towards receiving business licenses or temporary permits. In Delek Israel's estimation, there is no essential obstruction to receiving them.

9.17.7 As of the report date, there are four pending indictments against Delek Israel concerning the operation of filling stations and/or convenience stores without a business license or exceeding a permit. In Delek Israel's estimation, beyond insignificant fines, there will not be any additional essential exposure in this matter.

9.17.8 Antitrust Matters

Exclusive Supply Agreements with Filling Stations:

On October 27, 1997 the Anti-Trust Commissioner and Delek Israel reached an agreement (hereinafter: "**The Agreement**"), that was presented to the Antitrust tribunal (hereinafter: "**The Tribunal**"), where the commissioner reduced the scope of his decision of June 28, 1993 (hereinafter: "**Original Decision**"), according to which the delivery agreement between the fuel companies and the filling stations, which are not owned or by primary lease from the Administration, are restrictive arrangements, such that the Original Decision will only hold for gasoline stations in which Delek Israel does not have an "accepted lease agreement" (in other words, a lease agreement where the rental fees paid are above a certain amount, as detailed in the agreement with the commissioner).

Also decided in the agreement were the conditions for future dealings of Delek Israel with gasoline stations, regarding exclusive agreements where Delek Israel can request a longer period from the Antitrust Tribunal. The agreement commits Delek Israel to submit a request for any agreement to the Tribunal. The Commissioner announced that he would recommend to the court that exclusive supply agreements be limited to a period of between 1-14 years, depending on the special circumstances of the station for which the agreement approval is requested.

In addition, Delek Israel has undertaken that there shall not be between it and Paz and/or Sonol a partnership or other arrangement for rights in the filling station's land or in marketing agreements with the filling station operator.

Under the arrangement, Delek Israel has agreed to the immediate release of 35 stations of the 65 that did not have an "accepted lease agreement", while the Commissioner has agreed to support Delek Israel's agreements with some of the rest of the 30 stations for fixed and limited periods, according to the specific circumstances.

As of now, most of the stations have been released from their obligation to purchase fuel exclusively from Delek Israel. However, most of these stations continue to purchase fuel from it.

On July 1, 2002 Delek Israel came to an agreement with the Commissioner regarding a consensual order according to paragraph 50b of the Restrictive Trade Practices Law, 5748-1988 (hereinafter: "**The Consensual Order"**), which was confirmed by the tribunal.
One of the main points of the consensual order was that the rental of gasoline stations by Delek Israel for a period of greater than seven years, which falls under the circumstances stated in paragraph 17 of the law, would be considered as a merger. This means that such a lease needs the approval of the commissioner.

Concerning the agreement with the Anti-trust Commissioner, regarding Pi Glilot, see Section 9.13.3, above.

9.17.9 Recognized Supplier to the Ministry of Defense

Delek Israel participates in tenders published by the Ministry of Defense which contain standards and thresh-hold requirements, and meets all of them.

9.17.10 Standards

Israel has standards for the fuels that are marketed in Israel. Delek Israel markets only those products that meet these standards.

9.18 Legal Proceedings

For a description of the legal issue to which Delek Israel is a party, see note 25A of the financial statement.

9.19 Strategy and Business Goal

The company reviews it's strategic and business plans from time to time and updates them according to developments in the fuel market, the competitive environment and the economic situation.

The operations of the company in the coming years are expected to focus on the following areas:

9.19.1 Increasing the number of fuel stations owned and operated by Delek Israel and the establishment of gasoline stations and convenience stores at strategic locations and increasing the geographical reach of the company.

9.19.2 Establishment of mini fuel stations in strategic locations.

9.19.3 Further penetration of Delek Israel's unique products, like "Dragon".

9.19.4 Attempt to reduce the credit given to customers and receiving more security for the open credit.

9.19.5 Establishment of retail sites – Delek Israel intends to focus in the coming years on the area of gasoline and retail sites by establishing dozens of new convenience stores, gasoline and retail sites in all parts of the country and in particular within municipal areas.

9.19.6 **Improve Problematic Leases.**

The above estimates are to be considered forward-looking information, and realization of the targets and strategy are also dependent on external factors. Also, the risk factors are detailed below in Section 9.20 may impact on Delek Israel's ability to realize its said targets and strategy.

9.20 Risk Factors

Its possible to indicate certain risk factors that threaten the operations of Delek Israel as follows:

9.20.1 The security and political situation – the global security and political situation has a direct influence on the world's economy and oil prices and on the general operations of the company and its ability to import refined oil. Additionally, the security and political situation in Israel has a significant impact on the country's economic situation. A slowdown in the economy is likely to lead to a reduction in demand for the company's products and a resulting reduction in the volume of sales of petroleum products and retail products.

9.20.2 Changes in exchange rates – fuel products are purchased by Delek Israel from its suppliers in or linked to US Dollars and therefore changes in the Dollar/Shekel exchange rate are likely to affect the value of its inventories. The policy of Delek Israel is to avoid currency exposure by way of various financial instruments and financing inventories by way of Dollar loans. It should be emphasized that Delek Israel records exchange rate differences on operating inventories immediately as they arise. As such, changes in exchange rates may have a detrimental effect on the financial results of Delek Israel.

9.20.3 Changes in the economy's interest rates – changes in interest rates are likely to affect the financing given to Delek Israel by financial institutions. As such, Delek Israel is exposed to changes in interest rates.

9.20.4 Changes in the Consumer Price Index – at the date of this report, Delek Israel has long and short-term loans linked to the CPI. Additionally, Delek Israel has provided loans to the Delek Group and its customers that are also linked to the CPI. As such, a significant increase in the CPI would lead to an increase in the finance costs of Delek Israel, and as a result damage the profitability of Delek Israel. In order to protect itself against fluctuations in the CPI, in July 2006 Delek Israel entered hedging agreements against the said index exposure.

9.20.5 Strikes and closures in the Israeli economy – strikes and closure in the Israeli economy, especially closure of the ports and/or closure of the companies involved in fuel distribution, is likely to prevent

import of raw materials and meeting orders on time and therefore harm the capability of Delek Israel to meet its commitments to customers which may damage the company's reputation.

9.20.6 Changes in oil prices and prices of petroleum products – the price paid by Delek Israel for the petroleum products it purchases is derived from fuel prices in the free market in the Mediterranean area, and is therefore exposed to fluctuations in fuel prices in these markets. The price is influenced by, amongst other things, economic and political instability in the oil producing countries.

9.20.7 The competitive environment – the petrol market is characterized by intense competition, which translates into erosion of profitability and increase in credit to customers. The competitive environment in which it operates significantly affects the financial results of Delek Israel.

9.20.8 Mini fuel stations – the approval of the recommendations of NUP Regulation 18 will allow the establishment of mini fuel stations in city centers by a shortened approval process. Establishment of such stations may affect the sales of Delek Israel in stations under its ownership and/or operation that are adjacent to mini fuel stations that will be established.

9.20.9 Fuel taxes – the excise tax element in the prices of oil products is very significant. As the credit terms Delek Israel receives from its suppliers for payment of the petroleum product price (including excise tax) is far shorter than the credit terms offered to its customers, Delek Israel has financing exposure which will increase with any change in excise tax rates (including those on diesel). This may have a detrimental effect on the business results of Delek Israel. Regarding the increase in excise tax on diesel, see Section 9.15, above.

9.20.10 Changes in demands for maintaining civilian inventories – as stated in Section 9.17.1, above, the High Court approved an interim arrangement requiring maintenance of emergency security inventories only. However, the State is entitled to change the current situation by giving 60 days notice whilst ensuring the rights of the parties to again turn to the High Court. The significance of maintaining civilian inventories, at whatever level, is an increase in finance cost for Delek Israel and an increase in the volume of credit.

9.20.11 Dependence on infrastructure installations – the fuel field has limited infrastructure installations (2 refineries, a small number of storage and filling facilities) and therefore a cessation in operations of an infrastructure installation is likely to harm the correct operation of the refineries and fuel companies. Cessation of operations may be caused by strikes, a security event, accident, natural disaster etc. In the opinion of Delek Israel, due to the level of inventories it maintains at various locations, Delek Israel is not exposed more than the normal exposure in this field.

9.20.12 Regulatory intervention – as stated, Delek Israel is influenced by regulatory changes in the fuel market including supervision of petrol prices and restrictions on the purchase price from refineries and regulatory restrictions on contracts relating to filling stations in the field of oil refining. Regulatory changes in the fuel market may affect the volume of investment required from Delek Israel in its operations and as a result affect the financial results of the company and its profitability.

9.20.13 The environment – laws, regulations and various ordinances as well as Ministry of the Environment requirements regarding filling station facilities and enterprises involved in environmental protection require of Delek Israel to allocate large financial resources to this issue. In recent years there has been a sharp increase in the requirements of the Ministry of the Environment and these demands are likely to expand and increase which may cause Delek Israel to allocate additional financial resources to this issue. Delek Israel cannot accurately estimate the consequences of environmental legislation and the demand of the Ministry of the Environment.

Delek Israel is exposed to legal proceedings, civil and criminal, due to environmental pollution charged as caused in the past and liable to be caused in the future as a result of its operations and within this framework the authorities carry out examinations and checks from time to time. There is a danger of claims against Delek Israel and its officers if ground and water contamination is found at stations other than those listed in Section 9.16 to the report. As stated, rehabilitation of the environment of a station where contamination of water has occurred can cause significant costs that it is not possible to estimate.

The third party insurance policies taken out by Delek Israel cover, amongst other things, against physical harm or damage to property that may be caused by accidental environmental pollution. Delek Israel does not have an insurance policy for liabilities that may be imposed as a result of ongoing environmental pollution that is not accidental, for instance pollution detailed in Section 9.16, above.

9.20.14 Hazardous and toxic materials – as Delek Israel deals with hazardous and toxic materials with potential for explosion, ignition or poisoning, it is exposed to damage that may be caused by these materials including health damage, environmental damage, damage resulting from igniting of flammable materials etc. Claims for these damages are likely to have a detrimental affect on the business results and harm the company's reputation. Delek Israel has taken out insurance policies customary and acceptable in Israel in order to insure its assets and liabilities involved in dealing with these materials. There is no certainty that the cover and/or limits of liability in the policies cover all the risks involved in the operations of Delek Israel, and there is no certainty that its possible to carry on with these policies in the future under reasonable commercial terms or at all.

9.20.15 Product liability – Delek Israel markets various refined oil products that are especially sensitive due to them being hazardous materials and due to the nature of their uses. A large body of laws and regulations govern the rights of victims of groups of victims to whom damage has been caused due to products produces, stored, marketed or sold by the supplier. As far as any damage caused to a consumer or group of consumers as a result of materials marketed by Delek Israel, the company is liable to be sued by those consumers, including class action cases and this is likely to have a detrimental affect on the business and the results.

9.20.16 Natural gas – the State published an offer to submit tenders for the rights to distribute natural gas in the south of the country. The gas is used for burning and is an alternative to kerosene, fuel oil and LPG marketed by Delek Israel. Marketing of natural gas expands the range of alternatives to Delek Israel products and as a result may reduce the sales volume of the company.

9.20.17 Development of alternative energy sources – apart from use of alternative energy sources such as natural gas, electric engines and their consequences may affect the volume of oil products that Delek Israel sells and compel the company to make a substantial investment in adjusting its stations to new requirements of customers and may lead to competition outside filling stations. Delek Israel estimates that this process will not materially affect its results in the coming years apart from the natural gas issue stated above.

9.20.18 Automotive gas for vehicles – the transition from filling by means of automotive gas which will replace filling with gasoline will require Delek Israel to prepare in advance by establishing gas filling points (filling points) at a cost of hundreds of thousands of Shekels for each gas filling point integrated into filling stations. It should be emphasized that it is unclear what will be the scope of transition to filling with automotive gas, due in part to uncertainty regarding government intentions for taxing gas (excise) and matching the tax levels to those levied on gasoline.

9.20.19 Shortage in LPG storage sites – Since the court decision to discontinue the natural gas operations at Pi Glilot, there exists a shortage in LPG storage sites in Israel, which imposes difficulties on the current operations of the gas companies, including Amisragas.

9.20.20 Dependence on refineries – as stated in Section 9.11.5, above, companies operating in the field of refined oil are almost totally dependent on refineries that are the central and major suppliers of various oil extracts purchased by these companies. Spin off and privatization of the refineries could change the structure of the fuel market and influence the operations of the fuel sector especially of the refineries will be allowed to market directly to consumers.

9.20.21 Sale of Pi Glilot assets – privatization of Pi Glilot and the sake of its assets to one of the main competitors of Delek Israel could give the competitor an advantage over fuel companies operating in the fuel market including Delek Israel.

9.20.22 Economic slowdown in the local economy – a slowdown in the economy brings a worsening in payment culture including for objective reasons damage to the payment capabilities of customers. The field is characterized by large credit to customers, partly without security or with partial security and a slowdown expose the companies operating in the field to the possibility that such credit may not be returned. Additionally, a slowdown on the global and Israeli economy may bring a reduction in private demand and commercial operations and as a result cause a reduction in the volume of sales of the group's products, its income and profitability.

9.20.23 Transition to use of public transport – in recent years there has been a consistent increase in the use of the railway network, including the "light" railway that is planned for the large cities, a fact that reduces usage of private motor vehicles. As far as this tendency continues, the amount of gasoline and diesel sold to customers will decrease, a fact that may affect the financial results of Delek Israel.

9.20.24 Directives of the Anti-Trust Authority regarding exclusive supply to stations where fuel companies do not have proprietary rights – according to regulations of the Anti-Trust Commission it is possible to enter into agreements as sole supplier for a maximum period of 3 years at stations at which fuel companies do not have concessions. This fact increases competition and could cause changes in the deployment of filling stations in Israel.

9.20.25 Regulations in the food sector – food products sold at convenience store chains are subject to many and varied regulations. In the event that such regulations are not complied with, Delek Israel is likely to bear responsibility for damages from consuming spoilt food and for not meeting legal requirements of the authorities.

9.20.26 Failure to attain required approvals and licenses for operating filling stations – operating a filling station of Delek Israel requires attaining approvals and licenses from various bodies. At some of the stations Delek Israel does not have all the required approvals and licenses or in some cases these have expired and need to be renewed. To the extent that Delek Israel does not succeed in attaining the said approvals and licenses, this may have a detrimental affect on the operating results.

9.20.27 Credit risk - Delek Israel has a credit risk that can be expressed in a number of ways:

A. In the field of direct sales, the sale of fuel by Delek Israel to institutional customers is mainly by credit. Part if the credit is unsecured and as such Delek Israel has risk relating to that credit. Delek Israel estimates that the large range of its customers reduces the risk to some extent and it also has a policy of reducing exposure to problematical customers.

B. Also for sales at filling stations part of the credit given to customers is unsecured and the company is exposed to risk relating to this credit.

C. Additionally, the fuel market in Israel is characterized by a large penetration of Dalkan systems, which increases the volume of credit to customers.

D. During a period where fuel prices (which are under government control) are rising, the volume of customer credit financed by fuel companies grows.

9.20.28 Ownership structure at filling stations – due to the ownership structure of filling stations, some of which are rented by Delek Israel and some with which Delek Israel only has a supplying contract, there is a risk that these stations will transfer to marketing products of other fuel companies at the end of the rental/supplying period. Additionally, at stations not under the ownership of Delek Israel and not operated by it, Delek Israel is subject to greater pressures from operators/owners and the profitability of such stations is therefore eroded.

9.20.29 Short term contracts in the field of direct marketing – in the field of direct marketing the contracts are short term, and as such there is a risk that customers will leave and transfer to competitors with short notice.

9.20.30 Claims – Delek Israel is subject to material claims for substantial sums (see note 25A to the financial statements). Delek Israel is exposed to the consequences resulting from these claims.

9.20.31 Dependence on brand name and reputation – Delek Israel has a fine reputation earned over many years and a brand name that distinguishes the company and its subsidiaries and affiliates from its competitors. Damage to this reputation or Delek Israel brands through various publications or other means could have a detrimental affect on Delek Israel even if such publications are incorrect.

9.20.32 Environment at veteran stations – Delek Israel has veteran public filling stations established before 1997 that make up some 59% of all its stations. These stations were built to standards acceptable in the past and which according to current know-how do not ensure that there will not be leakage from a tank or pipe.

9.20.33 Raising the utilization value of company cars – In January 2007, the Ministry of Finance announced a plan to raise the utilization value of company cars. According to the plan, still pending approval by the Knesset's Finance Committee, the value for tax purposes is expected to be increased gradually over a period of several years. if the plan is approved and implemented, it may have a long-term impact on the number of company cars granted to employees, which in turn, may lead to a decrease in fuel consumption.

Following below is a summary of the risk factors described above according to their type (macro risks, industry-wide risks and special risks to the group) which were rated according to the estimates of the Delek Israel management (significant, medium, small):

	Influence of Risk Factors on The Company's Business		
	Significant	**Medium**	**Small**
Macro-level Risks	Changes in FX and CPI rates Changes in interest rates Slowdown in local economy	Security situation Fuel price volatility	Alternative energy sources
Industry-wide Risks	Regulatory Intervention Environmental Regulation Anti-Trust Authority	Competition Class Action lawsuits Fuel taxes Sale of Pi Glilot assets Hazardous and toxic materials Shortage of LPG sites	Civil inventories Infrastructure installations Food regulations Raise in company car utilization value
Specific Risks to Delek Israel	Privatization of Ashdod Refineries Mini fuel stations Customer credit risk Failure to attain approvals and licenses for stations Ownership structure of gasoline stations	Transition to public transport Dependence on reputation and brand name	Short-term nature of direct marketing Automotive gas Natural gas Product liability

The scope of the effect of risk factors on the business of Delek Israel are based on estimates only and it is possible that in practice the scope of the effect may be different.

10. The Energy Sector

10.1 General Information on the Sector of Operations

10.1.1 The Company's energy sector is primarily under Delek Energy Systems Ltd. – a public company whose shares have been listed on the Tel Aviv Stock Exchange since 1982 (hereinafter: "Delek Energy") .

10.1.2 Delek Energy is engaged, via partnerships and subsidiaries in oil and gas exploration and production in Israel and in several countries around the world. Gas is produced at the Yam Tethys project in the Mediterranean off the shores of Israel, an oil and gas are produced in Southern USA. Oil and gas explorations are conducted in assets in Israel, Vietnam, Southern USA and Guinea-Bissau. As of the report date, Delek Energy's major project, responsible for most of its revenues, is the Yam Tethys project.

10.1.3 Structure of Sector of Operations and Changes Therein

A. Operations in Israel: Delek Energy operates in Israel via its holdings in the limiter partnerships Delek Drilling (hereinafter: "**Delek Drilling Partnership**") and Avner oil exploration (hereinafter: "**Avner Partnership**") (Delek Drilling Partnership and Avner Partnership collectively in this Chapter 10: "**the partnerships**" or "**the limited partnerships**").

The general partner of Delek Drilling Partnership is a wholly owned subsidiary of Delek Energy, and the general partner of Avner Partnership is a company in which Delek Energy holds half of the shares.

In addition to managing the partnerships, Delek Energy holds participation units issued by the limited partners in the partnerships as follows:

Direct and indirect holding of 62.3% of participation units issued by the limited partner of Delek Drilling Partnership (hereinafter: "Delek units"). The limited partner and trustee of this partnership is Delek Trustees Drilling Ltd., wholly owned by Delek Energy. These holdings in the limited partner do not bestow on Delek Energy any management rights or rights to profits.

Direct and indirect holding of 39.02% of participation units issued by the limited partner of Avner Partnership (hereinafter: "Avner units"). The limited partner and trustee of this partnership is Avner Trustees Ltd., 50% owned by Delek Energy. These holdings in the limited partner do not bestow on Delek Energy any management rights or rights to profits.

Note that Delek Investments directly holds 6.53% of Delek units and 12.59% of Avner units.

The primary activity of the partnerships is the Yam Tethys project, which includes two oil leases (Noa and Ashkelon) in the Mediterranean Sea off the shores of Israel, where proven gas reservoirs have been found. Within this project natural gas is produced and further exploration is conducted. In 2004 the partnerships started selling natural gas produced from the Mari reservoir in the Ashkelon lease, and Delek Energy started recognizing significant revenues as a result. Moreover, Delek Drilling Partnership, Avner Partnership and Delek Investments hold 25.5%, 23% and 4.441%, respectively, of the Yam Tethys project and of Yam Tethys Ltd. which owns the license to install and operate a natural gas pipeline. In addition, Delek Drilling Partnership, Avner Partnership and Delek Investments hold 48.17%, 43.44% and 8.39%, respectively, of Delek & Avner – Yam Tethys Ltd., which was incorporated by the Israeli partners in the Yam Tethys project in order to issue debentures to institutional investors in the USA. For further details on the Yam Tethys project, see section 10.2 below. In addition to the Yam Tethys project, the limited partnerships conduct other oil exploration operations in Israel, as set forth in section 10.3 below.

B. Operations Abroad: Delek Energy's overseas operations started in 2001 with acquisition of holdings in an oil exploration project in Vietnam, and in the past year has expanded with acquisition of rights to oil and gas exploration and production in Southern USA (in September-October 2006); and acquisition of rights in Guinea-Bissau (in February 2007). The overseas operations are conducted via the following companies:

1. Delek Energy (Vietnam) LLC, a wholly owned subsidiary of Delek Energy Systems Ltd., incorporated in the USA (hereinafter: "**Delek Vietnam**"), holds participation rights in an oil and gas exploration project off the shores of Vietnam.

2. Delek Energy International Ltd., a wholly owned subsidiary of Delek Energy Systems Ltd., incorporated in Israel (hereinafter: "**Delek Energy International**") holds rights to two marine concessions in Guinea-Bissau in West Africa.

3. Delek Energy Systems US Inc., a wholly owned second-tier subsidiary of Delek Energy Systems Ltd., incorporated in the USA (hereinafter: "**Delek Energy USA**") holds rights in the limited partnership AriesOne Limited Partnership (hereinafter: "**AriesOne**") which owns oil assets located in Southern USA, including exploration and production areas.

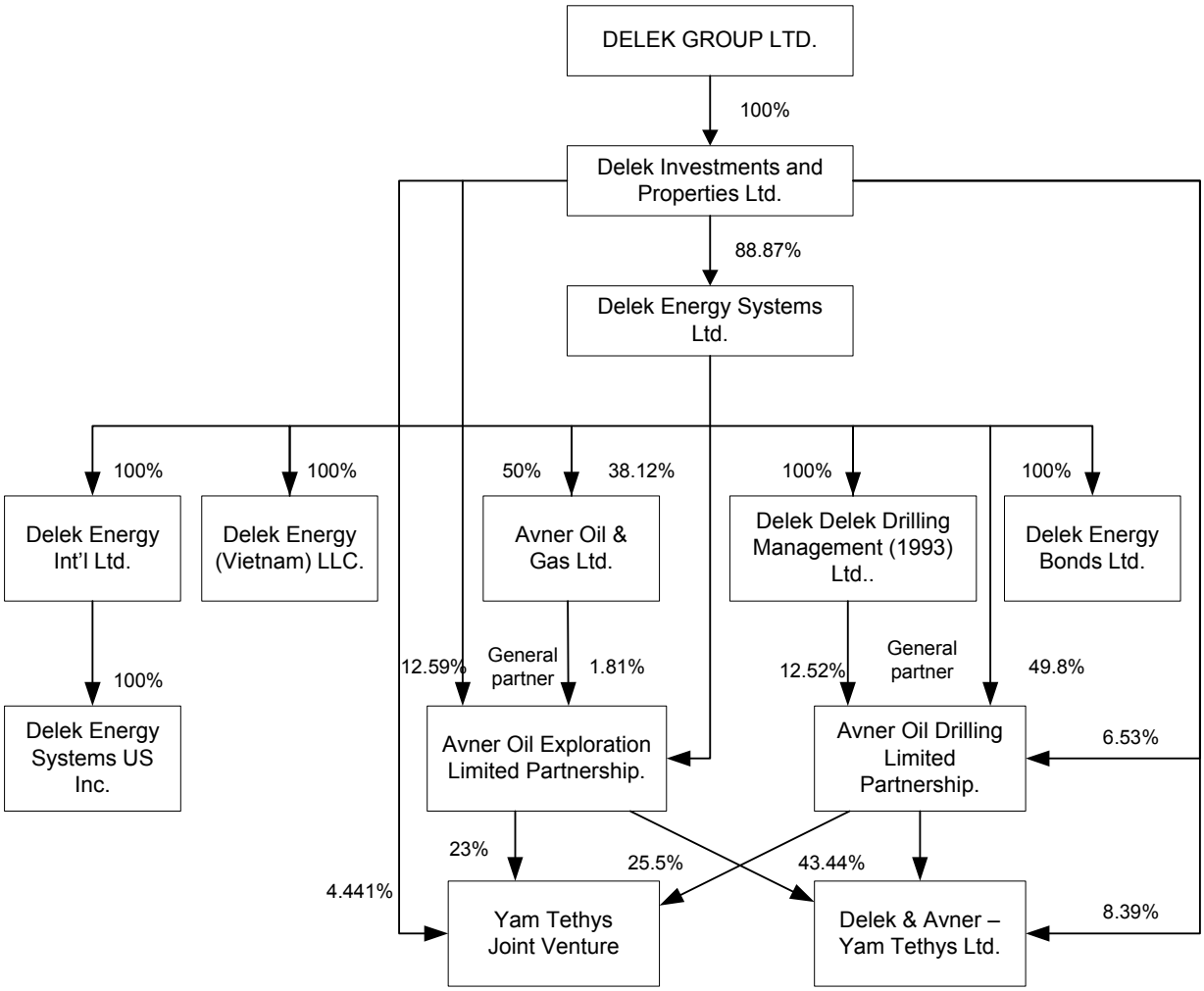
4. Delek Energy USA holds rights to exploration and production of natural gas in Wise County, Texas.

10.1.4 Delek Energy's Investments in its Operations

Below is a description of Delek Energy's investments in oil exploration projects in the period 2004-2006 (in NIS thousands), including amounts recorded as profit or loss:

Operation	2006	2005	2004
AriesOne, USA	34,504	---	---
Rights to gas exploration, USA	5,418	---	---
Vietnam	82,312	816	1,868
Yam Tethys – investments in platform, Mari drilling and reception terminal	29,816	4,913	---
Yam Tethys – other investments	377	862	24,856
Med Ashdod	---	6,703	---
Med Yavne	---	---	1,878
Others	1,071	1,053	1,744
Total	**153,498**	**14,347**	**30,346**

10.1.5 The following is a chart describing the Group's main holding structure in this sector:



* Holding percentages in limited partnerships are of participation units in the limited partner.

10.1.6 As of the report date, the limited partnerships hold rights in the following oil assets in Israel:

ID	Name	Right Type	Area in km^2	Share of Delek Drilling Partnership	Share of Avner Partnership	Right valid through[1]
I/7	Noa[2]	Lease	250	%25.50	%23.00	31.1.2030
I/10	Ashkelon[3]	Lease	250	%25.50	%23.00	10.6.2032
313	Ashkelon Amok	License	133.9	%25.50	%23.00	30.4.2008
I/9	Med Ashdod[4]	Lease	250	%21.766	---	14.6.2030
308	Michal[5]	License	393	%15.125	%15.125	31.12.2008
309	Matan[6]	License	318	%15.125	%15.125	31.12.2008
321	Zerach (Tzuk Tamrur Enclave)[7]	License	16.5	%25	%25	31.12.2007
327	Tzurim (Halamish Enclave)[8]	License	35.4	%25	%25	18.7.2008
331	Ohad[9]	License	400	---	---	14.6.2009
332	Shimshon[10]	License	400	---	---	14.6.2009

10.1.7 For details of oil assets in which Delek Energy had rights since 2004 which it no longer holds as of the report date, see section 10.4 below.

10.1.8 For details of natural gas production at Yam Tethys project, see section 10.2.7g below.

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1 Subject to terms stipulated by law and oil regulations and/or set forth in the oil right terms.

2 The share of Delek Investments in the lease is 4.441%.

3 The share of Delek Investments in the lease is 4.441%.

4 Pursuant to agreement dated Oct-28-04, and to decision of the Antitrust Supervisor, Delek Drilling Partnership has sold to Ratio Oil Exploration (1992) – Limited Partnership the share limited to natural gas only out of the participation rights of Delek Drilling Partnership in the Med Ashdod Lease.

5 The partnerships' rights in this license have yet to be fully registered in the Oil Registry (see section 10.3.2 below).

6 The partnerships' rights in this license have yet to be fully registered in the Oil Registry (see section 10.3.2 below).

7 The above rights are participation rights in the "Tzuk Tamrur" Enclave, which is an enclave within the license area. In "Tzuk Tamrur 3" drilling, the partnerships each own 22.386%. (see section 10.3.3 below).

8 The above rights are participation rights in Halamish Enclave, which is an enclave within the license area (see section 10.3.3c below).

9 The license was granted to the general partners, and rights therein have yet to be transferred to the partnerships (see section 10.3.5 below).

10 The license was granted to the general partners, and rights therein have yet to be transferred to the partnerships (see section 10.3.5 below).

10.1.9 As of the report date, companies held by Delek Energy hold rights in the following oil assets outside Israel:

Name	Area in km^2	Name of Holding Company	Share of Asset
Vietnam – blocks 12W and 12E	6,900[1]	Delek Vietnam	25%[2]
AriesOne partnership	40[3]	Delek Energy USA	83.49%[4]
Texas - Barnett Shale	11	Delek Energy USA	50%
Guinea-Bissau – Esperance and Sinapa concessions	4,900	Delek Energy International	11.43%[5]

10.1.10 The oil and natural gas exploration and production operations are complex, involving considerable costs and extremely high uncertainty as for exploration cost, schedule, availability of oil or natural gas and the ability to produce it while maintaining economic viability. As a result, despite considerable investments, often drillings do not achieve positive results and do not yield any revenues, resulting in loss of the investment in whole or in part. Exploration and production of oil and natural gas are usually undertaken by joint ventures involving multiple partners, who sign a joint operation agreement (JOA) whereby one of the partners is appointed to operate the joint venture. The oil and natural gas exploration and production process in any concession involves several stages, including: analysis of geological and geo-physical data for selection of areas showing potential for oil and gas exploration; conducting seismic surveys, which assist in locating geological formations which may contain hydrocarbons (oil and/or gas); preparation of promising prospects for exploration; contracting with contractors for drilling; and conducting exploration drilling. Not all projects go through all stages, and sometimes no drill-worthy formations are found and therefore there is no viability in preparing a prospect for drilling, hence the process is terminated sooner. Furthermore, the time periods for each stage vary by the nature of the project, and it is almost impossible to demonstrate an exploration process where the above stages are conducted continuously and with no unexpected set-backs. The oil and gas exploration and production processes on land and at sea are essentially similar. The major difference is in technology used and in costs, which are typically considerably higher at sea than on land.

10.1.11 Limitations, Legislation, Regulations and Special Constraints – Oil and gas exploration and production are subject to extensive regulation by countries where operations are conducted. For details of regulation applicable to Delek Energy operations, see section 10.23 below.

10.1.12 Technology Changes to Operating Sector – Over recent years, technological changes to oil and gas exploration have improved the quality of data available to oil explorers, and have rendered drilling operations more efficient. In addition, thanks to technological improvements it is currently possible to conduct operations under much tougher conditions than before, and at great depth at sea. In many cases these methods have also brought about reduced risks in drilling. As per the above, oil exploring companies may invest exploration efforts in areas where no drilling was possible in the past, or where drilling could only be conducted at very high cost and even higher risk.

10.1.13 Critical Success Factors in Operating Sector – locating and obtaining exploration rights (by purchasing or joining in) in areas showing potential for commercial discovery; ability to raise considerable financial resources; partnering with international entities operating in the sector for conducting complex drilling, utilizing their professional knowledge and for sharing in the investment cost; successful exploration operations.

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1 Under terms of the concessions in the above area, the partners in the project have returned 25% of the area, and under merger of concession areas and concession terms, the partners are expected to return a further portion of the area (see section 10.5 below).

2 The national oil company of Vietnam has an option to acquire, in case of declaration of a commercial discovery, 15% of the rights in the asset. In case this option is exercised, the share of Delek Vietnam would decrease to 21.25% of rights (see section 10.5 below).

3 Note that this involves a large number of small, non-contiguous areas.

4 The share of AriesOne partnership in most areas is less than 100% (see section 10.6.1 below).

5 The national oil company of Guinea-Bissau has the option to acquire, in case of a commercial discovery, 30% of the rights in the project. In case this option is exercised, the share of Delek Energy International would decline to 8% in each of the concessions.

10.1.14 Barriers to Entry and Exit – The major entry barriers in the exploration sector are the need for permits and licenses to conduct oil explorations, as well as the major investments at relatively high risk levels involved in oil and gas exploration. There are no significant exit barriers in the sector, other than long-term gas supply agreements contracted by the partnerships (see section 10.25 below) as well as the duty to dismantle production facilities prior to abandoning the search areas. Furthermore, the exit barriers for limited partnerships include regulations of the Tel Aviv Stock Exchange Ltd. and their limited partnership agreements which restrict the partnerships from conducting any operations which are not oil and gas exploration operations, as set forth in said agreements.

10.1.15 Substitutes for Products of Operating Sector – Natural gas and oil serve as combustibles and are sold to industrial and residential customers. The partnerships and Delek Investments sell natural gas to industrial customers. Substitutes exist for natural gas, such as diesel or fuel oil and substitutes for oil include coal, hydro-electric energy, solar energy and bio-diesel. Each of the above substitutes has advantages and disadvantages, and is subject to price fluctuations. The move from use of one energy source to another typically requires considerable investment. The major advantages of natural gas over coal and liquid fuels are high yield and relatively low pollution (compared to oil and coal).

10.1.16 Structure of Competition in Sector – See section 10.14 below.

10.2 Yam Tethys Project

10.2.1 The limited partnerships mostly operate via marine oil leases and licenses, named "Yam Tethys project". As of the report date, the Yam Tethys project includes the leases I/7 "Noa" and I/10 "Ashkelon" as well as the license 313 "Ashkelon Amok". The Yam Tethys project previously included additional permits and licenses which were used for exploration operations, which did not yield any discoveries (see section 10.4 below).

10.2.2 Operations in the areas of Yam Tethys project are conducted via a joint venture managed under a joint operation agreement dated Feb-24-99 with partners Noble Energy Mediterranean Limited [1] hereinafter "Noble") (47.059%), Delek Drilling Partnership (25.50%), Avner Partnership (23.00%) and Delek Investments (4.441%).

10.2.3 The Yam Tethys Project partners hold two proven gas reservoirs. The Noa reservoir was discovered in June 1999 and the Mari reservoir in February 2000. In light of the findings concerning these reservoirs, the partners in the Yam Tethys Project started developing the reservoirs in 2001 by establishing a production infrastructure and a gas transmission to the shore.

Construction of Phase 1 of the production system was completed in late 2003, except for construction of the fixed reception terminal on Ashdod shore, whose construction is expected to be completed in Q3 2007. As of Dec-31-06, expenses for construction of Phase 1 of the production system (for 100% of the rights) amounted to $350 million. Completion of the reception terminal is estimated at a further cost of $10 million.

In Q4 2006 and Q1 2007, another development drilling took place in the Mari field (Mari 7-B drilling), intended to improve gas production capacity from the Mari field. The total cost of drilling for the Yam Tethys project (for 100% of the rights) is expected to be $26 million, of which $14 million have been spent through Dec-31-06.

Phase 2 of the production facility, which has yet to be started, is expected to include the sub-sea completion of the Noa field and its connection to the production platform. Their total cost for the Yam Tethys project (for 100% of rights) may amount to $150 million with no participation of others. The Yam Tethys project partners are reviewing potential cooperation with British Gas (BG), *inter alia*, in conjunction with joint development of the Noa field and the adjoining natural gas field, located at sea off the shore of Gaza Strip, which BG operates, as well as for transmission of natural gas from these fields via the Yam Tethys project production and transmission facility.

Notice regarding forward-looking information – The above estimate is forward-looking information, based on preliminary assessments by Delek Energy of completion costs for phase 2, based on preliminary opinion provided to Delek Energy by the operator. The actual completion cost

[1] Previously Samedan Mediterranean Sea.

for phase 2 may differ (be higher or lower) from the above estimate, and is contingent, *inter alia*, on detailed planning of phase 2 which is yet to be executed; on obtaining bids from contractors; on changes to global supplier and raw material markets, e.g. metals; and in joint development with BG as set forth above.

10.2.4 As per the above, starting in 2004 the Yam Tethys project partners have been supplying natural gas to IEC under a gas delivery contract dated Jun-25-02 and amendments thereto. Furthermore, starting in November 2005 the Yam Tethys project partners have been supplying natural gas to Oil Refineries Ltd. (hereinafter: "ORL") and have signed gas delivery contracts with AIPM and with I.P.P. Delek Ashkelon Ltd.

For the Yam Tethys project different terms have been specified for the leases and licenses, stipulating, *inter alia*, the duties to develop the discovery and to produce gas; milestones for project progress; duties to submit a work plan to the Oil Supervisor; and instructions concerning safety, environmental protection and security coordination.

10.2.5 Permits and licenses for production and transmission systems: In conjunction with development of gas discoveries by the Yam Tethys project partners, the partners have been granted permits and licenses under the Oil Law, 1952 (hereinafter: "the Oil Law") and the Natural Gas Sector Law, 2002 which are mandatory for construction and operation of the production system and the transmission system from the production platform to shore.

10.2.6 The Joint Operating Agreement: Exploration and production activities in the Yam Tethys Project operate under Joint Operating Agreement dated Feb-24-99. The parties to the JOA are the limited partnerships and other partners in the Yam Tethys Project as set forth below. According to the Joint Operating Agreement, Noble was appointed operator of the Yam Tethys Project. Noble is an indirect subsidiary of Noble Energy Inc. which is a US oil company engaged in the exploration and production of oil and natural gas. Noble Energy Inc. Nobel Energy Inc. is a public company whose shares trade on the New York Stock Exchange (NYSE) under the symbol "NBL".

10.2.7 The joint operating agreement includes the following provisions:

A. Noble would be the operator under the joint operating agreement and would be solely responsible for management of the joint operations. In managing the joint operations, Noble is subject to obligations concerning, *inter alia*, compliance with instructions of the Operating Committee, with agreements, licenses and legislation.

B. The operator will determine the number and identity of the workers, their work hours and the salary that will be paid to them in conjunction with the joint operation.

C. Provisions were specified for indemnification of the operator, its officers and associated companies with regard to discharging his duties as operator, as set forth in the joint operating agreement.

D. The operator is entitled to receive operator fees based on the expenses of the joint venture, ranging from 1% of venture expenses when the annual venture expenses exceed $12 million, to 4% of venture expenses when these are below $4 million annually. With regard to expenses associated with development and production operations of the Yam Tethys Project, the parties agreed that for development and production expenses starting on Jan-01-04 the operator will be paid 1% of expenses up to a limit of $20 million in expenses, and 0.85% of expenses exceeding that threshold.

E. The partners to the joint operating agreement have committed to protect and indemnify the operator, on a pro-rata basis in line with their share of participation in Yam Tethys licenses. The operator's liability is limited to certain cases, such as cases where he was grossly negligent.

F. According to the joint operating agreement, Avner Oil and Gas Ltd. was appointed as the Israeli operator to fulfill tasks, functions, roles and services in Israel to benefit the joint operations, subject to coordination with Noble. The proceeds from such services are not material.

G. Operating Committee: Under the agreement, the parties have established an operating committee, having the authority and role to approve and supervise the required joint operations to comply with terms of licenses to which the joint operating agreement applies. The operating committee is composed of representatives of the parties, with each representative having voting rights commensurate with rights of the party being represented.

Unless otherwise determined in the joint operating agreement, all decisions, approvals and other acts by the operating committee on any proposal brought before it shall pass by affirmative vote of two or more parties (which are not associated / affiliated parties) who jointly hold at the time of the vote at least 51% of total participation rights in the area of the license to which the decision applies.

10.2.8 Proven Gas Reserves at Yam Tethys Project[1]

The following gas reserve table shows changes to proven gas reserves at Mari and Noa gas reservoirs in 2004, 2005 and 2006. The changes to reserves are due to sale of gas to IEC and ORL, as well as to updated estimates of the proven and developed gas reserves at Mari reservoir. Below are details of proven gas reserves at Mari and Noa reservoirs[2]:

	BCM[3]
Proven gas reserves (Mari and Noa reservoirs)[4] pre-production	31.9
Gas sold in 2004	(1.2)
Gas sold in 2005[5]	(1.7)
Gas sold in 2006	(2.3)
Balance of proven gas reserves as of Dec-31-06 (Noa and Mari reservoirs)	26.7

10.2.9 Planned Activities for the Yam Tethys Project:

To the best of Delek Energy's knowledge, construction of the Yam Tethys project's permanent reception terminal in Ashdod is expected to be completed in 2007 (see section 10.2.3 above). Furthermore, the partners in Yam Tethys project review the option to conduct further geological and geo-physical work in marine areas in Israel.

10.3 Exploration Activities of the Limited Partners other than the Yam Tethys Project

In addition to the production activity of the Yam Tethys Project, the partnerships are engaged in further oil and gas exploration pursuant to permits, licenses and leases granted under the Oil Law.

Typically explorations are conducted under terms of the lease or license specified by the Oil Supervisor in the Ministry of National Infrastructures (hereinafter: "the Oil Supervisor") including provisions concerning drilling schedules, duty to maintain insurance, being subject to environmental protection guidelines etc. The partners in the lease enter into a joint operating agreement which specifies, *inter alia*, issues such as responsibilities of the operator; charging of expenses to partners; setting up an operating committee and the required majority for decisions to pass in said committee; sanctions against any party in breach of obligations etc. The partnerships do not serve as operators of the lease or license.

Below is a brief description of the oil and gas exploration operations of the limited partnerships in other areas outside the Yam Tethys Project:

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1 Rules of the US Securities Exchange Commission (SEC) which are binding on reservoir engineering companies, stipulate that proven gas reserves are the gas volume which, according to geological, engineering and financial information may be produced at high probability (90% or higher) from the relevant reservoir.

2 The data are for proven gas reserves at "proven" probability only (excluding volumes at "probable" or "possible" probabilities). See also section 10.29.7 regarding risk factors.

3 The data in this section are for 100% of the reservoir (including the share of other participants and royalties).

4 Pre-production reserves are in line with the reserve estimate report for the Mari and Noa reservoirs of March 2001, issued at the request of the operator of the Yam Tethys Project by a leading independent foreign company, specializing in estimating oil and gas reserves in reservoirs, as amended in three additional reserve estimate reports referring solely to the developed reservoir at the Mari gas field (following the first report, the original evaluation was reduced by 0.8 BCM; the second led to a further reduction by 0.2 BCM; and the third led to an increase of 0.2 BCM). The aforementioned amendment reports were obtained from a different independent foreign company, which is also one of the leading companies specializing in estimating oil and gas reservoirs.

5 It should be noted that in the financial statements of Noble's parent company for 2005, the number listed as the pre-production proven gas reserves in the Noa and Mari reservoirs was 29.9 BCM.

10.3.1 Ashdod I/9 Lease:

A. Delek Drilling Partnership holds 21.766% of exploration, production and exploitation rights for oil (other tan natural gas) and other valuable materials in the lease. Isramco Inc. Serves as lease operator (hereinafter in this section: "**the operator**").

B. Exploration operations in Med Ashdod lease:

Oil and gas exploration operations in 2004-2006 focused on location and review of prospects in the geological layers deeper than the Pliocene later (a layer about 2000 meter deep where gas is found). Following a three-dimensional survey made in the lease area, several prospects for oil and gas were located at different geological layers fro which the operator conducted comparative studies while quantifying the risk level for each prospect.

On Sep-25-05, drilling began at Gad-1 within the Gad-1 enclave, created in conjunction with drilling in part of the Ashdod lease. Drilling was planned for target production of gas in 100 meters of water. In November 2005 the operator announced that Gad-1 drilling had reached its total depth (2,550 meters) and that electric testing conducted indicated that the target layers are waterlogged, hence it was decided to abandon the drilling. The Partnership's share in the aforementioned drilling was 9%, and its proportional share of drilling costs amounted to approximately $1.5 million.

The partners in the project are preparing to conduct further drilling, Yam-3 - drilling for target production of oil in the Jurassic layer. The budget estimated by the operator in 2004 was $40 million, but is expected to be higher due to increase in prices of drilling tools and services. The updated budget has not been presented yet, and when presented it would be brought up for approval by the project partners.

Under the Oil Law, if no oil or gas is produced from the lease area in commercial quantities within three years from grant of the lease, the minister in charge may send a notice to the lease owner, demanding that production start within a period of 60 days or more. If production does not commence as demanded, the lease shall expire. Delek Energy anticipates, based on information conveyed to it following discussions held by the operator with the Oil Supervisor, that the minister would not send such a notice.

Notice regarding forward-looking information – The above estimate by Delek Energy is forward-looking information, based on the position of the Oil Supervisor, as verbally conveyed to the operator in discussions held with their representatives. The estimate may not materialize should the minister, despite the Oil Supervisor's position, issue such a notice, or should the Oil Supervisor decide to change his position on this matter.

10.3.2 308/Michal and 309/Matan Licenses

A. Following changes to rights holding in the 308/Michal and 309/Matan licenses (hereinafter in this section: "**the licenses**") pursuant to agreements between the license partners in 2005-2007, the limited partnerships each hold participation rights of 15.125% in the licenses. Noble, holding 33% of the rights, is the operator for the licenses.

B. Pursuant to terms of the licenses, the license partners must contract no later than Sep-01-06 to order engineering planning for drilling in the area of the licenses.

C. Work plan and budget: Following Noble's joining as operator of the licenses, it conducted further geological and geo-physical work in the license area, based on results of seismic survey conducted by BG in the past; consequently in November 2006 Noble recommended to the other project partners a work plan including executing the Tamar drilling and additional operations at a total budget of $71 million for 2006 and 2007. The above work plan and budget have been approved by all project partners.

Noble currently continues to conduct geological and geo-physical work as well as detailed planning of the Tamar drilling, purchasing of the equipment required for drilling and negotiating a contract with a drilling vessel, which would allow the Tamar drilling to be made in the second half of 2007.

The Tamar drilling is planned some 90 kilometers west of Haifa, at very deep water (1,650 meters).

The drilling is planned for target production of gas in total depth of 5,000 meters (including water depth) in a large formation of layers from the tertiary epoch.

Should the drilling result in a discovery, the project's viability would depend on several factors, including the size and quality of the reservoir, development costs (which may be exceedingly high), nature of the target market and sale prices of natural gas. Should the drilling result in a commercial discovery, i.e. an economically viable one, the discovery may have a material impact on Delek Energy. For the sake of clarity, this is an exploratory drilling (Wildcat), and by its nature it is impossible to say whether it would achieve its objectives; find a geological formation; contain gas and/or oil; be viable for production; and/or be economically viable. The geological and geo-physical means and techniques do not provide an accurate forecast of all the above parameters, hence the decision to conduct the drilling is based to a large extent on estimated data and on unproven assumptions (see risk factors in section 10.29 below).

10.3.3 321/Zerach license – Tzuk Tamrur Enclave[1]

A. Tzuk Tamrur enclave covers some 16.5 million m^2 within the Zerach license area, located in the Dead Sea area. The share of each partnership in rights to Tzuk Tamrur enclave is 25%. In "Tzuk Tamrur 4" drilling, as set forth below, the share of each partnership is 22.386%.

B. Under terms of the license and amendments following its issue, the license period is through Dec-31-07, and Zerach-2 drilling ("Tzuk Tamrur 4") is to be conducted no later than May-15-07. As of the report date, drilling has yet to start.

C. The work plan for Tzuk Tamrur enclave includes the "Tzuk Tamrur 4" drilling to depth of 2,100 meters in a formation some 3 kilometers north of "Tzuk Tamrur 3", at a budget of $4 million.

10.3.4 327/Tzurim license – Halamish Enclave

A. Halamish enclave covers some 35 million m^2 within the Tzurim license area, located in the Dead Sea area. The share of each of the partnerships in rights to Halamish enclave is 25%, with Ginko Oil Exploration – Limited Partnership holding the remaining 50% of the rights.

B. In the past the Halamish-1 drilling was conducted in the Halamish enclave area, and was abandoned in 1999. The work plan for Halamish enclave has yet to be established.

10.3.5 331/Ohad and 332/Shimshon Licenses

A. On Jun-15-06 the licenses were granted to Delek Drilling Management (1993) Ltd., to Avner Oil & Gas Ltd. and to Isramco Inc. with each of the partnerships holding 25% of the rights. As of the report date, the rights have yet to be registered in the partnerships' name in the Oil Registry, and approval of the Antitrust Supervisor has yet to be obtained (see section 10.24.2c below).

B. The work plan for the license areas is based on terms of the licenses, and includes determining a drilling location no later than Apr-01-07; presentation of a contract with a drilling contractor no later than Feb-01-07; start of drilling for target in Pliocene layer at estimated depth of 1,700 meters, no later than Dec-01-08; analysis of drilling results and update of work plan for Pliocene target within 4 months after drilling is complete; preparation of additional, deeper prospects for drilling in the license area before the end of the license term. As of the report date, execution of the work plan has yet to be started since approval by the Antitrust Supervisor for transfer of rights to the partnerships has yet to be obtained (see section 10.24.2c below).

C. For the Ohad license, Avner Oil & Gas Ltd. would serve as operator; for the Shimshon license, Isramco would serve as operator.

10.4 Operations in Israel Discontinued in the Reported Year

In the reported year, Delek Energy has discontinued its operations in the following licenses: 314/Guy, 315/Eli and 325/Rishon-West. In October 2004, Delek Drilling Partnership sold all its rights in lease I/8 "Med Yavne" (8% out of 100%) and all its rights for natural gas only in lease I/9 "Med Ashdod" (21.766% out of 100%) due to instructions of the Antitrust supervisor whereby acquisition of additional oil rights in Yam Tethys project is contingent on sale of Delek Drilling

[1] On Nov-21-06 the limited partnership Zerach Oil and Gas Exploration published a prospectus to issue capital in order to finance its share of exploration in the license area. This prospectus included Zerach's estimates and data with regard to planned operations in the license area.

Partnership's natural gas rights in the Ashdod and Yavne leases. In exchange for said rights, Ratio assumed all obligations of Delek Drilling Partnership, under existing agreements, for payment of royalties for its share of the aforementioned lease areas (including royalties to Delek Investments and Delek Energy).

10.5 Oil Exploration Operations in Vietnam

10.5.1 Delek Vietnam, a wholly owned subsidiary of Delek Energy, owns participation rights of 25% of an exploration project in Vietnam (hereinafter in this section: "the project"), which originally covered an area of 6,900 km^2 at sea, some 400 kilometers south-east of the shores of Vietnam, in 100 meters of water (known as blocks 12W and 12E). The rights in the project arise from a production sharing contract (hereinafter: "the PSC") between Delek Vietnam, its partners in the project and the national petroleum company of the Government of Vietnam (hereinafter: "PetroVietnam"). For terms of the PSC, see section 10.25.9, below. Under terms of the PSC, the partners in the project have waived in the past 25% of the original license area, and are expected to waive a further 25% in the near term, in conjunction with merger of both blocks into a single block[1]. The other partners in the project, each holding 37.5% of the rights in the project, are: Premier Oil Vietnam Offshore B.V. (hereinafter: "Premier Vietnam"), a subsidiary of Premier Oil, a British company with international oil exploration and production operations, whose shares trade on the London Stock Exchange under the symbol "PMO". And Santos International Operations PTY Ltd., an Australian company engaged in oil and gas exploration and production (hereinafter: "Santos"). Premier Vietnam is the project operator.

Rights in the project are subject to an option by PetroVietnam, a company controlled by the Government of Vietnam, to acquire 15% of the rights in exchange for expense reimbursement. The rights are also subject to super royalties payable to third parties at a rate of 3.8%. On Sep-11-06, Delek Vietnam with its other partners in the project, each one according to its share, acquired the rights of the aforementioned third parties to receive the super royalties. Delek Vietnam acquired 25% of the aforementioned royalties in exchange for $875 thousand.

10.5.2 Exploration Operations

Over the period when Samedan was the project operator (until it withdrew in January 2004), three drillings were conducted in the project area. One of the drillings (Swan-1) resulted in a gas discovery, while in another (Lark) very good oil signs were found.

Under the agreement to acquire the rights from Delek Vietnam in 2004, Premier Vietnam committed to execute the project work plan, including, *inter alia*, conducting a seismic survey in 2005 and conducting a single verification or exploration drilling. In addition, Premier Vietnam committed to bear the share of Delek Vietnam in this work plan.

In 2005 a three-dimensional seismic survey of the exploration area was conducted. Following analysis of the seismic survey results, the Dua-4x drilling was drilled, located down formation from the discovery drilling Dua-1x, which was drilled in 1974 and which produced, in production testing, 1,500 oil barrels per day. Pursuant to the discovery of hydrocarbons in the Dua-4x drilling, a diagonal drilling was conducted (Dua-4X ST1) in order to obtain further geological information.

In tests conducted in the vertical Dua-4x drilling and in the diagonal Dua-4x ST1 drilling, oil and core samples were removed and pressures were measured, to assist in determining the quantity and quality of hydrocarbons in the part of the Dua formation lying north of the rift. As planned, no production tests were conducted in the drilling.

Subsequently a second diagonal geological drilling, Dua-4x ST2, was conducted in order to further evaluate the potential of oil and gas reservoirs in the part of the Dua formation lying south of the rift. This diagonal drilling traversed a gas section within limestone above the main target layer. Additional work is required in order to evaluate the implications of the gas found, but as the drilling approached the limestone base, technical issues arose. In order to ensure operating safety, the Dua-4x ST2 drilling was capped, and was re-done as vertical drilling Dua-5x RE in the southern part of the Dua formation. The Dua-5X RE drilling crossed several gas and oil reservoirs in the part of the Dua formation located south of the rift. Using log testing in the Dua-5X RE drilling, oil samples have been removed and pressures have been measured in the drilling, to assist in determining the quantity and quality of hydrocarbons in the southern part of the Dua formation.

[1] The process of merging the two blocks into a single block is nearing completion.

Production tests have been conducted in two reservoirs in this drilling: from the primary target reservoir oil gushed at a constant rate of 5,543 oil barrels per day plus 6.76 million cubic feet of gas per day; from a second, deeper reservoir oil gushed at a rate of 247 oil barrels per day. Both reservoirs produced no water during testing.

On Oct-17-06 the exploration drilling Blackbird (12E-CS-1X) was started. The drilling was made using a large slanted block, about 21 kilometers south-west of the successful drillings recently conducted in Dua field, and up formation where the 12E-LK-1X drilling was made in the past, producing good oil signs. The drilling reached a total depth (TD) of 4,058 meters.

The drilling discovered four oil-containing reservoirs at the primary target area, Middle Dua. Tests were conducted in these reservoirs using logs and oil samples were taken for further evaluation. In total over 70 meters of oil-bearing layers have been found. Production tests have been conducted in two of the reservoirs.

From the first area where production tests were conducted, oil gushed at a constant rate of 2,177 oil barrels per day plus 1.63 million cubic feet of gas per day. From the second area where production tests were conducted, oil gushed at a constant rate of 3,706 oil barrels per day plus 2.49 million cubic feet of gas per day. Both production tests produced no water.

In view of the production test results, it was decided to conduct a diagonal drilling from the Blackbird drilling, in order to obtain further information on the reservoir. The diagonal drilling was intended to accelerate the evaluation process of the Blackbird field.

The diagonal drilling from the Blackbird drilling started in December 2006, and ended in early February 2007. Cores removed and electric logging conducted in the sandstone reservoir have confirmed expectations with regard to the size of the hydrocarbon section.

Concurrently, a complimentary two-dimensional seismic survey was conducted (including data processing) in blocks 12E and 12W, completed in August 2006 at a cost of $2.4 million.

According to initial evaluation by Premier Vietnam, based on currently available information, it is most likely that Dua and Blackbird oil fields would contain some 80 million recoverable oil barrels, based on the estimate that the oil in place in these oil fields may be between 180 and 620 million barrels.

Notice regarding forward-looking information – the aforementioned data with regard to production capacity of Dua and Blackbird oil fields is forward-looking information. The aforementioned information refers to data obtained from Premier Vietnam, and at this point in time these are only estimates of the above oil volumes, which are as yet uncertain. The above estimates should be updated when further geological and engineering information becomes available and/or due to a range of unexpected factors associated with oil and gas exploration (see also section 10.29, below on risk factors).

The cost of exploration operations in Vietnam in 2004, 2005 and 2006 amounted to NIS 1,868, NIS 816 and NIS 82,312 thousand, respectively.

10.5.3 Work Plan and Budget for 2007

Since production of oil from the fields is currently planned to commence in 2010, Premier Vietnam has commenced doing preparatory work to develop the two oil fields, and to prepare for a comprehensive 3D seismic survey which is due to commence in April 2007, and which is intended, *inter alia*, to assist in reducing the uncertainty relating to the quantities of petroleum in the Blackbird field. The planned seismic survey will be conducted over an area extending beyond the Blackbird field, in order to define new prospects for the next stage of exploration drilling.

The work plan for 2007 includes conducting a 3D seismic survey of the Blackbird discovery area and other prospects; continued evaluation of oil reserves in Dua and Blackbird fields; creation of development plan for the above fields; creating exploration plan for 2007 and 2008; and signing a contract with a drilling contractor. In addition, it is possible that in 2007 two drillings will be conducted, one for exploration and one for validation. Conduction of the drillings is contingent on results of analysis of the three-dimensional seismic survey and availability of the drilling rig.

The budget for 2007 is estimated at $96 million, of which $41 million are optional for conducting the two aforementioned drillings. Should the entire budget be used, Delek Vietnam is expected to pay its share (25%) of the above budget, which may amount to $24 million.

The results of this project may impact Delek Energy's business results in a most significant manner.

Notice regarding forward-looking information – the above estimate by Delek Energy with regard to operations undertaken in the Vietnam Project, to drilling costs, and to its impact on Delek Energy is forward-looking information. The above information is based on estimated Delek Energy received from the operator, on estimated data and on unproven assumptions. The estimate may not materialize should the operator's estimates change, should the plan change due to results of the survey, and/or should changes be made to the final development plans for Dua and Blackbird fields, and/or should a final contract be signed with a drilling contractor and/or by a range of unexpected factors associated with oil and gas exploration (see also section 10.29 below on risk factors).

10.5.4 Joint Operating Agreement

The joint operating agreement for the Vietnam project covers the same issues included in the joint operating agreement for the Yam Tethys project described in section 10.2.6 above, and decisions are made by a majority vote according to the share of holding in project rights.

10.6 Participation Rights in Oil Assets in the USA

10.6.1 AriesOne Limited Partnership

A. An agreement was signed in August 2006 between Delek Energy USA and a US financial institution, pursuant to which Delek Energy USA acquired the financial institution's share in the Aries One Limited Partnership, engaged in oil and gas exploration and production and registered in the United States (hereinafter: "**AriesOne**"). The rights acquired by Delek Energy USA are 83.49% of rights in AriesOne, with the remaining rights (16.51%) being held by the general partner, Aries Resources LLC, a US company from Houston, Texas engaged in management and development of oil assets. AriesOne owns petroleum assets located in the Southern USA (Texas, Louisiana, Colorado, Kansas, Oklahoma and New Mexico), including exploration and production areas containing 240 oil- and natural-gas-producing wells.

In exchange for the aforementioned rights, Delek Energy USA paid the seller $7.3 million and also assumed obligations by AriesOne amounting to $0.3 million. Delek Energy USA also committed to invest a sum of $2 million in performing three development drillings in undeveloped, proven reserves of AriesOne.

B. According to the reserve report as of Dec-31-06 received in March 2007 from an independent foreign company engaged in estimation of reserves in oil and gas reservoirs, the net proven reserves of AriesOne less royalties and less the share of third parties (100%) are as follows[1]:

	Oil (Barrels in thousands)	Natural Gas (Cubic feet in millions)
Proven, developed and productive reserves	2,176	1,507
Proven, developed and non-productive reserves	–	82
Proven, undeveloped reserves	1,521	970
Total	3,697	2,559

C. Work plan and budget

The work plan for 2007 includes three development drills at a total estimated cost of $2 million.

As of the report date, preparations are underway to conduct one drilling in the first half of 2007 (Lieurance) at a budget of $700,000 and development work involving layer cracking on another drilling, not yet completed, at a total cost of $100,000.

D. Management Agreement

Concurrently with acquisition of the rights, the parties agreed on terms of the limited partnership and of the management agreement under which the general partner would manage operations of AriesOne through Jan-01-11.**McCommons Oil Company**

[1] For oil price hedging transactions, see Note 8d1 to financial statements.

A. On Oct-10-06 an agreement was signed between Delek Energy USA; Jay Petroleum LLC, a company controlled by Isramco Inc. (hereinafter: "**Jay**"); and McCommons Oil Company, a US company engaged in the energy sector (hereinafter in this section: the "**Seller**"). According to the agreement, Delek Energy USA and Jay each acquired 50% of the right to explore and produce natural gas and/or oil in the layer known as Barnett Shale (at a depth of 2,100 meters or more), over a total area of over 11 million m^2 in Texas. In return for the said rights, Delek Energy USA and Jay each paid the seller a sum of $1.2 million.

B. Work plan and budget

The JOA outlined a preliminary work plan within whose framework a three-dimensional seismic survey would be conducted, along with two natural gas drillings and that pursuant to the results, the partners will consider conducting additional drillings. The budget for these operations is expected to be $5.5 million (for 100% of the rights).

C. Joint operating agreement

In addition to signing the acquisition agreement, Delek Energy USA and Jay signed a Joint Operations Agreement (JOA), pursuant to which, Jay Management Company LLC, wholly owned and controlled by Isramco Inc., was appointed operator of the exploration project.

10.7 Rights to Oil Production in Guinea-Bissau

10.7.1 On Feb-08-07 Delek International signed a contract with Premier Oil West Africa B.V., a subsidiary of Premier Oil (hereinafter: "Premier Africa"), under which Delek International acquired 11.43% of the rights in two marine concessions in Guinea-Bissau in West Africa: The Esperance concession (Blocks A4 and A5) and the Sinapa concession (Block 2) (hereinafter in this section: "the concessions").

The total concession area is 4,900 km^2 and they are located some 70-150 kilometers off-shore in shallow waters (up to 150 meters deep).

In return for the said rights, Delek International undertook to bear 22.86% of the drilling expenses (including bearing of Premier Africa), up to a total cost (for its own share) of $13.3 million and to bear its relative share (11.43%) of the project's remaining expenses.

10.7.2 Partners in the Concessions

For the Sinapa concession, the holdings are as follows: Premier Africa, which is also the project operator, holds 43.57% of the rights; Occidental of Guinea Bissau LLC holds 40% of the rights; Sterling Northwest Africa Holdings Ltd., which holds the concession, holds 5% of the rights; and Delek International holds 11.43% of the rights .

For the Esperanca concession, the holdings are as follows: Premier Africa, which is also the project operator, holds 48.57% of the rights; Occidental of Guinea Bissau LLC holds 40% of the rights; and Delek International holds 11.43% of the rights.

The company Empresa Nacional De Pesquisa e Exploracao Petroliferas, E.P (hereinafter: "**Petroguin**"), which is the national petroleum company of Guinea-Bissau, has an option, pursuant to terms of the concessions, to receive 30% of the rights in the project in case a commercial discovery is made, as defined in the partnership agreement signed between the partners in the project and Petroguin, in exchange for reimbursement of expenses incurred by the partners in conjunction with the project. In such case the rights of all parties would be reduced by 30%, so that Delek International's rights would be 8% of the rights in each of the concessions.

The agreement is subject to obtaining required approvals from the competent authorities in Guinea-Bissau.

10.7.3 Past Operations

Premier Africa has conducted in the past two drillings in the Sinapa concession area, which revealed oil signs. The drillings did not amount to a commercial discovery, but they allowed Premier Africa to expand the geological knowledge base and to identify additional prospects which it determined were drill-worthy and showing potential for commercial discoveries.

10.7.4 Work Plan and Budget

The work plan for the concessions includes two drillings in block A4, planned to be conducted sequentially at an estimated total cost of $64 million. The drillings are targeted at two large formations adjacent to salt diapiric structures, with each drilling being independent of results of the other drilling. The first drilling, Espinafre1, is located in 30 meters of water and was planned to be drilled to a depth of 2,800 meters, commenced drilling on Feb-07-07. The Espinafre1 drilling was sealed and abandoned for technical reasons before the target reserve was reached. The drilling was intended to examine a target reserve at a depth of at least 2,500 m, adjacent to a salt diapir (body). The drilling found salt at shallower depths than expected and repeated attempts to relocate the drilling from the diapir and continue drilling toward the target reserve diagonally have failed due to serious problems in the stability of the drilling shaft in shallower levels far above the target reserve. Due to the above, the project operator, Premier Africa, recommended to seal and abandon the drilling. The Espinafre1 drilling budget is expected to total $35 million, of which Delek Energy International is expected to cover $7.3 million.

With the completion of operations at the Espinafre1 drilling, the drilling rig is expected to begin working at the Eirozes1 site, that lies at a water depth of 120 meters and is planned to examine a potential oil reserve, that is larger than the target reserve at Espinafre1, that is at a similar depth.

The drilling is scheduled to last 30 days at a total estimated cost (100%) of $30 million.

10.8 Other Projects

10.8.1 In addition, Delek Energy is also currently working to locate and investigate additional investment opportunities in oil and gas exploration, development and production worldwide.

10.9 Products and Services

As of the report date, the limited partnerships provide natural gas to IEC and to ORL from Mari reservoir, and AriesOne provides natural gas and oil to various customers. As more gas and/or oil are discovered in the course of exploration operations by Delek Energy and/or the limited partnerships – Delek Energy will act to sell them.

10.10 Segmentation of Revenues and Profitability - Products and Services

Most of Delek Energy's revenues and profits as of the report date come from sale of natural gas and royalties from the Yam Tethys project. The rest of Delek Energy's revenues are derived from rights acquired in 2006 in the AriesOne partnership. Delek Energy's share of AriesOne's revenues (net, less royalties) in Q4 2006 amounted to NIS 9.6 million from oil sales and NIS 0.5 million from gas sales.

10.11 Accounts Receivable - Trade

10.11.1 Customers in Israel

As of the report date, the limited partnerships (together with other partners in Yam Tethys project) have signed four contracts to provide natural gas, totaling 21.5 BCM (excluding the volumes purchases under the addendum to the contract), which account for 68% of the total estimated gas reserves (at proven level) in Yam Tethys project (see table in section 10.2.3 above). Yam Tethys provides natural gas on a regular basis to two customers: IEC and ORL. Delek Energy's revenues from IEC in 2004-2006 accounted for 100%, 99% and 97% of its revenues in Israel, respectively.

Delek Energy is dependent on IEC, since cancellation or termination of the contract with IEC would materially impact Delek Energy's operations and profitability. For details of the contract with IEC, see section 10.25.1 below.

For a summary description of the limited partnerships' contracts for sale of natural gas, see section 10.25 below. The potential customers of Yam Tethys in Israel are customers from the electricity sector and significant industrial customers.

10.11.2 Customers is the United States

In 2004-2006 AriesOne sold oil to multiple customers, since in the USA oil and gas are commodities, whose prices are determined by global fluctuations in supply and demand. The US market is a large, perfect market and contracting is possible with a wide variety of customers. No single customer in the USA accounts for 10% or more of Delek Energy's total revenues.

10.12 Marketing and Distribution

10.12.1 The Yam Tethys project partners act to market gas from Mari and Noa reservoirs to potential customers beyond the current ones, and are at various stages of negotiations. There is no certainty that these negotiations would culminate in signing of binding contracts for gas delivery. As of the report date, the government-held company Israel Natural Gas Lines Company (INGL) (tasked with construction of the national gas pipeline system) has yet to complete said construction so as to allow gas to be delivered to additional customers and to additional IEC power plants. Consequently, the gas consumption rate of IEC as of the report date is lower than earlier anticipated by the partnerships, mostly due to said delay. Furthermore, two customers which have contracted with the partnerships (AIPM and Delek Ashkelon) have yet to be connected to the national pipeline system and therefore have yet to start consumption of natural gas.

10.12.2 The US oil market is highly developed, with proper infrastructure for delivery of oil and/or gas. Therefore marketing and distribution are made using existing infrastructure, and Delek Energy is not required to make investments in additional facilities.

10.12.3 If and as more commercial oil discoveries are made in the exploration project in Vietnam, Delek Energy and its partners would have to market such oil to the local market in Vietnam and to markets outside Vietnam; distribution would probably be independent, using oil tankers to carry the oil from the marine drilling site.

10.13 Order Backlog

For binding contracts by the limited partnerships for delivery of natural gas, see sections 10.25.1 through 10.25.4 below. As of the report date, it is not feasible to estimate at a high certainty level the forecast gas consumption under current contracts for sale of gas, primarily due to the uncertainty and possible delays in schedule for connection of additional power plants and consumers to the gas pipeline system. For the minimum quantity which IEC has committed to purchase, see section 10.25.1.

10.14 Competition

In the natural gas sector, sales are intended for local markets only due to impracticality of transporting gas other than by transmission pipeline, and therefore the competition is with entities operating in the same markets. In Israel as of the report date, the Yam Tethys Project partners are the only actual suppliers of natural gas. The partners believe that the other potential suppliers include:

A. The EMG Group, which holds import licenses for gas from Egypt and which has signed a contract to supply natural gas to IEC; and

B. British Gas group, which to the best of Delek Energy's knowledge has discovered, off the shore of Gaza, natural gas reservoirs of similar size to current discoveries at Yam Tethys.

Delek Energy estimates that these groups would, in the future, be able to supply substantial amounts of gas to the Israeli market. Nevertheless, in view of the time required for EMG to construct the infrastructure required to deliver gas from its gas reservoirs, Delek Energy estimates that Yam Tethys group would remain the sole natural gas supplier in Israel at least until early 2008.

Furthermore, to the best of Delek Energy's knowledge, the State of Israel has been in negotiations for a while now to purchase from BG gas produced from the above discoveries. Such a purchase, should it materialize, may have a material negative impact on future business of Delek Energy.

There are many players in the natural gas sector around the world, including mega corporations, and the volume of gas produced by Delek Energy are negligible compared to the global market. Oil

sales are not limited to local customers, and may be made on the local as well as on the global markets, hence the sales options are more numerous.

10.15 Seasonality

In Israel, IEC's gas consumption varies, *inter alia*, with seasonal changes in demand for electricity and with IEC's maintenance plan. In the third quarter of each year (the summer months) power consumption is highest, followed by the first quarter (the winter months). Accordingly, IEC consumes more gas in these quarters. Note that for some of the gas consumed in peak months, IEC pays a higher rate under terms of the addendum to the contract (see section 10.25.1 below).

Below are data of the breakdown of natural gas sales to IEC over the past two years:

	Q1 (in BCM)	Q2 (in BCM)	Q3 (in BCM)	Q4 (in BCM)
2006	0.5	0.5	0.7	0.6
2005	0.4	0.4	0.5	0.4

The seasonal effect of gas and oil consumption by customers in the USA does not materially impact Delek Energy's revenues from projects in the USA.

10.16 Facilities and Production Capacity

Yam Tethys Project

The production system of the Yam Tethys project includes, *inter alia*, a production platform; an marine pipeline of 42 km for transmission of gas; a temporary reception terminal on Ashdod shore (construction of a permanent terminal to replace it has started). The production platform is anchored to the sea bed in 236 meters of water. The top part of the production platform, above sea level, contains all the platform decks. The four decks, 60 meter long and 35 meter wide, contain, *inter alia*, production facilities planned for gas capacity of up to 600 million feet^3 per day (equal to 6 BCM per year). The platform also includes generators; space reserved for future installation of compressors; connection outlets for gas transmission pipeline; gas well heads; space for drilling machine; helipad; employee living quarters and work area; raised gas removal facility; antennas; fire extinguishing facilities; life boats and security devices; measuring and other facilities associated with the platform production system. Construction of the permanent reception terminal on Ashdod shore to process and measure natural gas is expected to be completed in Q3 2007.

Other than the aforementioned, the company has no additional production facilities of any substantial monetary value.

10.17 Human Resources

As of the report date, Delek Energy has no employees. Delek Energy operates mostly via external service providers and experts.

Delek Energy receives management services from two managers serving as CEO and co-CEO ("**the managers**"). The managers provide the management services via companies owned and controlled by them, but they commit to provide their services in person. Each person employed has signed waivers in which they commit to compensate and indemnify Delek Energy for any expense incurred by it should it be determined that an employment relationship existed between the employee and Delek Energy. In conjunction with the aforementioned management contracts, the managers were granted benefits associated with use of cars. In addition to the managers' services, Delek Energy and its subsidiaries receive from Delek Investments administrative and financial services, office and secretarial services, treasury management and accounting services in exchange for NIS 1,186 per annum. In addition to the above, Delek Energy (together with the limited partnerships and Delek Investments) receives consulting services from a geologist. In addition, Delek Drilling Management receives consulting and management services from one manager, under a consulting and management contract.

As of the report date, the limited partnerships do not have any employees (other than an administrative assistant at Avner partnership) and are managed by the general partners pursuant to the limited partnership agreement of each partnership. The general partners provide to the

limited partnerships management services including managers (directors of the general partner), comptroller services, accounting and office services. In addition to management of the general partner, the limited partnerships utilize consultants (including attorneys, geological and financial consultants) as required.

Note that under operating agreements in various projects to which Delek Energy is partner, the project operator employs staff for management and operation of the project.

10.18 Suppliers and Raw Materials

A project operator is appointed for each drilling project in which Delek Energy has rights. The operator contracts with professional contractors, which have the proper equipment, for each and every project. Currently in Israel there are no contractors who can conduct drillings or marine seismic surveys of the type conducted by the limited partnerships. Therefore, the partnerships need to contract with foreign contractors in order to obtain the necessary services. Drilling equipment is transported from all over the world according to availability, project type and special needs of each project. A significant increase in oil prices typically causes an increase in demand for service providers in the energy sector, leading to a significant increase in operating costs in the sector and to reduced availability of contractors and required equipment. In the three years prior to the report date, the increase in cost of service providers and decreased availability led to an increase in exploration costs and to delays in conducting drilling work.

Delek Energy does not directly contract with suppliers or professional contractors, and such contracting is left to the project operators.

Metal is a significant raw material in exploration facilities, as it is used to construct pipes, drill bits and platform structures. Global metal prices have increased significantly in recent years.

10.19 Working Capital

Revenues of the limited partnerships in conjunction with the IEC contract are received by the later of the 20th of the invoicing month or 15 working days from the invoicing date for gas supplied in the previous month. Revenues of the limited partnerships in conjunction with the ORL contract are received no later than 30 days after the billing period (as defined in the contract) or 20 days from the monthly invoicing date for the previous billing period. The partnerships make payments to operators of the joint ventures under terms stipulated in each operating agreement.

10.20 Financing

10.20.1 Delek Energy's operations are financed by foreign capital. The foreign capital is mostly from long-term loans granted by Delek Investments and a long-term loan granted by a subsidiary, Delek Energy Debentures (see section 10.20.2 below).

10.20.2 The unpaid balance of the loans (principal and interest) granted to Delek Energy and its subsidiaries by Delek Investments as of Dec-31-06 amounted to NIS 590 million. The unpaid balance of the loans (principal and interest) granted to Delek Energy by its subsidiary, Delek Energy Debentures as of Dec-31-06 amounted to NIS 57 million bearing average annual interest at 7.75% (linked to CPI). Note that financing received from Delek Investments is part of a framework contract under which Delek Investments may grant Delek Energy loans totaling up to $150 million.

10.20.3 Note that Delek Group guarantees the debentures issued by Delek Energy Debentures, having an un-redeemed balance as of Dec-31-06 amounting to NIS 57 million. Delek Energy has placed a lien to benefit Bank Leumi Trustees Ltd., which serves as trustee for holders of debentures issued by Delek Energy Debentures, on its rights to super royalties from Delek Drilling Partnership as collateral for redemption of debentures issued by Delek Energy Debentures.

10.20.4 Oil exploration operations (as distinct from production and development) of the limited partnerships is wholly financed by the shareholders' capital of the limited partnerships, raised pursuant to prospectuses for public offering of rights published by the limited partnerships. Pursuant to permit granted by the Income Tax Authority to the partnerships close to the date of their establishment,

the limited partnerships have committed not to obtain loans exceeding 2-3% of the amount raised from investors in the partnerships without prior consent of the Income Tax Authority[1].

10.20.5 On Mar-09-05 agreements to obtain non-recourse financing for the share of Israeli partners in Tam Tethys project (the partnerships and Delek Investments & Properties Ltd.) were concluded, totaling $275 million, with the shares of Delek Drilling Partnership, Avner Partnership and Delek Investments in the said amount is about $130, $120 and $25 million, respectively. The capital was raised by a dedicated company named Delek & Avner – Yam Tethys Ltd. (hereinafter in this sub-section: ("the SPC") which issued to institutional investors in the USA, pursuant to Rule 144a, debentures in the total amount of $275 million ("the debentures"), of which $175 million bearing fixed interest at 5.326% per annum, and $100 million bearing variable interest at 3-month LIBOR plus a margin of 1.1% per annum. To guarantee repayment of the debentures, the partnerships, Delek Investments and the SPC placed liens on their rights in various assets associated with the Yam Tethys project (primarily the contract with IEC).

10.20.6 Below are the average interest rates on loans from bank and non-bank sources effective in 2006 and are not intended for specific use by Delek Energy:

	Average Interest Rate	
	Short Term Loans	**Long-Term Loans**
Bank Sources	Libor + 1.5%	--
Non-Bank Sources	--	6.2%

10.20.7 **Credit Limits**

In addition to the collateral mentioned in section 10.20.6 above in conjunction with the debentures, the Israeli partners in Yam Tethys project have undertaken several covenants, including the following:

A. Not to reduce their share of the Ashkelon lease;

B. Not to vote in the operating committee for any additional operations not intended for production of gas to be supplied to IEC (hereinafter in this sub-section: "**additional operations**") unless one of the following is true: (1) The partnership has all the monetary sources necessary to fully finance for additional operations and has given assurances to the debenture trustee that the monetary sources are liquid and are earmarked for the additional operations, until they are completed; (2) The vote for the additional operations was approved by a majority of bondholders; (3) Rating agencies have confirmed that commitment to undertake the additional operations will not negatively impact the rating.

C. Not to neither commit nor agree to expand or modify the production system, unless conditions stipulated by the financing documents are met.

10.20.8 **Credit Rating**

On Jan-18-07 Moody's issued an update to the rating report, maintaining the debenture rating at Baa3 with stable outlook. In addition, on Jan-19-07 Standard and Poor's issued an update to the rating report, maintaining the debenture rating as before: BBB- with stable outlook.

10.20.9 **Credit Facilities**

Delek Energy has obtained preliminary approval, subject to certain conditions, to obtain a credit facility from two banks in Israel amounting to $60 million. Delek Energy is in negotiations with the two banks to finalize terms for this credit. Delek Energy is also reviewing raising capital and/or debt from institutional investors and/or from the general public.

10.21 Taxation

10.21.1 For details of taxation of Delek Energy profits, see Note 33 to the financial statements. Delek Energy has tax assessments considered final through 2002.

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[1] In September 2001 the partnerships received approval from the Income Tax Authority to obtain loans for construction of production infrastructure for the Yam Tethys project.

10.21.2 The Partnerships are not taxed under the Income Tax Ordinance (Revised), 1961 (hereinafter: "the Ordinance"), and revenues, expenses, profits and losses of each partnership are assigned to the general partner (according to its share of the partnership) and to unit holders (including Delek Energy) which are "eligible holders" according to their share of holdings in the partnership. An "eligible holder" is any entity holding participation units on December 31 of the tax year.

10.21.3 An eligible holder is subject to provisions of Section 63 of the Ordinance and to Section 13 of the Income Tax Law (Adjustments for Inflation), 1985. Accordingly, the eligible share that each eligible holder is entitled to from partnership revenues for the tax year, including their share of the partnership's exploration and development expenses (as per Income Tax Regulations (Deductions from Revenues of oil right holders), 1956, will be deemed as revenues and/or expenses of the eligible holder, and are to be included in the income report he is obligated to submit according to provisions of the Ordinance.

10.21.4 In October 2004, the partnerships signed an agreement with the Income Tax Authority with regard to tax withholding by the limited partnerships. Pursuant to the agreement, the limited partnerships have committed, under certain conditions, to pay the required tax annually, for the taxable revenues of the eligible holders of participation units, arising from revenues of the limited partnership assigned to them, as set forth above. The tax payment will constitute an advance tax payment on behalf of the unit holders, and will be deducted from the partnership capital.

10.22 Environmental Protection

Drilling and production operations carry environmental risks associated with oil gushing and/or oil spill and/or gas leak. In Israel, the Oil Law and its regulations stipulate that, *inter alia*, the drilling shall be accomplished with due caution so as to prevent pouring of liquids and gases into the ground or gushing from it uncontrollably, as well as to prevent their penetration from one geological layer to another. Furthermore, it is forbidden to abandon a well unless it is sealed in accordance with instructions of the regulator. As set forth above, under licenses and permits obtained by the Yam Tethys Project partners in conjunction with construction of the project's production system, the partners are required to operate incompliance with environmental protection standards set forth in said licenses and permits.

Delek Energy's operations abroad are also subject to standards and legislation pertaining to environmental protection, under laws of each country where operations take place. Delek Energy does not serve as operator in any of the projects it is involved with, and subject to operating agreements applicable to the various projects, the operators are required to comply with applicable laws. The cost of operations related to environmental protection is included in the different projects' budgets.

10.23 Restrictions on and Supervision of Operations

10.23.1 Israel

In Israel, oil and gas exploration and production are primarily regulated under the Oil Law, 1952 and its associated Oil Regulations, 1953. Exploration is conducted under permits, licenses and leases (as defined in the Oil Law) granted by competent authorities, and which include work plans, schedules and various restrictions. The Oil Law also stipulates that a lease owner must pay the State royalties equal to one eighth of oil produced in the lease area, but no less than the minimum royalties stipulated by the law. Oil rights may be revoked if the right owner fails to comply with legal provisions or with terms of the oil right. In Israel, transmission, distribution and marketing of natural gas are regulated by the Natural Gas Market Law, 2002. Construction and operation of a natural gas transmission system and distribution network require a permit from the Minister of Infrastructures.

10.23.2 Vietnam and Guinea-Bissau

In Vietnam and Guinea-Bissau, the project partners do not directly contract with the government for project execution. In these countries, the government authorizes the national oil company to manage oil and gas rights throughout the country. Therefore, oil and gas exploration and/or production rights in these countries are granted under a cooperation agreement with the national oil company.

In projects carried out in these countries, the project partners contract Production Sharing Agreements or Agreements for Joint Venture Participation) with the national oil companies, which regulate the relationship between the national oil company and the project partners for operation of the project. These agreements include a definition of partners' rights and obligations associated with the oil rights, which apply to oil and gas exploration operations in the country where the project takes place, including: The exploration plan and schedule, including investments required and the rights obtained in exchange for such investments; following a commercial discovery – commitment of the project partners to develop the discovery and the oil or gas field discovered, and to produce at maximum efficiency. These agreements also typically determine the tax rates applicable to the project and the royalties and bonuses payable by project partners. The national oil company is granted an option to acquire some of the rights in case of a commercial discovery. See sections 10.25.10 and 10.25.11 below.

10.23.3 The USA

In the USA, acquisition of oil and gas exploration and production rights is usually from the land owners. Typically, only the oils and gas exploration and production rights are acquired, with other ownership rights in the real estate remaining with the land owner. In exchange for acquisition of exploration and production rights , the land owner usually receives current lease payments as well as royalties from the buyer in case discovered oil or gas is produced. The rights buyer is committed to minimal exploration operations, otherwise they may lose the right to explore and produce oil or gas, and the land owner may then sell the exploration and production rights to a third party. Oil and gas exploration operations are subject to various laws, including environmental protection laws regarding prevention of pollution of land, water reservoirs and air etc.

10.24 Antitrust

10.24.1 On Oct-11-00 the Antitrust Supervisor (in this section: "the Supervisor") consented to transaction in which the Israeli partners acquired the Reading & Bates rights in Yam Tethys project. This consent, as amended, was contingent on the following major conditions:

A. By a date set by the Supervisor (as amended on multiple occasions), Delek Group (including its affiliates) will not hold, directly or indirectly, rights in the marine oil and gas exploration projects known as "Med Ashdod", "Ashdod Enclave" and "Med Yavne" (hereinafter in this section: "**Med project**") or the holding share of Delek Group in Yam Tethys project would not exceed its holdings in Yam Tethys as of Aug-01-00. In discussions held between representatives of the limited partnership and the Supervisor, the latter confirmed that sale of the share associated with natural gas in the Med project would be deemed to comply with the above condition.

B. There will be a separation of personnel such that information will not be exchanged relating to natural gas operations between the Yam Tethys and Med projects (i.e.: Med Yavne lease and Med Ashdod lease).

C. Any purchase of holdings by Delek Group (including its affiliates) of 5% or more in a corporation engaged in exploration, production, transmission, marketing or sale of natural gas in Israel, requires prior approval of the Supervisor – if the corporation has any natural gas discoveries; this sub-section (c) does not apply to the Yam Tethys joint venture.

As set forth in section 10.3.1 above, in October 2004 Delek Drilling Partnership contracted to sell to Ratio its share of the Med Yavne lease and the Med Ashdod license to Ratio (the sale of the Med Ashdod lease was restricted to natural gas rights only). On Feb-07-05 the Supervisor confirmed that it has no intention to intervene in terms of the contract with Ratio.

10.24.2 On Feb-28-06 the Supervisor consented to the transfer of participation rights in the Matan and Michal licenses to Noble. The Supervisor's decision was contingent on the following major conditions:

A. The "local corporations" (as defined below) would not hold jointly, whether on their own or with additional holders, any gas rights other than those directly and exclusively arising from the Matan and/or Michal licenses, without express prior written consent of the Supervisor. By Dec-31-06 the "local corporations" shall terminate any joint holding in gas rights, other than those directly and exclusively arising from the Matan and/or Michal licenses, which they held jointly on the decision date, whether on their own or with other holders, unless such joint holding is expressly permitted in writing by the Supervisor.

B. In any arrangement, agreement or understanding, verbally or in writing, with regard to setting a mechanism or system for decision making between holders of Matan and Michal licenses with regard to marketing of natural gas produced under the Matan and Michal licenses, none of the "local corporations" shall individually own, directly or indirectly, any right or power to prevent the other holders from taking any decision or action with regard to marketing of natural gas produced under the Matan and Michal licenses.

C. Definitions: The "local corporations" – "Delek Group" and "Isramco"; "Delek Group" – Avner Oil Exploration Limited Partnership and/or Delek Drilling Limited Partnership and/or any person affiliated with any of them; "Isramco" – Isramco Negev 2 Limited Partnership and any person affiliated with it.

10.24.3 On Jan-18-07 the partnership filed a request with the Supervisor to waive approval of a restrictive agreement by the Antitrust Court. The above request was filed in conjunction with conducting joint exploration operations by the partnerships and Isramco in the area of licenses 331/Ohad and 332/Shimshon. In the request, the partnerships claimed that such joint exploration operations do not constitute a restrictive agreement as defined in the Business Antitrust Law, 1988 and that the request is filed merely for the sake of caution and in view of the Supervisor's decision on the Matan and Michal licenses. As of the report date, the Supervisor's decision on the request is still pending.

10.25 Material Agreements

Delek Energy contracted certain material agreements which were effective in the reported period as follows:

10.25.1 Agreement to Sell Natural Gas to IEC:

A. On Jun-25-02 the partners of Yam Tethys project (in this section: "**the sellers**") and Israel Electric Company Ltd. (in this section: "**IEC**" or "**the buyer**") contracted an agreement for delivery of natural gas to IEC.

B. The term of the agreement is through Jul-01-14 or by such date as the sellers have delivered to the buyer a cumulative gas volume equal to 643 million MMBTU[1] (about 18 BCM) (hereinafter: "**total contracted volume**"), whichever is earlier.

C. The sellers and IEC may terminate the agreement with prior written notice of 30 days or more, should the other party (and for the sellers – should any of them) take any bankruptcy action (as defined in the agreement) which is likely to negatively impact the discharge of their obligations pursuant to the agreement. The buyer and sellers have agreed not to exercise any right they may have to lawfully terminate the agreement other than in conjunction with significant or continued breach of material provisions of the agreement, and only after granting a 90-day period to the party in breach to remedy such breach (unless a shorter period is specified in the agreement).

D. The agreement further stipulates that, without prejudice to sellers' obligations under the agreement with regard to maintaining gas reserves, the sellers would not be limited to any sources of natural gas (either from Israel or imported) which they supply to the buyer under the agreement.

E. The sellers will ensure that at any time during the term of the agreement they shall have available remaining reserves in reservoirs amounting to 130% of the remaining total contracted volume. The agreement sets forth instructions for reporting on and supervision of the remaining reserves and for adjustment of certain contractual instructions should the sellers fail to maintain sufficient remaining reserves as required.

F. The agreement stipulates the annual contracted volume of gas, which changes over the term of the agreement, *inter alia*, according to the pace of completion of the transmission system and its connection to buyer's power stations such as to allow delivery of gas at said power stations (hereinafter in this section: "**the annual contracted volume**").

G. The supply of gas under the agreement is on an hourly basis with a minimum and maximum volume per hour, in accordance with procedures and mechanisms set forth in the agreement.

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[1] MMBTU equals one million BTU. BCM is one billion cubic meters. As of Dec-31-06 a gas volume of 5.1 BCM has been delivered to IEC.

H. Minimum Bill Quantity: The agreement specifies the minimum bill quantity annual amount, at 80% of the annual contracted volume (subject to adjustments) for which the buyer has committed to pay even should the buyer fail to consume said volume, subject to provisions of the agreement (hereinafter: "**minimum bill quantity**") as well as instructions regarding calculation and adjustments of the minimum bill quantity, including for cause of Force Majeure or failure to supply by the sellers. The agreement also specifies a mechanism for the accumulation of excess volume consumed by the buyer in the course of any year, and its use to reduce IEC's obligation to purchase a minimum quantity, as set forth above, in subsequent years. Furthermore, the agreement specified mechanisms allowing IEC to obtain gas at no additional charge up to the volume paid for, on account of gas not consumed due to activation of the minimum bill quantity mechanism.

I. Financial Value of the Agreement: The Group estimates that total net receipts (excluding royalties to the State and to third parties, including interested parties and Delek Energy) arising to Delek Drilling Partnership, to Avner Partnership and to Delek Investments, from the production start date for their share alone, at $330 million, $300 million and $63 million, respectively, based on hedging agreements contracted by the partnerships and Delek Investments. (See subsection (j) below). Furthermore, Delek Energy and Delek Investments have direct revenues from super royalties paid by Delek Drilling Partnership (see section 10.25.7 below).

Notice regarding forward-looking information – the aforementioned estimate by the Group is forward-looking information, based on its estimates of future gas consumption by IEC, based on professional opinion obtained by the general partners in the limited partnerships. The estimate may not materialize should actual gas consumption by IEC be lower than the projections aforementioned.

J. The contracted price for the gas is denominated in USD per energy unit (BTU) and is linked to a basket of fuels and to the US Producer Price Index according to the mechanism in the agreement, including minimum and maximum prices. Note, in this context, that the partnerships and Delek Investments have contracted hedging agreements following signing of the contract with IEC and have effectively set the price for gas volumes to be sold under the agreement with IEC at $2.47 per million BTU.

K. Gas Quality: Natural gas to be delivered under the contract must be, at the point of delivery, in accordance with specifications set forth in the agreement and according to requirements of the transmission company as approved by the appropriate authorities from time to time. The buyer has the right to refuse delivery of non-compliant gas until such non-compliance is remedied. All disputes between the parties with regard to gas quality may be submitted to an expert for resolution at the request of any of the parties.

L. Breach and Damages: Under the agreement, should the sellers fail to supply in any given hour the gas volume ordered by the buyer under provisions of the agreement, and should the non-supply exceed the deviation allowed by the agreement, the sellers would compensate the buyers by selling to the buyers in the subsequent month gas at a discounted price up to the volume of gas not supplied in breach of provisions of the contract. Furthermore, the agreement sets forth specific breaches by any party for which damages are payable at high rates (including monetary damages). The agreement also sets limits to liability of each party for breach of some of the agreement provisions at amounts specified in the agreement.

M. Collateral and Guarantees: The agreement establishes collateral to be provided and maintained by each of the sellers to benefit the buyer, in order to guarantee the sellers' obligations pursuant to the contract, all at dates, terms and amounts set forth in the agreement. The shares of Delek Drilling Partnerships and Avner Partnership in said collateral are $7.65 million and $6.9 million, respectively, through Mar-15-06 and $12.75 million and $11.5 million, respectively, after Mar-15-06. The aforementioned collateral has been provided by the partnerships in form of bank guarantees.

N. Relationships between Sellers and the Seller's Coordinator: The sellers operate jointly on issues such as development of the reservoir, the sellers' facilities and gas production, delivery and supply pursuant to the agreement. Notwithstanding, the buyer declares that none of the agreement provisions shall be deemed to create mutual liability between the sellers, and each seller is individually liable to the buyer for its share of the oil rights and in conjunction with any liability arising from the agreement. Although the buyer may order gas volumes by a single

notice to the sellers' coordinator, the volume deemed as ordered from each of the sellers will be the portion of each of the sellers out of the total volume ordered.

O. On Aug-15-06 the sellers contracted an addendum to the agreement for supply of additional volume of natural gas (hereinafter: "**the addendum to the agreement**"). Pursuant to the addendum to the agreement, the sellers have granted to IEC an option to purchase additional volumes of natural gas, primarily to provide an answer to IEC's gas supply requirements during peak consumption hours. The aforementioned option is valid through 2007 and pertains to additional gas volumes purchased since July 2006. The price for gas purchased under provisions of the addendum to the agreement is significantly higher than the price at which IEC purchases natural gas under the current agreement.

10.25.2 Agreement for Sale of Natural Gas to Oil Refineries Ltd[1]:

On Sep-03-04 an agreement was signed between the Yam Tethys Project partners and Oil Refineries Ltd. ("**ORL**"), for supply of gas to ORL's oil refinery in Ashdod. Under the agreement, the total contracted volume that Yam Tethys group is required to supply to ORL is 1.3 BCM. The term of the contract is ten years from the end of the trial period specified in the contract, or until ORL consumes the total contracted volume, whichever is earlier. ORL has committed to take or pay for a minimum annual gas volume. The total financial value of the agreement (for all Yam Tethys project partners) is estimated at $120 million.

Gas supply to ORL started in November 2005.

10.25.3 Agreement for Sale of Natural Gas to Delek Ashkelon

In August 2005 an agreement was signed and approved between Yam Tethys project partners and Delek Ashkelon, which is a company controlled by Delek Group for supply of gas to Delek Ashkelon's power station adjacent to the desalination plant in Ashkelon. Gas supply under the agreement shall commence when natural gas arrives at Delek Ashkelon's power station, subject to terms set forth in the agreement, and shall terminate after 15 years from the end of the run-in period of the power station or Jun-30-22, whichever is earlier. The annual gas volume to be purchased by Delek Ashkelon is 0.12 BCM. The total financial value of the agreement (for all Yam Tethys project partners) is estimated at $160 million.

Gas supply under this agreement is expected to start in Q2 2007.

10.25.4 Agreement for Sale of Natural Gas to AIPM:

On Jul-29-05 an agreement was signed between the Yam Tethys project partners and American Israeli Paper Mills Ltd. (hereinafter: "**AIPM**") for supply of natural gas to AIPM. Gas supply under the contract shall commence upon completion of the delivery pipeline and required facilities, and shall terminate on the earlier of: 5 years from commencement of gas flow or upon purchasing of 0.43 BCM, but no later than Jul-01-11.

The gas price formula specified in the agreement is based on the price of fuel oil with a discount component, including minimum and maximum prices. AIPM has a take-or-pay agreement for a minimum annual volume of gas according to a mechanism set forth in the agreement.

The total financial value of the agreement (for all Yam Tethys project partners) is estimated at $40 million. Actual revenues will be influenced by a variety of conditions, primarily the price of fuel oil and gas consumption rate.

Gas supply under this agreement is expected to start in the second half of 2007.

10.25.5 Joint Operating Agreement for Yam Tethys Project (see section 10.2.6 above).

10.25.6 Financing Agreements for Yam Tethys Project (see section 10.20 above).

10.25.7 Agreements on Royalty Payments to the Company:

Royalties received from Delek Drilling Partnership

Delek Energy and Delek Israel (hereinafter in this sub-section: "**the transferors**") and the general partner of Delek Drilling Partnership, on behalf of the partnership, signed in 1993 a rights transfer

[1] Following the division of ORL, this contract is being transferred to Ashdod Oil Refinery Ltd.

agreement. The right of Delek Israel was transferred on Mar-30-00 to Delek Investments and Properties Ltd. as part of a re-organization of Delek Group.

Under the agreement, Delek Drilling Partnership has committed to pay the transferors royalties at rates set forth below out of the Delek Drilling Partnership's share of oil, gas or any other material of value produced and exploited from the oil assets in which Delek Drilling Partnership has or will have an interest (before deduction of any royalties, but after deduction of oil used for production). The royalty rates are as follows: Until such date as the investment of Delek Drilling Partnership is recouped, royalties will be paid at a rate of 5% of land oil assets and 3% of marine oil assets; after such date – 15% of land oil assets and 13% of marine oil assets.

Delek Energy estimates that the royalties will increase from 3% to 13% in Q3 2007.

10.25.8 The Limited Partnership Agreements of Delek Drilling and Avner : Delek Drilling Management (1993), Ltd., and Avner Oil and Gas Ltd. are party, as general partners, to the limited partnership agreements of Delek Drilling Partnership and Avner Partnership (as the case may be). Most of the provisions in the limited partnership agreements of Delek Drilling and of Avner are essentially similar. Below is a summary description of the major provisions of the above agreements (in this section: "the limited partnership agreement"):

A. The limited partnership agreement was signed between the general partner on one side and the limited partner and trustee on the other.

B. The goals of the partnerships are to participate in oil and/or gas exploration operations in geographical regions specified in the limited partnership agreement.

C. The main expenses of the partnerships will be "exploration and development expenses" as defined in the Income Tax Regulations (Rules for Tax Calculation on Holding and Sale of Participation Units in an Oil Exploration Partnership), 1988.

D. The general partner of each partnership is entitled to 0.01% of revenues and is liable for 0.01% of expenses and losses of the limited partnership, as well as for expenses and losses of the limited partnership for which the limited partner may not be liable, due to limitations pertaining to the limited partner.

E. Under provisions of the limited partnership agreement, the general partner will manage all of the limited partnership affairs at his discretion and to the best of his ability, and shall make his best endeavors in order to carry out the limited partnership's goals as set forth in the limited partnership agreement. Each partnership appointed a supervisor, given certain specific supervisory authority intended to protect the interests of holders of participation units in the partnerships. The general partner is entitled to monthly management fees of $40,000 and to reimbursement of certain direct expenses allowed under the limited partnership agreement.

F. The limited partnership agreement stipulates that all of the limited partnership's profits, which are lawfully eligible to be distributed by the partnership as profits after deduction of amounts (excluded in determining the profit) required by the partnership - will be distributed to the partners, according to their rights, as set forth in the limited partnership agreement.

G. The general partner and/or his employees and/or his management shall not be liable to the limited partnership nor to the limited partner for any deed or omission made on behalf of the limited partnership under authority granted to the general partner within or pursuant to the agreement or by law, unless said deeds were made fraudulently or maliciously or constitute gross negligence. The agreement also includes provisions with regard to insurance and indemnification of the general partner.

H. The term of the limited partnership shall remain in effect as long as the limited partnership owns, directly or indirectly, an un-expired oil asset or rights therein or in any oil or gas to be produced. The limited partnership shall be terminated before the specified dates if it is disbanded earlier by order of the limited partnership agreement or by law or by the partners' consent.

Note that the limited partnership agreement of Avner Partnership stipulates that the general partner may serve as operator of oil exploration operations in areas where the limited partnership has interests, and will be eligible to be appointed operator in areas where it may have interests in the future.

Furthermore, the limited partnership agreement of Avner Partnership specifies the right to royalties at 6% of the entire share of Avner Partnership in oil and/or gas and/or any other

material of value produced and exploited from oil assets where Avner Partnership has or may in the future have an interest (before deduction of any royalties, but after deduction of oil used for production); Delek Investments is eligible to 1% of the aforementioned 6%.

10.25.9 Vietnam Agreements

A Production Sharing Contract was signed for each different block in Vietnam (hereinafter in this section: "**PSC**"). The PSC specifies the terms for conducting oil exploration in the project area, including: The term of the agreement; project area; project work plan; royalties payable by project rate of progress; tax rates; bonuses payable by project development stage; and the right of PetroVietnam to acquire 15% of rights in the project in exchange for expense reimbursement, in case of a commercial discovery. The term of the agreement is specified by progress in work stages, with the overall term being through 2030. Note that in addition to the PSC, the partners in the Vietnam project have signed a Joint Operating Agreement worded as commonly accepted in the oil exploration sector.

Under the PSC, royalties are paid by set tiers according to average daily production rate. Royalties for oil production range from 4% at an average daily production of up to 20,000 barrels, and reach 20% at an average daily production exceeding 150,000 barrels. Royalties for natural gas production range from 0% at an average daily production of up to 5 million m^3, and reach 6% at an average daily production exceeding 10 million m^3.

Furthermore, the PSD makes a distinction between the share of production intended to recoup expenses (both capital investments and current investments) or "Cost Oil" at 70%, and the share intended for distribution as profit to partners, or "Profit Oil" at 30%[1].

Under the PSC, the production classified as Profit Oil is shared between PetroVietnam and the right holders in the project (including PetroVietnam after exercise of the option) according to tiers specified by average daily production rate. The part paid to right holders in the project ranges from 82.5% at average daily production up to 15,000 barrels, and gradually decreases to 40% at average daily production exceeding 150,000 barrels. [2]With regard to natural gas, the rate is the same and quantities are converted at 1 oil barrel per 6,000 cubic feet.

The PSC further stipulates the tax rates applicable, including income tax, VAT, export taxes etc. as well as bonuses payable based on production rate.

10.25.10 Guinea-Bissau Agreement

On Feb-08-07 Delek International and Premier Africa signed an agreement to transfer rights in the Esperance and Sinapa concessions in West Africa (hereinafter: "**the concessions**"). Under the agreement, Premier Africa transferred to Delek International 11.43% (out of 100%) of its rights in the concessions. Under the agreement, Delek Energy International assumes the provisions of the Agreement for Joint Venture Participation in the two concessions, as amended by the national oil company of Guinea-Bissau, Petroguin, from time to time (hereinafter: "**AJVP**"). The AJVP stipulates the terms for operating in the concession areas, including: Area of the licenses; work plan; rights distribution; creation of a management committee including a representative of Petroguin, and which is to make decisions subject to a 51% majority; execution budget; bonuses and royalties payable to Petroguin at several project milestones; the income tax rate for project revenues; and provisions with regard to liability and insurance. The agreement grants to Petroguin 30% of the rights in the project in exchange for expense reimbursement in case of a commercial discovery. Note that in addition to the AJVP, the partners in the Guinea-Bissau project have signed a Joint Operating Agreement worded as commonly accepted in the oil exploration sector.

Under the agreement, royalties are paid according to average daily production rate, ranging from 5% at an average daily production rate of up to 10,000 barrels, and gradually increasing to 12.5% at an average daily production rate exceeding 20,000 barrels. In case of natural gas production, the royalty rate is fixed at 5% for any production rate.

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[1] The above rates are according to an amended PSC which is in the process of being signed; under the current agreement the Cost Oil in case of gas discovery is 70%, but in the case of oil discovery it is 35%.

[2] The above rates are under the amended PSC which is in the process of being signed; under the current agreement the distribution is at slightly different rates.

10.26 Legal Proceedings

On May-01-03 Avner Partnership received a motion for approval of a derived lawsuit (hereinafter in this sub-section: "**the motion**") along with a derived lawsuit (hereinafter: "**the lawsuit**") filed by a shareholder in Cohen Development and Industrial Structures Ltd. (hereinafter: "**Cohen Development**") against Avner Partnership, Avner Oil and Gas Ltd. and directors of Cohen Development. The lawsuit involves claims of the plaintiff that the rights of Cohen Development to receive royalties from production and exploitation of oil assets by Avner Partnership was allegedly impaired, by the fact that the limited partnership has transferred oil rights in marine oil assets to third parties, without ensuring that rights recipients would undertake the commitment to royalties to Cohen Development out of production derived from said oil assets. The Tel Aviv District Court rejected the motion, stating that it was filed in bad faith and deceptively. In a hearing on Nov-01-06 in the Supreme Court on appeal of the District Court's decision to reject the motion, the Supreme Court ordered the case returned to the District Court for discussion of the issues of good faith and of validity of the affidavit attached to the motion. The Supreme Court decided that should the court reject the motion by Avner Partnership and other defendants to reject the motion out of hand, they would maintain all of their claims. The Supreme Court further stated that the deposit paid to the Supreme Court in conjunction with the appeal hearing, would be transferred to the District Court to serve as payment of expenses there, should any be awarded.

10.27 Business Objectives and Strategy

Delek Energy operated to review and locate investment opportunities around the world, in order to expand its operations in oil and natural gas exploration and production. This operation is part of Delek Energy's strategy for creating value by putting together an international diversified and balanced portfolio of investments in oil and/or natural gas assets expected to yield returns in the mid- to long-range, combining exploration projects at low risk and development projects with exploration projects which may be significant for Delek Energy. To this end, Delek Energy is geographically focused on preferred operating areas, in cooperation with experienced partners in those areas, while maintaining its leading position, extensive experience and professional capacity in this sector in Israel. In order to achieve its objectives, Delek Energy strives to develop its professional capacity, including independent operation capacity and creation of management and control systems which would allow it to expand operations in Israel and globally.

10.28 Insurance Coverage

In each drilling project in which Delek Energy participates, it maintains property insurance, as is common practice in this sector, of type Control of Well (for taking control of a well which is out of control, including new drilling expenses) as well as liability insurance for damage to third parties and/or to employees.

In addition, Delek Energy holds directors liability insurance under a policy acquired by Delek Group for group companies.

10.29 Risk Factors

Oil and gas exploration and the development of oil and gas discoveries involve large monetary outlays with a high financial risk, primarily for reasons set forth below. This is even more significant with regard to oil exploration and production operations at sea.

10.29.1 Fluctuations in the USD Rate: Delek Energy is exposed to fluctuations in the USD rate. Revenues of the limited partnerships under current agreements for sale of natural gas (and the hedging agreement in conjunction with the IEC agreement) are denominated in US dollars and therefore a decline in the USD rate would cause a decrease in NIS revenues of Delek Energy and the limited partnerships. Note that most of Delek Energy's expenses are also denominated in USD, however its financing is primarily NIS-denominated.

10.29.2 Dependence on Global Oil Prices: The prices paid by consumers for gas in reservoirs in which the partnerships are party, are derived, *inter alia*, from prices of alternative energy sources to gas, such as oil and coal. Fluctuations in prices of alternative fuels could influence the prices which Delek Energy is able to obtain from its customers for gas sold by the partnerships and/or may influence the viability of production from newly discovered reservoirs (if any) by Delek Energy and/or its subsidiaries.

10.29.3 Competition for Gas Supply: To the best of Delek Energy's knowledge, as of the report date there are two major competitors for gas supply in the Israeli market (see section 10.14 above). In light of the relatively small Israeli gas market, said competition may lead to decreased prices and consequently may impact the ability of the limited partnerships to market the gas reserves discovered by them or to be discovered by them in the future. With regard to oil exploration in Vietnam and West Africa, too, Delek Energy may have to compete with other gas suppliers for supply of gas to the local markets in Vietnam and West Africa, inasmuch as natural gas discoveries are made.

10.29.4 Uncertainty Regarding the Construction of the National Gas Pipeline System: The ability of the Yam Tethys project partners to sell their gas to other potential consumers and to increase the gas volume supplied to IEC is dependent, *inter alia*, on establishment of a national gas pipeline system. As of the date of this report, there is still uncertainty with regard to the completion date of said system.

10.29.5 Insurance: Although Delek Energy is insured against possible damages with regard to projects it is involved with, such policies do not cover all potential risks and therefore the insurance payout may not cover all potential losses. Furthermore, there is no certainty that appropriate policies may be purchased in the future under reasonable commercial terms, if at all.

10.29.6 Operational Risks: Oil and gas exploration and production operations are exposed to risks such as uncontrolled gushing from the well, explosion, collapse and conflagration of the well. Any of these may cause damage or destruction to the oil or gas wells, production facilities, exploration equipment as well as bodily injury and damage to property. An additional risk is of equipment becoming embedded in the drilling well such that continuation of drilling operations may be impossible or may involve significant expenditure. Should any of these events occur at sea, consequences may be extremely severe and major damage may be caused. Furthermore, there is risk of liability for pollution damage due to gushing and/or leaking of oil and/or gas. There is no certainty that all required insurance to cover said risks may be obtained, nor that coverage provided by the insurance policies obtained would be sufficient.

10.29.7 Dependence on Contractors, Equipment and Professional Services: Currently in Israel there are no contractors for drilling or seismic surveys of the type carried out by the limited partnerships at sea. Therefore, the partnerships contract with overseas contractors to conduct such work. Furthermore, the number of rigs and other vessels capable of drilling at sea in general, and in deep water in particular, is small compared to the currently large demand and there is no certainty that proper vessels would be available for drilling when required. Therefore offshore oil exploration (in Israel and abroad) may involve high costs and/or significant delays in schedules set in the work plans, or part thereof. Contracting with foreign contractors for offshore oil exploration, development and production operations (including maintenance and repairs contractors) may sometimes be difficult due to the security and geo-political situation of the State of Israel.

10.29.8 Exploration risks: Oil and gas explorations are not an exact science, hence they involve a high degree of financial risk, since failed exploration may cause loss of all invested monies. The geological and geophysical means and techniques do not provide an accurate forecast as to the location, shape, features or size of oil or gas reservoirs. Therefore, determining exploration prospects and size estimates of existing reservoirs and proven gas reserves therein may be based, to a large extent, on partial or approximate data and on unproven assumptions. It is obviously impossible to ensure that oil or gas will be found at all as a result of exploration operations, or that it would be commercially viable for production and exploitation. Furthermore, there is shortage of direct geological and geophysical information for some of the offshore areas of the limited partnership's oil assets. This is due, *inter alia*, to

the limited number of drillings conducted at sea and the paucity of information that may be derived from them. Furthermore, changes may occur from time to time to estimates of proven gas reserves in the reservoirs. Estimates of the proven and developed gas reserves, currently only in the Mari gas field, are used to determine the depreciation rate of assets in financial statements of the limited partnerships. Depreciation of investments associated with discovery and production of proven and developed gas reserves is made using the depletion method, i.e. in each accounting period the assets are depreciated at a rate determined by the number of units of gas actually produced, divided by the proven and developed gas reserves remaining according to estimates. The estimated gas volume in gas producing reservoirs during the reported period is calculated each year, *inter alia*, based on opinions of external experts on assessment of oil and gas reserves. Estimation of proven and developed gas reserves according to the aforementioned principles is a subjective process, and the estimates of different experts may significantly vary. Given the fundamental importance of the depreciation expenses, the changes described above may significantly impact the operating results and the financial situation of the limited partnerships and of Delek Energy.

10.29.9 Merely Estimated Costs and Schedules and Potential Shortage of Means: Estimated costs and estimated schedules for execution of exploration operations are based merely on general forecasts and may entail significant variance. Exploration plans may change significantly due to findings discovered during such operations, causing significant delays in schedules and in estimated costs of such operations. Mishaps during exploration and production operations, as well as other factors may cause the schedule to extend far beyond the forecast and may cause actual costs required to complete exploration operations to be significantly higher than forecast costs for such operations. Furthermore, proposed exploration operations may involve financial outlay which the limited partnerships may not be able to cover. Pursuant to joint operating agreements, non-payment on time of Delek Energy's share of an approved budget for an approved work plan is a breach which may lead to forfeiture of rights in the oil asset to which the operating agreement applies. In cases where other parties to the agreement have not paid amounts due, and are in breach of the agreement, Delek Energy may be liable for payments significantly exceeding its proportional share, and if such payments are not made on time – it may risk forfeiture of all its rights in the assets. Due to especially high costs of offshore drilling and development, budget overruns - expected or unexpected – may cause Delek Energy to not be able to fulfill its financial obligations, therefore resulting in forfeiture of its rights.

10.29.10 Arrears in Payments for Joint Operations: Under agreements with the other partners in the oil assets, any party that does not pay in full the amounts it owes may, under provisions of the agreements, forfeit their rights in oil assets to which the agreement applies without any compensation.

10.29.11 Dependence on Obtaining Permission from External Entities: Conducting exploration and production operations is subject to obtaining permissions from various authorities of the states where operations take place. Obtaining such permissions may entail additional expenses beyond the budgets allocated for such operations, or cause delays to schedule of planned operations. The above notwithstanding, some of the limited partnerships' operations are subject to coordination and scheduling with Israeli security forces. Such dependence on security forces may disrupt plans of the partnerships with regard to such operations, both in terms of their ability to carry out planned activities and in terms of the schedule and costs of such operations.

10.29.12 Regulatory Changes: Stricter regulation, with regard to exploration and production rights of Delek Energy, royalties, taxation, creation of transmission infrastructure, connection to power stations consuming oil and gas etc. may negatively impact Delek Energy's current business as well as the viability of conducting further exploration.

10.29.13 Dependence on Weather and Sea Conditions: Rough seas and difficult weather could cause delays in schedules set for project work plans at sea and extend the time for their completion. Such delays could increase expected costs and may even cause non-compliance with mandatory schedules.

10.29.14 Tax Risks: The tax issues involved with limited partnerships' operations have yet to be litigated in Israeli courts and it is impossible to determine or to anticipate how the courts would rule on such issues, if and when they are brought before them. Furthermore, regarding some of the legal issues there is no way to anticipate the position of tax authorities.

10.29.15 Financing Obligations: Delek Energy's operations are mostly financed by loans received from Delek Investments. In case such loans are not extended, there may be challenges in raising the funds required for their repayment.

The limited partnerships have contracted financing agreements as set forth in section 10.20 above. Under said financing agreements, the limited partnerships have place liens on various rights in the Yam Tethys project. Should the limited partnerships fail to comply with their obligations under the aforementioned financing agreements, this could lead to a demand for immediate repayment of amounts due under the financing agreements, as well as to liquidation of the collateral provided by the limited partnerships.

10.29.16 Dependence on a Major Customer: IEC is the largest single consumer of natural gas in Israel, and the primary gas consumer of the partnerships. Payments received from IEC under the IEC agreement are currently the main source of revenue for the limited partnerships. Failure of IEC to comply with its commitments to pay on time the amounts payable under the agreement with IEC could lead to a breach of the financing agreements and consequently to demands for their immediate repayment. Moreover, the term of the IEC's license expires in 2007. It is impossible to anticipate the changes to IEC's operating license (inasmuch as it would be extended), nor how such changes would influence the financial status of IEC. It should be noted that the government's policy to increase competition in Israel's energy market by introducing new, private power producers, as well as the government's intention to privatize IEC may impact IEC's financial robustness and therefore impact its ability to meet its obligations under the agreement. The agreement with the IEC has several *force majeure* provisions which would release the IEC from its obligations to continue making payments under the agreement.

10.29.17 Dependence on Operators: Delek Energy relies to a large extent on operators in the Yam Tethys, Vietnam and Guinea-Bissau projects, both due to the experience of said operators compared with Delek Energy's relative lack of experience, and due to the fact that the company has no presence in Vietnam or Guinea-Bissau.

10.29.18 Development of a Field in Case of Discovery, and Lack of Means to Develop and Produce: The decision making process as to continuation of investment in development of a field and in commercial production, as well as intermediate operations prior to commercial production and carrying out development and commercial production (if feasible) may require an extended period of time and may involve heavy financial expenditure. Additional commercial discoveries would require Delek Energy to invest additional monies in development and production beyond the means currently available to it. These costs, especially with regard to offshore discoveries, are extremely high and said operations would also entail risks, including operational risks. Although in case of a discovery, Delek Energy may have a valuable asset, there is no certainty that collateralizing such an asset would suffice for Delek Energy to be able to obtain credit for its development and production. It should be noted that due to the royalty payments due to the state where the project takes place, to Delek Energy and to others, there is no certainty that, in case of a commercial discovery, operations to develop the oil field and well and to produce the oil would be financially viable. A sharp rise in production expenses or a sharp drop in oil prices may impact the viability of production.

10.29.19 Cancellation or Expiration of Oil Rights and Assets: Oil rights are granted for a limited term, and are contingent on fulfilling commitments on dates specified in terms of such oil assets, with non-compliance with such commitments potentially leading to cancellation of the oil rights. An extension of the oil right is at the discretion of competent authorities, which may refuse an extension, restrict the oil right or add other conditions. The ability to exploit oil assets depends, *inter alia*, on financing of various operations and on availability of appropriate equipment and personnel, whose absence may prevent or restrict the extension of rights to assets or cause them to expire.

10.29.20 Migrating Reservoirs: It is possible that natural gas reservoirs that are discovered or will be discovered in the areas in which Delek Energy has rights will "migrate" (in terms of the geological formation and size of the reservoir) into other areas where Delek Energy has no rights, and vice versa. Gas may even migrate to areas outside of the continental shelf of the State of Israel. In the case where gas "migrates" to areas in which others have rights, the sides may need to come to an agreement on joint exploitation and production from the reservoir, in order to achieve maximum resource efficiency.

10.29.21 Security and Geo-Political Risk: Delek Energy's exploration operations in Israel and abroad is often conducted in remote locations (at sea) and/or in countries where the political regime is unstable.

Therefore Delek Energy is exposed to security risks, primarily in the area where Yam Tethys facilities are located, in relative proximity to Israel's border with Gaza Strip, including terrorist acts, and to geo-political risk including regime change and coups-d'état. The exposure to geo-political risk in countries where exploration is conducted may cause damage to Delek Energy in case of events such as war, coup-d'état or financial crisis.

The table below presents risk factors described above by type (macro-economic risks, sector-specific risks and company-specific risks for Delek Energy), according to their impact on the energy sector:

	Impact of Risk Factors on Delek Energy's Business		
	Major Impact	**Medium Impact**	**Minor Impact**
Macro-economic risks			
Volatility of the US$	X		
Dependence on global Oil Prices		X	
Sector-specific risks			
Competition for gas supply	X		
Uncertainty regarding construction of the National Transmission System	X		
Insurance		X	
Operational Risks		X	
Dependence on Contractors		X	
Exploration risks	X		
Estimated Schedules and Costs		X	
Field Development upon discovery	X		
Dependence on obtaining approvals from external entities		X	
Regulatory Changes		X	
Dependence on Weather and sea conditions			X

Company-specific risks for Delek Energy			
Tax Risks			X
Financing Obligations		X	
Dependence on primary Customer	X		
Dependence on Operator			X
Arrears in Payments for joint operations			X
Lack of Production and Development Resources and participation in operations		X	
Cancellation or expiration of oil rights and assets			X
Reservoir overrun			X
Security and geo-political risks			X

The impact of the above risk factors on the energy sector are based on estimates alone, and may actually differ.

11. The Automotive Sector

The automotive sector is handled by Delek Automotive Systems Ltd., its subsidiaries and other entities (Delek Automotive Systems Ltd., its subsidiaries and other entities are referred to collectively as "**Delek Automotive**"). "**Delek Automotive**").

Since 1994, Delek Automotive has been the Israeli importer and distributor of Mazda automobiles and spare parts. In 1999, it also started to import and distribute Ford automobiles and spare parts in Israel. Delek Automotive also operates a main automotive garage where it provides maintenance and repair services to its customers as well as giving support and guidance to the authorized garages and dealerships for "Mazda" and "Ford" across the country (for details, see paragraphs 11.21 and 11.22, below). Additionally, Delek Automotive has a concession for marketing, distribution and sale in Israel of motor vehicles and spare parts manufactured by Lincoln. At the date of this report, Delek Automotive does not sell Lincoln vehicles and vehicle parts. In addition, Delek Automotive also holds 33.3% of A.D.C. Holdings Ltd., formerly Shagrir Towing Services Ltd. (hereinafter: "**A.D.C. Holdings**")[1], which, as of the date of the report, sold most of its operation in 2005 to Pointer (from Eden Telecom) Ltd., and have ownership of real estate, cash and cash value as well as other assets.

Delek Automotive is a public company and its securities are registered for trading on the Tel-Aviv Stock Exchange Ltd.

11.1 General Information Regarding the Sector

11.1.1 Structure of Sector of Operations and Changes Therein

The Israeli automotive market is different from most other markets in the world resulting from its geographical isolation and high import taxes on vehicles. The automotive level in Israel is low vis-à-vis western countries, due to a relatively low standard of living, relatively high prices due to high import taxes, poor road infrastructure and high population density.

The automotive market in Israel is comprised of a number of importers (compared to other sectors in the economy) that import vehicles manufactured in different parts of the world. Most importers import only two or three brands.

The development of the automotive market in Israel is characterized by volatility caused by changes in the macro-economic surroundings.

Following are a number of characteristics and trends that affect Delek Automotive' operations and its competitors: (a) Dependence on suppliers – the general success of car importers is dependent upon the financial and business strength of the car producers and in new product strategies, worldwide brand management, model and pricing policy and marketing support. (b) Changes in consumer preference - consumers' preferences for certain models are based on technological advantages, price and marketability in the secondary market. (c) Import duties – In Israel, there are a number of purchase and import duties on the importation of private cars that amount to about 100% of vehicle prices. These tax rates are of the highest in the world. These taxes have an effect on the purchasing power of private consumers in buying new automobiles and therefore may have an effect on Delek Automotive sales. For an explanation of the Purchase Tax reforms, which applies to all private automobiles, see Section 11.14.2 below. (D) Fuel prices – the prices of fuel may have an effect on consumer tastes and the scope of car sales in Israel. Fuel prices may also have an effect in the long run on the type of automobiles sold, according to the type of fuel used (diesel, natural gas, or gasoline).

11.1.2 Limitations, Legislation, Regulations and Special Constraints upon Operations

The vehicle market is influenced by legislative and regulatory requirements, which constitute a significant factor that may affect the supply of and demand for vehicles in Israel.

A. In 1999 the government started a reform of the Israeli automotive market. The Finance and Transportation Ministries formed a committee in order to remove barriers and eliminate

[1] It should be noted that Phoenix also holds 33.3% of the issued and outstanding share capital of ADC Holdings.

centralization in the automotive market and to open the market to competition. The committee recommended a series of steps upon which legislation was based. The main reform was abolishing the legal requirement for exclusivity by the Israeli automobile importer from the manufacturer. An additional report on the subject was issued in December, 2003. The report recommended that direct contact between car-maker and dealer no longer be required, allowing the importer to deal with authorized dealers of the brand as long as there was a mechanism to make sure of the following: The existence of appropriate technical standards, technical suitability of the vehicle to Israel, warranty requirements, routine parts availability and support services, financial ability of the authorized dealer as stipulated in the committee's report (hereinafter: "**Parallel Import**"). After publishing their report, the committee's members held a hearing that gave interested parties the opportunity to state their opinion of the committee's conclusions. At the end of the hearing the committee decided to make a validity test of the parallel import. As of the date of this report, validity tests are being held for parallel imports. It is still unclear whether legislative action will come into effect on this topic nor what will be its content and scope. Delek Automotive estimates that parallel importing is not economically appealing in the current market conditions with the exception of importing prestige and niche vehicles. Since the vehicles Delek Automotive imports do not fall into those categories, the management of Delek Automotive expects that parallel import will not have a substantial effect on their activities. Similarly, according to an agreed upon order by power of section 50b of the Restrictive Trade Practices Law, 5748-1988, came into effect on April 24, 2003, and applied restrictions and disallowances for preventing car importers from entering into restrictive arrangement so as to prevent the entrance of competitors in the business of importing car parts. For further details on the limitations and legal arrangements applicable to the importation of cars and car parts, see paragraph 11.15, below.

B. In 2005 a further reform was started in the vehicle market in Israel, relating to changes in the Purchase Tax imposed on vehicles. As part of the above reforms, graduated (multi-annual) steps were initiated in respect to vehicle taxation, which includes: (1) a graduated decrease of the tax burden on vehicles; (2) an enhancement of the incentives for installing safety accessories beyond the basic safety accessories; (3) a reduction in the tax rates on private vehicles, equalizing them with commercial vehicles. As part of the above reforms, the effective purchase tax on vehicles will be reduced by some 15% over five years. According to the Ministry of Finance, at the end of the process, an average reduction of some 10% is expected in the price of private vehicles that will be fully accessorized.

C. On December 17, 2006, the Knesset Finance Committee ratified an update of the price groups for all vehicles at a rate of 5%--7% relative to the update made in May 2006. As a result of the price group update, most of the automobile importers updated vehicle prices downwards.

D. In January 2007 the Ministry of Finance announced its plan to increase the value, for tax purposes, of the private use of company vehicles. According to the plan; which is still pending confirmation by the Knesset's Finance Committee, the value for tax purposes is expected to be increased gradually over a period of several years. This plan, should it be implemented, might have an effect in the long run on the distribution of vehicle sales in Israel, and on the segmentation of Delek Automotive Sales, between institutional customers (including leasing companies) and private customers. It should be emphasized that the passenger vehicle market size prior to the expansion of the leasing segment was equal to its current market size. Delek Automotive estimates that the effect of this change on the company's activity will be negligible. The management's assessment constitutes forward-looking information that is based on market analysis and on past experience. This information constitutes forward-looking information that is based on a market analysis of the automotive market and on past experience. This forward-looking information may not materialize, due to changes in customer preferences, among other things.

E. **Standards**

The standardization department in the Motor Vehicle Division of the Ministry of Transport, each year redefines the mandatory requirements for various car types, for the next model year; while specifying the amendments made by European standardization, and in addition, the specific demands for the State of Israel. Mandatory Israeli demands are based on the EEC Members standardization requirements, as well as on USA federal standards. The main standards pertain to air pollution, passenger vehicle and pedestrian safety. A vehicle that does not comply with this standard is not permitted to be imported into Israel. In 2004, the Standardization Department in the Ministry of Transport determined that as of January 1, 2006 vehicles imported into Israel whose weight does not exceed 3,500 kg, must comply with the

Euro 4 air pollution standard. Accordingly, vehicles imported by Delek Automotive meet this standard.

According to the Transportation Regulations (1961), no vehicle shall be registered, or licensed unless the Licensing Division examined and approved the prototype of such vehicle, or was presented with a certificate from an approved laboratory, or any other certificate as per its demand, attesting that the vehicle is similar to such prototype or model.

11.1.3 Changes to Volume of Operations in the Sector and its Profitability

During the past several years, market terms improved for the Israeli customer due to favorable currency rates and a reduction of taxes. Following the growth trend in vehicle deliveries in 2004 and 2005, a growth of 2.4% in vehicle deliveries was recorded in 2006, amounting to 153,794 deliveries, as compared with 150,215 in 2005[1]. Although much more substantial growth could be expected in view of market terms improvement; 2006 growth was relatively negligible. Delek Automotive' management estimates that the decrease in the growth trend was attributed to the uncertainty prevailing in the automotive market for some time, as a result of publications in the past two years, some of them inaccurate, concerning reforms pertaining to parallel imports, tax reductions and the value for tax purposes of company vehicles used privately, as well as concerning a price reduction that took place at the beginning of 2007.

The changes in the volume of activity in the automotive market took place due to the increase in sales to institutions. These customers tend to avoid servicing their vehicles in an approved service station chain and some use non-original spare parts. The company nevertheless possesses maintenance and spare parts supply agreements with numerous large organizations such as the Ministry of Defense and some leasing companies. Delek Automotive estimate that changes in the operational leasing sector, should they take place, will not have a substantial effect on the sales of spare parts by the company.

11.1.4 Critical Success Factors in the Sector of Operations and Changes Therein.

In the opinion of Delek Automotive, there are several significant factors on which the success of companies operating in the field of importing motor vehicles and spare parts to Israel are dependent: (a) New models and their branding among consumers. (b) The importer's high marketing ability. (c) The reputation and the level of service by the importer, the spare parts supplier and the garage. (d) Good relationship with manufacturers. (e) Commercial relationships with the leasing and rental companies. (f) Trading terms under which Delek Automotive operates - and in particular, the currency exchange rates used for importing and the relationship to currencies used by competitors; (g) The resale value of the vehicles in the used car market. (h) Price of spare parts as it is possible to obtain any part from a large number of suppliers, (i) Availability of spare parts.

11.1.5 Principal Entry Barriers in the Sector of Operations

In the opinion of Delek Automotive, the barriers to penetrating the vehicle import sector in Israel are relatively high for, amongst others, the following reasons: (a) The strong ties between the importer and the manufacturer. (b) The high economic solidity required from the car importer. (c) The significant importance of the service level provided by the importer and its past experience with customers.

On the other hand, in the opinion of Delek Automotive, there are no barriers to the market of importing spare parts to Israel because, amongst other things, of the fact that trading in spare parts requires a transportation product trading license from the Ministry of Transport and attaining such a license does not involve a great investment in resources and effort.

11.1.6 Competitive Structure in Sector of Operations and Changes Therein

For details, see paragraph 11.6, below.

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[1] This information is to Delek Automotive's best knowledge and is quoted from Vehicle Importers Union reports dated January25, 2007.

11.2 Products and Services

11.2.1 Vehicles Manufactured by Mazda and Ford

Delek Automotive imports, markets and distributes a wide range of private and commercial vehicles manufactured by Mazda and Ford in accordance with franchise rights with these manufacturers. For a description of the concession agreements see paragraphs 11.16.1 and 11.16.2, below.

The following table illustrates the breakdown of vehicle deliveries by Delek Automotive in units for the years 2006, 2005 and 2004, by quarter and by manufacturer:

Year 2006:

Manufacturer	Q1	Q2	Q3	Q4	Total
Mazda	5,911	6,530	5,498	4,944	22,883
Ford	3,124	3,749	3,369	2,978	13,220
Total	9,035	10,279	8,867	7,922	36,103

Year 2005:

Manufacturer	Q1	Q2	Q3	Q4	Total
Mazda	4,669	6,064	6,703	4,439	21,875
Ford	1,912	3,553	3,435	3,297	12,197
Total	6,581	9,617	10,138	7,736	34,072

Year 2004:

Manufacturer	Q1	Q2	Q3	Q4	Total
Mazda	6,037	7,770	5,536	5,257	24,600
Ford	1,883	3,056	3,184	3,069	11,192
Total	7,920	10,826	8,720	8,326	35,792

The major models marketed by Delek Automotive as of the date of this report are: Mazda 3, Ford Focus, Mazda 6, Mazda 5, Ford Mondeo, Mazda MPV, Ford Transit, Mazda BT-50, Ford Explorer and Ford Connect.

Delek Automotive's market share for the years 2006, 2005 and 2004 was 23%, 23.5% and 25% respectively, of all vehicle deliveries in Israel.

Additionally, Delek Automotive has a concession for marketing, distribution and sale in Israel of motor vehicles and spare parts manufactured by Lincoln. As of the date of this report, Delek Automotive has not made such sales.

11.2.2 The Importation of Spare Parts and Provision of Garage Services

Delek Automotive markets and distributes all the types of spare parts and accessories that are complementary to the vehicles it imports.

Additionally, Delek Automotive provides maintenance services and repairs to its customers, as well as support and instruction to agency networks and authorized garages for "Mazda" and "Ford vehicles in the country at its central garage in Holon. Delek Automotive intends to move its central garage to its logistic center in Nir Zvi (see Section 11.7, below).

11.3 Revenue and Product Segmentation

Below are the data related to Delek Automotive's income from products that comprise 10% or more of the Group's total income during 2006, 2005 and 2004 (in NIS millions and percentage):

	The Year 2006		The Year 2005		The Year 2004	
	NIS millions	(%)	NIS millions	(%)	NIS millions	(%)
Mazda 3	- [1]	-	- [2]	-	1,674	11.73%

The Gross profit from the vehicle sector for the years 2006, 2005 and 2004 totaled NIS 496 million, NIS 441 million and NIS 466 million, respectively. The percentage of the gross profit from income in the sector for the years 2006, 2005 and 2004, were approximately 12.22%, 11.4% and 11.8%, respectively.

11.4 Accounts Receivable

11.4.1 Delek Automotive customers are composed of two key types: Private and institutional. The meaning of the phrase "Institutional Client" includes leasing and car rental companies and the government's vehicle (purchase) manager. Below is a distribution of sales to private and institutional customers for the years 2004 – 2006:

	2006	2005	2004
Private Customers	40%	42%	50%
Institutional Customers	60%	58%	50%

11.4.2 Delek Automotive customers who purchase spare parts and maintenance services are mainly: Customers of the central garage, authorized garages, distributors, private customers and insurance companies who provide services for their clients in the framework of the insurance and institutional customers.

11.5 Marketing and Distribution

11.5.1 Delek Automotive markets and distributes the cars it imports via nine showrooms owned by Delek Automotive as well as through eight showrooms belonging to independent dealers. Most of Delek Automotive's sales are completed at its showrooms. Delek Automotive also sells directly by approaching institutional customers.

11.5.2 Delek Automotive's showrooms are located throughout the country and are rented from third parties, with the exception of the Mazda showroom in Tel-Aviv, which Delek Automotive owns, and a Ford showroom in Tel Aviv that was leased from Delek Investments.

11.5.3 Delek Automotive has six independent agents that maintain and operate showrooms in the main urban cities in which the cars imported by Delek Automotive are displayed. The agreement with the said dealers is not an exclusive one. Therefore, Delek Automotive can contract with other dealers at the same or better terms. However, Delek Automotive does identify sales areas where it will agree not to put more than one dealer (although Delek Automotive itself can act in any area, regardless). The agreements with the dealers are for one-year periods from signature time and are renewed automatically for periods of one year unless one party gives three months written notice of his wish to discontinue the agreement. The payments made by Delek Automotive to agents are made through commissions, determined by Delek Automotive and only after it has received full payment for the car sale.

11.5.4 The marketing of most of the spare parts produced by Mazda and Ford is executed by Delek Automotive's central logistics center in Nir Zvi from were they are sold to 61 authorized garages across the country that are allowed to give service to Ford and Mazda cars (hereinafter: the

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[1] Income from this model comprises less than 10% of the Group's income.

"Authorized Garages"). Delek Automotive also sells parts to dealers and distributors of spare parts in Israel. According to the agreement with the authorized garages entered into by Delek Automotive, they must locate, operate, maintain and manage their garages according to rules and instructions of Delek Automotive and according to the law. The garage owner is also required to use parts and accessories that are up to the standards of the automobile manufacturer. Delek Automotive is authorized to instruct the authorized garages to use specific parts, as detailed in the agreement. The garage owner is required to purchase and hold in inventory the parts in quality, type and number that will satisfy the level of service required for Delek Automotive customers as defined by Delek Automotive from time to time. The garage owner also commits to fix, without charge to the customer all work in respect of which a Delek Automotive warranty will be presented thereto, according the car-makers warranty agreement or any other service contract that has received the prior approval of Delek Automotive. Delek Automotive will pay the garage owner for the services according to the warranty or the service contract which includes the price for parts minus a discount that will be decided upon from time to time by Delek Automotive, with an addition of labor costs as determined by the agreement. The period of the agreements are for one year from signing and are renewed automatically for one-year periods. Each party can end the agreement with three month's written notice of their wish to discontinue the agreement.

11.5.5 Delek Automotive markets its products through advertisements in the various media outlets, according to Delek Automotive management's judgment and maintains the rules stipulated by the manufacturer.

11.6 Competition

The Israeli automotive market is characterized by an oligopolistic structure, which includes a number of importers that represent various manufacturers. The competition in the vehicle market is between the various importers and finds expression in the large number of car types imported from various regions of the world: Europe, USA and the Far East, but is manifested in the comparative representation of a particular manufacturer by more than one importer. The competition is based on brand, model, price, payment terms, service quality and the car's resale value in the used car market. There are external influences on the Israeli market such as: Competition in the global automobile markets, car manufacturers and currency rates according to which the cars are purchased. Internal influence comes from the activities of the other importers in the Israeli market. To the best of Delek Automotive's knowledge,[1] its main competitors are: Union Motors (Toyota importers), Kolmovil-Kolmotor (Mercedes, Hyundai and Mitsubishi importers), David Lubinski (Peugeot and Citroen), Moshe Carasso & Sons (Nissan and Renault), Champion Motors (VW, Audi and Seat) and UMI (importers of General Motors – Opel, Saab and Isuzu). In 2005, Delek Automotive's market share was 23% of the total automotive market, 25% of the private sales and 60% of imports from Japan.

The competition in the spare parts and garage service markets is intense. There are other parallel importers of original parts and generic spare parts. Also available are counterfeit parts, parts from used cars, reconditioned parts and stolen parts. The service competition is between official authorized garages and unofficial ones. Delek Automotive cannot estimate its market share in the service and spare parts market, since there are no official data in this field, due to the multiplicity of service providers, distributors, as well as small and medium sized merchants.

11.7 Fixed Assets and Facilities

Set forth below is a short description of the main real estate and other significant fixed assets of Delek Automotive:

Delek Automotive has a new, state-of-the –art logistics center located close to Ben Gurion international airport, comprising 85,000 m^2 of warehouses and office space (hereinafter: the "**Logistics Center**"). At the date of this report, the Logistics Center's activities include the storage of vehicles, preparation and handover of the vehicle to the customer and marketing and sales of its spare parts. Similarly, Delek Automotive management and service staff are located in the Logistics Center. Today, the Logistics Center is capable of storing 2,500 vehicles and in the future, will be able to store an additional 1,000. As of the report date, Delek Automotive is utilizing around 80% of its current storage capacity. During 2006, Delek

[1] Based upon the reports published from time to time by the Association of Automobile Importers.

Automotive invested a total of NIS 25 million in said property of which NIS 11 million was paid in respect of Improvement Tax. Delek Automotive does not anticipate another material investment, such as the aforementioned, in its property.[1]

Between 2002 and 2006, the Logistics Center was granted a construction permit, the last one having been granted on January 10, 2006 to the overall real estate of the Logistics Center, for changes in the buildings located in the area, as well as for erection of an additional building, which contains the central garage. Said building permit is provided subject to the terms stipulated therein, some of which are addressed by the Company.

As of the report date, the logistic center has not been provided with Form no. 4 (construction completion) and Delek Automotive is making efforts to obtain this form.

On February 6, 2006, Delek Automotive was instructed to pay Improvement Tax by the Lodim Regional Planning and Construction Committee, in respect of a building permit issued for the Logistic Center, in the amount of NIS 21,600,000. Delek Automotive paid half of the amount of the tax and provided the committee with a bank guarantee for the remaining half, in effect until August 13, 2007. Delek Automotive is taking action at several levels to reduce the tax assessment.

In addition, Delek Automotive owns 68 thousand m^2 acres of land near the Logistics Center. In 53 thousand m^2 of the said real estate, Delek Automotive had leasing rights (from the Israel Lands Authority – ILA) that expired in 2002-2003. By the report date, Delek Automotive has approached the ILA to extend the lease, but the ILA has yet to respond. Delek Automotive also has leasing rights for an area of 15,000 m^2, in effect until 2042, with an option for extension for an additional 49 years. This land was used to build the main Delek Automotive garage, and as of next month, it will house the Company's garage-service activities.

11.8 Intangible Assets

Delek Automotive has import concessions for the sale of Mazda and Ford, from the manufacturers as detailed in 11.16.1 and 11.16.2, below. Delek Automotive is materially dependent on these franchises

11.9 Human Resources

11.9.1 As of the report date, Delek Automotive numbers 236 employees, divided into seven departments, as detailed below:

Department	Number of Employees
Management	8
Finance, IT, Administration	22
Mechanics	60
Service Workers	30
Sales	35
Logistics	43
Spare parts personnel	38
Total	236

Ford has the right to terminate the Ford franchise, in the event that a change occurs in the management of Delek Motors Ltd. (a wholly-owned subsidiary of Delek Automotive) (hereinafter: "**Delek Motors**"), under which, if Gil Agmon's ceased to manage Delek Motors without Ford's agreement (see paragraph 11.16.2, below).

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1 [1] Unless the bank guarantee deposited in respect of the remaining land betterment tax, is forfeited.

11.9.2 Terms and Conditions of the Employment Agreements and Benefits

Delek Automotive workers and management are employed under employment agreements. According to Delek Automotive policy and the Employee Notice (employment terms) Law, 5762-2002, each Delek Automotive worker gets a detailed written notice describing the terms of his employment. The workers receive all the rights due to them according to Israel's labor laws. Most of the Delek Automotive workers have manager's insurance policies that include allocation for retirement and severance pay according to Delek Automotive's undertaking when an employer-employee relationship is terminated and as such is part of the terms of employment

In addition, by virtue of Delek Motors being a member of the Association of Car Importers, which constitutes a part of the Chamber of Commerce Association, Delek Motors employees are covered by the collective bargaining agreement for import, export, service and trade sector workers of February, 21, 1977 (as amended June 11, 1980 and October 27, 1983) that was signed by the Histadrut Trade Union, the clerks union, the management and services workers (hereinafter: the "**Histadrut**") and the office of the Tel-Aviv Jaffa Chamber of Commerce. In addition, extension orders applied some of the provisions of the aforesaid collective agreement to all the employees in the import and export wholesale sectors, and therefore, it seems that they apply to all Delek Automotive employees.

Officers and senior management employees at Delek Automotive are employed under personal employment contracts, which include allocations for manager's insurance. Some of the officers and senior management employees are entitled to grants as a function of the Group's business results.

Additionally, according to the agreement from October 4, 1999, that was extended on November 28, 2002, Rami Naor, Vice-Chairman of the Board of Directors of Delek Automotive and a relative of the controlling shareholder, has placed his services on behalf of Delek Automotive's use in recompense of NIS 17,000 gross, linked to the Cost of Living Index of July 1999, and for reimbursement of expenses expended while an officer of Delek Automotive. The Agreement remains valid until one of the parties terminates it. Delek Automotive is allowed to terminate the said agreement at any time with a two (2) months advanced written notice. Rami Naor may terminate the agreement with one (1) month advanced written notice.

Training and Guidance -Delek Automotive has regular training sessions for its workers, as needed by Delek Automotive and the employee's position. Among other things, Delek Automotive sends it professional workers to trade exhibitions, seminars and workshops on relevant topics.

11.9.3 Employee Compensation Plans

Delek Automotive compensates its workers according to position and seniority. The compensation is not part of the general employment agreement and may vary from year to year.

11.9.4 Allocation of Securities to Senior Employees

A. On January 9, 2006, Delek Automotive privately allocated to the CEO of Delek Motors, Mr. Gil Agmon, 9,000,000 regular shares of Delek Automotive in exchange of approximately NIS 255 million. After the aforesaid allocation, the CEO of Delek Motors holds about 15.74% of the capital stock, issued and paid, of Delek Automotive and about 15.28% in full dilution. For additional information concerning the aforesaid allocation, see Note 9j(d) to the financial statements.

B. On April 10, 2006, the Delek Automotive Board of Directors approved a compensation plan for seven (7) senior employees of Delek Motors, according to which, 2,720,000 unlisted options were allocated that can be realizable as 2,720,000 regular shares of Delek Automotive in accordance with Paragraph 102(B)(1) of the Income Tax Ordinance (New version) 5721-1961, as an income track through a trustee appointed by the Company and approved by the tax authorities, according to the options plan for employees as approved on February 9, 2006, which was presented to the Income Tax Commission in accordance with the regulation's instructions. The aforesaid options were allocated to the employees on June 6, 2006. For additional information concerning the aforesaid allocation, see Note 9d(2)of the financial statements.

11.10 Accounts Payable

The vehicles and spare parts are supplied to Delek Automotive by vehicle manufacturers Mazda and Ford, from various factories around the world at the manufacturer's discretion. Most of the Mazda products come from Japan while most of Ford's products come from Europe. Delek Automotive is dependent on these suppliers. Approximately 61% of the import value of vehicles, and 50% of the import of spare parts are from “Mazda’s” manufacture while the rest is from “Ford” (39% and 50%). For a description of the dealings with Mazda and Ford, see Paragraphs 11.16.1 and 11.16.2, below.

Cars and parts are available within 90 days from the time they are ordered according to the respective business plans with each of the vehicle manufacturers.

11.11 Working capital

11.11.1 Vehicle Inventory Policy

Once a month, Delek Automotive presents new car orders to the car manufacturers. The vehicles arrive in Israel 2-3 months after the order. Delek Automotive’s policy is to have in inventory for an estimated two months. During 2006, an inventory of cars was held for an average of 2.5 months. The same held for the years 2004 and 2005.

11.11.2 Spare Parts Inventory Policy

By order of Supervision on Consumer Services (Vehicle Import and Service) Law, 5739-1978 the supplier needs to supply a spare part for any transportation product of any model that the importer sold, within seven days of the receipt of the order. With this, the importer is protected if he can prove that he followed proper procedures to order the transportation product from any possible source at the time, and that the delay was beyond his control, as long as the part is supplied within 14 days.

The spare part inventory at Delek Automotive’s Logistics Center, is based on the experience of Mazda and Ford as well as Delek Automotive’s accumulated experience as to the spare parts needs of the Israeli market.

The time it takes for replacement parts to be delivered is about three months from the time of order. Therefore, in order to provide good service, Delek Automotive maintains a six-month inventory of parts. In cases of immediate orders where it is not possible to supply the part via its regular inventory, Delek Automotive normally purchases the part from Mazda and Ford's central parts facilities in Europe and flies it to Israel. As of December 31, 2006, the replacement parts inventory totals about 50,000 items and its financial worth is, according to the financial statements, NIS 56 million. During 2004 and 2005, the spare parts inventory included some 60,000 items whose worth, according to Delek Automotive’s financial statements, was approximately NIS 55 million.

11.11.3 Warranty Policy

Delek Automotive provides a three year warranty to all vehicles it sells, in line with manufacturer's warranties. In addition, the manufacturers provide additional warranties as detailed in the warranty book found in each new car. The warranty that Mazda and Ford provide for all their models is three years or 100,000 km, whichever comes first. In the agreements with the manufacturers, Delek Automotive is obligated to carry out or cause the licensed garages execute the warranty services as set down in the aforementioned warranty book. Delek Automotive is entitled to reimbursement from the manufacturers for its expenses in carrying out the warranted services. In light of this, Delek Automotive does not foresee that it will have any expenses because of this warranty and so has not allocated any funds for warranties in its books. The agreements stipulate the means by which Delek Automotive gets compensation. Delek Automotive is obligated to report on each service call within 90 days and needs to keep the parts for 30 days after payment. Similarly, the manufactures can insist that the faulty parts be returned to them. Regarding service by the authorized garages in accordance to the warranty, see Paragraph 11.5.3, above.

Delek Automotive provides a full warranty on the spare parts installed in the vehicles it sells, for a period of three months or until the vehicle exceeds 6,000 km (according to the product), the earlier of the two, as required by the spare parts commerce license that it holds.

11.11.4 Credit Policy

The table below includes data concerning the average scope of credit and credit days for customers and suppliers (on an annual calculation) for the years 2006, 2005 and 2004 (all figures are in NIS million) respectively:

	2006		2005		2004	
	Scope	**Days**	**Scope**	**Days**	**Scope**	**Days**
Customers	880	69	713	58	580	54
Suppliers	410	90	360	90	415	90
Suppliers -Effective[1]	410	45	360	45	415	45

The difference is due to the tax issue which is included in the customer credit but not in the supplier's.

11.12 Investments

In April 2002, August 2003, and December 2005, Delek Automotive bought some 4.33% of the capital shares of Mobileye N.V and about 3.8% at full dilution for approximately $7.2 million (its worth in the books as of December 31, 2006 is NIS 34 million). Mobileye N.V. deals with the development of advanced technology sensing systems for the automotive industry. The fair value of the investment in Mobileye is estimated to be approximately NIS 64 million, on the basis that it raised capital during 2006.

11.13 Financing

11.13.1 Following below is the average interest rate on loans from bank and non-bank sources that were in effect in 2006 and are not intended for the exclusive use of Delek Automotive:

		Average Interest Rate	
		Short Term Loans	**Long-Term Loans**
Bank Sources	Shekel Credit	5%-5.85%	5.1%-5.9%
	Swiss Franc/Yen/Euro/Sterling Credit	Libor 0.6%	-
	USD Credit	Libor 0.6%	Libor 1.8%
Non-Bank Sources		5.4%	6.1%

11.13.2 Credit Limits

The credit line that Delek Automotive receives from the banks, obligates it to the following financial criteria:

A. End of calendar year shareholders' equity cannot drop below 20%-22%% of total assets for that year.

B. Delek Automotive undertook at one bank, that its share in its total bank credit will not constitute more than 30% and that the ratio of bank credit to the balance sheet total will not exceed 55%.

In addition, Delek Automotive is obligated to Israeli banks not collateralize its property and assets to another person or group and not to sell or transfer in any way (except in the regular Delek Automotive business), its assets to a third party without prior written consent from the banks.

As of December 31, 2006, Delek Automotive has met these financial criteria, as aforesaid.

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[1] Effective supplier's credit days are calculated in relation to the tax on the import turnover, which are paid in cash by Delek Automotive.

11.13.3 Between the date of the balance sheet and that of the report, there has been no significant change in the bank credit and no new loans have been received.

11.13.4 **Delek Automotive's Credit Lines and Terms**

Delek Automotive has credit lines, as of the balance sheet date and that of the periodical report, that total approximately NIS 1,700,000 thousand. Of the above credit lines, Delek Automotive has utilized, as of the balance sheet date, about NIS 900,000 thousand. The credit line was granted for a term of one year.

11.13.5 **Credit at Variable Interest Rates**

Below are details of credit at variable interest rates utilized by Gadot as of the balance sheet date:

Variance Mechanism	Interest Rate Range	Basic Interest Rate for 3-5-07
Bank of Israel Interest +	0.35%-0.8%	4%
Euro Libor+	1.5%-0.6%	3.6%
USD Libor +	2.4%-0.6%	5.3%
Japanese Yen Libor +	0.6%	0.43%

11.13.6 **Credit Rating**

On February 17, 2004, Maalot, the Israel Securities Rating Company Ltd. (from herein: "**Maalot**") that Maalot's rating committee on February 11, 2004, had set a rating of AA for Delek Automotive obligations, based, among other things, upon Delek Automotive's financial policies. On August 1, 2006, Maalot announce its validation of the existing rating.

11.14 Taxation

11.14.1 For further details on taxation, see Note 33 to the Company's financial statements.

11.14.2 Purchase tax applies to vehicles imported by Delek Automotive. In September 2005, the Purchase Tax reforms imposed on the purchase of private and commercial vehicles came into effect. Under the aforesaid reform there will be a stepped multi-year cutback of the Purchase Tax on private and commercial vehicles as well as an equalization of the tax between commercial and private vehicles. The effective purchase tax rate currently applying to private vehicles that are the principal mass of vehicles imported into Israel (which constitute Delek Automotive principal sales) is 85%, and will decrease over four years to about 72%. Concurrently there will be a reduction in the tax benefits extended on existing safety accessories (an ABS system and two air bags) until their total cancellation in 2008, which will offset the effect of the reduction in the tax rate as aforesaid. Furthermore, tax incentives will be granted to encourage the installation of safety accessories over and above the existing accessories. Delek Automotive expects that the aforesaid reform upon the market sectors in which Delek Automotive operates is insignificant.[1] In January 2007, the Ministry of Finance announced its plan to increase the value, for tax purposes, of the private use of company vehicles in steps over a number of years, whereby the amount deducted from the employees wage for care-use will increase. Furthermore, changes in the charging of the income for the use of a vehicle may affect the ratio between sales to institutional customers (leasing and rental companies) and private customers as well as upon general vehicles sales in Israel.

11.14.3 Vehicles sold by Delek Automotive in Israel are subject to VAT at the rate applicable on date of the sale (the current VAT rate – 15.5%).

11.14.4 Vehicles imported from Japan into Israel are subject to tax at a rate of 7% of the value of the vehicle.

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[1] The Company's estimation is future looking, based upon past experience which shows that sales were not influenced when taxes were lowered over the past two years. Future-looking information can possibly not realize as the Company's estimation as aforesaid, is not certain and can change, among other things, because of an economic downturn and changes in the exchange rates for imports can influence the buying power for new vehicles.

11.15 Limitations and supervision of Delek Automotive operations

Below are the details of the legal restrictions and other legal arrangements regarding some of the basic Delek Automotive's operations and can influence them:

11.15.1 Legislation Regarding Automotive Import in Israel

By order of supervision of Consumer Services (Vehicle Import and Service) Law, 5738- 1978, it was established that no importer or agent might sell a new car unless he received a proper license from the authorized authority. Delek Automotive has licenses that allow it to import the vehicles it now imports, valid until December 31, 2006. The licenses are given for a year and are renewed for periods of one year. The order also stipulates that a holder of a vehicle import license must also provide maintenance services through licensed service garages that operate under the order for supervision of Consumer Services (Vehicle garages and workshops) Law, 5730- 1970. This includes having service garages in the following regions: Tel-Aviv, Jerusalem, Haifa and Beersheba as well as one central garage (which can also be one of the regional garages). Delek Automotive has one central garage as mentioned in Paragraph 11.2.2, above, that is a Mazda and Ford garage, authorized by the Motor Vehicle Department of the Ministry of Transportation. An additional condition for receiving a vehicle import license is that the holder provides a warranty for his maintenance services for not less than two years after purchase, where the first year needs to be under manufacturer warranty and where the warranty terms stay the same throughout the entire period. The order further stipulates that the importer must give his customer a certificate of warranty in the Hebrew language that includes all of the manufacturer warranties. For Delek Automotive's warranty policy, see Paragraph 11.11.3 above. The order imposes additional obligations on the importer, including, inter alia, the marketing of transportation products and accessories in the four regions of the country in a set period (see Paragraph 11.11.2, above).

11.15.2 Price Controls

Motor vehicles and spare parts are not under supervision deriving from any price control-law.

11.15.3 Business Licenses

Delek Automotive's activities require a business license under the Business License Law 1968. At the date of the report, some of its activities have yet to attain the proper business licenses and Delek Automotive is working on receiving them.

The car and spare parts sales business requires a permit from the Ministry of Transportation in line with the order for supervision of Commodities and Consumer Services (the manufacture of transportation related products and their trade) Law, 5743-1983. Delek Automotive has a valid license from the Ministry of Transportation for the trade in transportation related products.

11.15.4 Antitrust

According to an agreed upon order deriving from section 50b of the Restrictive Trade Practices Law 5748-1988, that came into effect on April 24, 2003, car importers are forbidden from, amongst other things, limiting service garages from acquiring transportation related products (as defined by the order) or using them except in events outlined in the order. Similarly, if the importer offers warranties beyond the legal limit or beyond what the manufacturer offers on a global or regional basis, according to the longer term (hereinafter: "**Supplemental Warranty**") he must present its worth and offer the consumer the option of buying the car without it. Also, it is forbidden for the importer to restrict the warranty by way of limiting the choice of garages to authorized ones, limiting the repair to specific kinds of transportation related products or to only original products, or for limiting service to a specific garage or specific worker except by the terms indicated by the law. Similarly, the importer is forbidden to request from garages or to cause them to give information about the type or number of transportation products the garage uses in a certain time period or to receive any information regarding the type or amount of parts used – except when the information is needed for the resolution of suits against the importer regarding his warranty of the car and subject to exceptions detailed by the law. It also forbids the importer to limit the garages as to price of service except for maximum prices for services provided according to the warranty. The order also obligates the importer to provide clear relevant criteria as to the ways a garage can reach and maintain authorized license status on behalf of the importer. As required by the order, Delek Automotive has made a list of rules and criteria and delivered it to the general director of the Israel Antitrust Authority. Also, the order forbids receiving obligation on the part of the garage operator for exclusivity as detailed and subject to the exceptions set therein. The period of the order is for five years.

11.16 Material Agreements

The key agreements Delek Automotive signed are as follows:

11.16.1 Mazda Agreement

Since 1992, Delek Automotive has imported and sold Mazda vehicles and spare parts according to an agreement from April 1, 2005 between Mazda Motor Corporation (hereinafter: the "**Manufacturer**"), Delek Motors and the Itochu Corporation (hereinafter: the "**Exporter**") (herein: the "**Mazda Agreement**") whereby the manufacturer is committed to supply Delek Motors specific models of Mazda vehicles as detailed in the appendix to the agreement, for the purpose of sales in Israel. Replacement parts and other accessories were also part of the deal (hereinafter: "**Vehicle And Spare Parts Manufactured By Mazda**").

Following below is a synopsis of the main conditions of the agreement:

The supply of vehicles and replacement parts from Mazda to Delek Motors according to the agreement will not prevent Delek Motors from purchasing other vehicles or replacement parts from other suppliers for the purpose of sales in Israel, as long as it will not have a significantly negative effect on the sale of Mazda vehicles. The Manufacturer has the sole discretion in determining whether the said sale has a significantly negative effect on the sale of Mazda manufactured vehicles. Delek Motors must inform Mazda of its intent to sell other cars or spare parts at least 90 days in advance.

Similarly, the manufacturer is prevented from selling cars or parts manufactured by other manufacturers to any other party in Israel.

Notwithstanding the aforesaid, the Manufacturer has the right to sell Mazda manufactured vehicles in Israel not via Delek Motors, to a number of parties detailed in the agreement. These parties include governmental bodies, the diplomatic corps, international bodies such as the UN, Japanese companies who purchase more than ten vehicles per year, companies controlled by the manufacturer, their employees and others. Delek Motors cannot sell, directly or indirectly vehicles and spare parts outside of Israel.

The period of the Mazda agreement is for three (3) years beginning April 1, 2005 until March 31, 2008. The orders for vehicles and spare parts are through specific agreements between Delek Motors and the exporter, and between the exporter and the manufacturer. Agreements, as aforesaid, will enter into effect on receipt of the order by the manufacturer. The manufacturer will make every effort to fill the orders as aforesaid, but it is not obligated to do so.

Delek Motors is obligated not to use replacement parts for any purposes other than to equip and service cars in Israel.

Delek Motors is obligated to purchase a minimum amount of vehicles each years as detailed in the agreement. Delek Motors has lived up to the minimum purchase commitments stated in the agreement. The Manufacturer and the Exporter are permitted to change the aforesaid amounts of vehicles subject to the agreement of all the parties in order to live up to the demands of the Israeli market and/or to act in concert with the strategic plan of the Manufacturer. If Delek Motors does not buy the minimum quantity it committed to buy, the Manufacturer can end the agreement by a written notice to Delek and the Exporter.

The Mazda agreement sets the legal and business conditions relating to the distribution of vehicles and replacement parts of Mazda including amongst others, the establishment of a marketing and distribution system and the execution of marketing and sales activities. Also, the establishment of a service facility for vehicles and a customer service management system. It also requires the establishment of storage facilities suitable for vehicle inventory; providing costumer warranties according to the manufacturer's warranty , the submission of regular reports to the manufacturer and exporter, confidentiality agreements, the safekeeping of intellectual property, an arbitration mechanism for solving problems between the parties, all as set in the Mazda agreement.

Each party is authorized to bring the agreement to an end a any time in writing to the other parties if one or the other parties has breached the agreement and has not repaired the aforesaid breach within two months after notice was given.

Each party to the agreement can terminate the agreement by a written notice to the other parties in one of the following events as set in the agreement, which includes amongst other: Foreclosure, bankruptcy, receivership, request to reorganize, insolvency, delay in payment, transfer of the

majority or substantial part of the business obligations and assets of Delek Automotive, the freezing of Delek Automotive's business, merger, and so forth.

The manufacturer is authorized to end the agreement at any time by a written notice to the exporter and to Delek Motors, if the manufacturer decides that he cannot continue business with Delek Motors because of the death, incapacity or inability or any change in Delek Motors management or as a result of a change in the legal or organizational structure of Delek Motors or in the case of a significant change in the company's shareholder base or its investors.

In the event where, as a result of force majeure (as defined in the agreement) any party to the agreement is prevented from fulfilling its commitments for a period of more then six (6) months, any party to the agreement shall then have the right to terminate the agreement immediately by a written notice to the other parties to the agreement.

The exporter and Delek Motors are not authorized to transfer their obligations and rights according to the agreement, in part or in full, to any third party without the prior agreement, in writing from the manufacturer.

11.16.2 Ford Agreement

Delek Motors has been importing and selling vehicles and spare parts of Ford manufacture since 1999, according to an agreement signed on June 1 of that year between Ford Motor Company (hereinafter: "**Ford**") and Delek Motors (herein: the "**Ford Agreement**"). The following are the main provisions of the Ford Agreement:

According to the Ford Agreement, Ford appointed Delek Motors as a non-exclusive authorized dealer in Israel of vehicles and spare parts produced by Ford or for it and other products as determined by Ford from time to time. Delek Motors agreed not to act directly or indirectly for another business enterprise and shall act as a Ford dealer unless Ford gives its agreement in writing.

Delek Motors undertook not to sell new cars or spare parts of Ford's competitors unless given prior written consent from Ford. Ford agreed that Delek Automotive could be a concessionaire of Mazda products and even set rules for the integration Mazda and Ford concessions in Israel.

Any change in the control of Delek Motors or any change in the management of Delek Motors wherein Gil Agmon will no longer manage the company, will depend upon the prior written consent from Ford. In the event that Ford does not provide its agreement to a change as aforesaid, Ford shall have the right to terminate the Agreement.

The Ford agreement is in effect from the date of the signing until it is ended by one of the parties in accordance with its provisions.

The agreement stipulates the business and legal principles dealing with the distribution of Ford products by Delek Motors in Israel, including the marketing and distribution operations, the setting up of a service system in line with Ford standards, the employment of a suitable work-force and its instruction, the provision of warranties for Ford products, providing service, maintenance and repair, the use of trade names and trademarks and an arbitration mechanism for dispute resolution between the parties. Everything is as set in the Ford agreement.

Delek Motors has the right to end the agreement at any point by 30 day advance written notice.

Ford has the right to end the agreement immediately in one of the events detailed in the agreement that are controlled by Delek Motors including, amongst others: The transfer by Delek Motors of the rights or obligations under the agreement; the transfer of Delek Motors essential assets necessary for the management of its business; a change in the ownership or management of Delek Motors without Ford's prior written consent; if it is discovered that Delek Motors gave false presentations regarding the agreement; if Delek Motors is insolvent; the failure of Delek Motors to act properly during regular business practices; if Delek fails to stay open during regular business hours as defined in the agreement; a conviction by court of Delek Motors, Delek Automotive, Yitzchak Sharon Teshuva or Gil Agmon for breach of law; the disagreement between the parties, that Ford feels can negatively influence on Delek Motors' business, the good name of Ford or Delek Motors or any related factors; the breach of certain parts of the agreement by Delek Motors; non-payment or non-timely payment to Ford or a company related to Ford after prior notice was given and the breach was not corrected in 15 days; if the necessary license for the operation of Delek Motors is either suspended or revoked for whatever the reason.

Similarly, Ford has the right to end the agreement with 60 days prior notice in cases where Delek Motors did not fulfill its obligations according to the agreement and Delek Motors did not repair the breach after receiving 60 days prior notice.

Ford and Delek Motors both have the right to bring the agreement to an end by a 15 day written notice in the case of the death or physical or mental incapacitation of the owners of Delek Motors as stated above. Ford can decide to delay this right for three months to a year if the representative or inheritor should ask Ford to do so and convinces Ford that he or she has the capabilities to live up to the terms of the Ford Agreement.

Ford has the right to end the agreement at any time, by 120 days prior written notice.

Ford has the right to end the agreement at any time by 30 days prior notice if Ford offers a new agreement or an amended agreement to its authorized dealers.

In the case where there will be a change in the ownership of Delek Motors or the transfer of most of the assets of Delek Motors to any other party, that will cause Ford to need to negotiate a new agreement with that party, Ford will have the right of first refusal to buy Delek Motors or the assets offered for sale at the same conditions as agreed by the that party. Ford has the right to give its right of first refusal to a third party. The right of first refusal will be in effect for any transferee of Delek Motors.

11.17 Business Objectives and Strategy

The main goal of Delek Automotive is to increase its operations and profits through a continual improvement of service. The completion of the Logistics Center by Delek Automotive was established with the outlook for future developments of the automotive market in Israel, this will allow it to improve its customer service and make the company more efficient. Construction of the central garage, which will be spread over an area of some 15,000 m^2 is being carried out in compliance with international standards. Furthermore, the company is improving the appearance of its authorized garages and is establishing unified standards for the appearances of its chain of authorized garages.

During 2007, Delek Automotive expects to launch many new models, some of which will be a penetration to market segments, which Delek Automotive does not operate such as the Mazda2 - Super Mini. Also, additional models are expected to be added this year the range of existing ones, such as Ford's Mini-van S-Max, which was chosen as Europe's car of the year in 2007. Also, Ford's Mini-Van Galaxy. In addition, Delek Automotive will launch two cars in the "executive car" category: The new Mazda 6 and Ford's new Mondeo.

11.18 Risk Factors

A number of risk factors can be stated that could threaten the operations of Delek Automotive as detailed in the table below:

11.18.1 Dependence on Manufacturers – Delek Automotive is dependent upon the manufacturers of the cars it imports. According to agreements contracted with them, Delek Automotive must operate under certain conditions. Similarly, the said agreements can be cancelled by the parties as described in the agreements. In addition, Delek Automotive is dependent upon the models and manufacturers' pricing structure. If the manufacturers produce expensive models, Delek Automotive's financial results may be influenced.

11.18.2 Changes in currency exchange rates of importing countries -Since most of Delek Automotive's expenses are in foreign currencies - Yen, Euro and USD, it is exposed to fluctuations in the currency rates. A currency revaluation versus the Shekel may cause a reduction of the Group's profitability.

11.18.3 Changes in foreign currency rates at competitors' importing countries - About 85-90% of the price of Delek Automotive's products are dependent upon the home currency of its manufacturers. Therefore, in the event that the foreign currency exchange rates of which the competing importers does not change or are reduced while there is a revaluation of those that Delek Automotive imports, then Delek Automotive competitive ability will be damaged.

11.18.4 Changes in the bank interest rates in Israel and abroad – A large portion of Delek Automotive's bank credit is at a variable interest, which is a function of bank interest in Israel and abroad. Therefore, Delek Automotive is exposed to the changes in the bank interest in Israel and abroad.

11.18.5 Customer Credit Risk – Delek Automotive's sales to institutional customers are partially accomplished using credit, as is common in the automotive industry. The credit is not secured and is concentrated amongst a few customers that have a large purchase volume. Therefore, the non-payment of credit by one or more customers can specifically affect Delek Automotive's cash flow and business results.

11.18.6 Reduction of Centrality in the Automobile Market - As detailed in Section 11.1.2 above, the Ministries of Finance and Transport have recently worked toward a reduction of the centralization in the vehicles market in Israel, and toward the removal of barriers therein, by examining reforms in the area of taxation, standardization and regulation of vehicle imports. Delek Automotive estimates that in the short term, these changes will have no significant effect on the Group's operations, since there is no economic viability to parallel imports except in respect of luxury and niche cars.

11.18.7 Down turn of the Economy – Changes in the scope of economic activity in Israel's economy, as a result of political, security and economic factors, may affect the scope of vehicle sales in Israel and have a negative influence upon the Company's business results. However, Delek Automotive has successfully established its standing as the largest car agency in Israel. These changes may have an effect on Delek Automotive's business results.

11.18.8 Regulatory Changes - Changes in regulatory arrangements that apply to the vehicle industry, such as changes in the government taxation policy, changes in the policy pertaining to the classification of vehicles as private or commercial for tax purposes, or changes in the policy pertaining to the usage value of a leased vehicle provided for the employee's use, may lead to changes in the demand for various types of vehicles and affect Delek Automotive's operation results. For details concerning the aforesaid changes, see Paragraph 11.1.2 above. In the opinion of Delek Automotive's management, it is not possible to estimate how these changes will affect the results of Delek Automotive's activity.

11.18.9 Changes in the management of Delek Motors or in the control of Delek Motors – In the Ford Agreement it is set that any change in the control of Delek Motors or any change in the management of Delek Motors wherein Gil Agmon will no longer manage the company, will depend upon the prior written consent of Ford. In the event that Ford does not provide its agreement to a change as aforesaid, Ford shall have the right to terminate the agreement. Also, the manufacturer is authorized to end the agreement at any time by a written notice to the exporter and to Delek Motors, if the manufacturer decides that he cannot continue business with Delek Motors because of the death, incapacity or inability or any change in Delek Motors management or as a result of a change in the legal or organizational structure of Delek Motors or in the case of a significant change in the company's shareholder base or its investors.

	Impact of Risk Factors on Company Operations		
	Major Impact	**Medium Impact**	**Minor Impact**
Macro-level risks		• Changes in the rates of exchange of currencies from the import countries • Changes in local and global interest rates • Economic Slowdown	
Industry-wide risks	• Currency changes from competitor source countries		• Customer Credit • Reduction of centrality in the market
Risks specific to Delek Automotive	• Dependence on Manufacturers	• Change in the management of Delek Motors or control over Delek Motors	

The above analysis of the risk factors is only an estimate. In reality, the factors could be different.

12. Real Estate Sector

12.1 General

12.1.1 The group's operations in the real estate sector are run through Delek Real Estate, Ltd. (hereinafter: **"Delek Real Estate"**). As of the date of the report, the group holds 67.91% of Delek Real Estate's share capital.[1]

12.1.2 Delek Real Estate is the owner of Delek-Belron International, Ltd. (hereinafter: **"Delek Belron"**).[2] Delek Belron and its investee companies concentrate on long-term real estate rental investments in western countries. Delek Belron's investments of are done via investments in foreign companies that hold long-term rental properties. They act independently in all their purchases, management and, on occasion, sale of real estate assets (Delek Belron, along with its investee companies, shall hereinafter together be called: **"Belron"**).

12.1.3 Delek Real Estate operates in Israel as a developer of residential projects. During 2004 Delek Real Estate purchased all of the shares owned by Danker Investments Ltd. (**"Dankner"**). Delek Real Estate continued Dankner's activity and Dankner became its operational arm in the residential construction sector (regarding negotiations that Delek Real Estate is conducting with Azorim Development and Construction Investment Company Ltd. (hereinafter: **"Azorim"**) for selling Dankner and its residential activity, see Paragraph 12.23 below).

12.1.4 Delek Real Estate also operates in Israel in developing and acquiring office and commercial projects, and leasing rental properties that it owns. Regarding development of projects for commercial and office projects (except for development of fuel stations and accompanying commercial areas), Delek Real Estate intends to carry out this activity through Vitania Company Ltd., regarding which the company has the right to acquire half of its shares (see Paragraph 12.15.4 below).

12.1.5 In June 2005, Delek Real Estate Ltd. issued securities that included shares and debentures. A total sum of NIS 755,000 thousand was raised. The issued securities are traded on the TASE.

12.1.6 In January 2006 Delek Real Estate Ltd. allocated 11% of Delek Real Estate Ltd.'s share capital to Tarshish – Hapoalim Holdings and Investments Ltd. (hereinafter: **"Tarshish"**) (a company wholly owned by Bank Hapoalim Ltd.), in return for about NIS 260,490,117 million.

12.1.7 In December 2006, Delek Real Estate allocated to Migdal Insurance Company and Hamagen Insurance Company shares that, together, constituted approximately 3% of its share capital, in exchange for the amount of NIS 130,111 thousand. Shortly thereafter, Delek Real Estate allocated to a third party shares that constituted 1.9% of its share capital, in exchange for the amount of about NIS 80,607 thousand.

12.1.8 On 16 March 2007, Delek Global Real Estate Ltd. (hereinafter: **"DGRE"**), a wholly controlled subsidiary of Delek Belron, announced its intention to issue about 22% off its shares to institutional bodies and to register its shares for trade on the AIM in London (for further details, see Paragraph 12.9.7 below).

12.1.9 For reasons of convenience, the description of the real estate operation will be split by geographic region. The first description will be of foreign operations, followed by the Israeli operations. There are some topics that are covered jointly.

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[1] 10.46% is held by Bank Hapoalim, 6.21% is held by Mivtachim – Workers Social Security Company, Ltd., 2.06% by Bank Hapoalim's provident funds, 1.51% by the CEO, 0.05% by Mr. Gabi Last (a company director), and the rest by the public.

[2] In 2000, Delek Belron issued non-convertible debentures that trade on the TASE.

12.2 General Information on Real Estate Sector Operations Overseas

12.2.1 Structure of Foreign Operations

Delek Real Estate Ltd. operates abroad in the UK, Canada, Sweden, Germany, Switzerland and Finland. S&P has given these countries an international AAA[1] rating, mainly reflecting their developed economies and relative stability over years.

12.2.2 The Markets in which Belron Operates may be Characterized as Follows:

A. The shareholders' equity required from the purchaser while purchasing property (if the property is rented out) is as follows: in the UK – 5-15% of the purchase price of the property; in Canada – 25-30% of the purchase price of the property; in Germany – 10-20% of the purchase price of the property; Switzerland – about 10% of the purchase price of the property; Finland – 10-15% of the purchase price of the property; Sweden – about 15% of the purchase price of the property.

B. Financing of the rest of the purchase price, except shareholders' equity (if the property is rented out), is mainly done through non-recourse loans, where the loan guarantee is the property itself, company shares and rental agreements. Occasionally, there is a cross-collateralization of several properties.

C. Rental contracts in countries where Belron operates in Europe are generally for a period of about 10 years. In the British real estate market, Belron strives for contracts for longer periods of time, of up to 30 years.

D. Rental fees are adjusted once every few years, with variations existing between agreements. In the UK, most rental fees are adjusted Upwards Only, or according to a regular Upwards Only method pursuant to the provisions of the agreement.

E. In the UK, rental agreements are generally Triple Net, e.g. commitments by the lessees that also include maintaining the property and paying taxes and insurance on the property. In Canada, Germany, Switzerland, Sweden and Finland, Triple Net agreements are less common, and therefore the property owner needs to arrange solutions regarding capital expenses and regarding insurance for the property. When the rent is not of the Triple Net type, Belron makes certain that the companies owning the properties have sufficient funds to make capital investments that may be required both during and after the end of the rental term.

F. External management companies with which Belron's management regularly conducts strategic discussions related to leasing and managing the properties perform current management of Belron properties.

G. The lessee is generally not required to give any guarantees to ensure his undertakings according to the rental agreements. When the lessee is a subsidiary of a well-known company, guarantees are occasionally required from the lessee's parent company.

12.2.3 Changes in the Sector's Scope and Profitability[2]

A. United Kingdom

The British economy has enjoyed stable growth for more than a decade. The British office market is considered to be a broad and developed market, with a high degree of liquidity and transparency. From the standpoint of investments in the real estate sector in Britain, 2005 was a peak year, with investments totaling €86 billion, a rise of 50% over 2004. In 2006, there were very high levels of investment in the British real estate market, totaling €80.4 billion. The British real estate market constituted 51% of all real estate investments in Europe in 2005, and 36% in 2006. The scope of transactions in the office sector in 2006 totaled €36.6 billion, a 7.7% rise over the €33.7 billion recorded in 2005.

Along with the increase in investments in high-quality offices, there was also a 13-19% rise in rental fees in areas of demand in London compared with the corresponding period the previous year. At the same time, there is a decline in the amount of available space for rent.

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1 For comparative purposes, S&P rates Israel A-.

2 All the figures in Section 12.2.3 originate from DTZ Research.

In light of the aforesaid, in 2006 there was a drop in returns, and Belron assesses that the ability to produce a higher return on capital in the future depends on professional management of the properties, more than on relying on a future increase in returns for the properties.

B. Canada

The Canadian economy has enjoyed 14 years of continuous growth in GDP. Due to the economy's growth, the amount of available space for rent in the Canadian market plummeted in the large cities. The real estate market in Canada includes large transactions, whereby in 2004, 2005 and 2006 the total amount of transactions were €5.2, 6.7 and 5.3 billion, respectively. Belron assesses that the price of quality real estate in the Canadian market is still low.

C. Germany

The German market is showed signs of strengthening in 2006, after nearly a decade of underperforming in relation to Euro Zone countries. Pursuant to data from the German Central Bureau of Statistics, GDP grew 2.5% in 2006, the biggest rise since 2000. The improvement in the macroeconomic situation also influenced the rental real estate sector, and it is possible to see a decrease in the amount of available space for rent.

Rental prices for high quality properties rose in 2006 in all of Germany's important cities.

D. Sweden

The growth in Sweden's GDP has continued for a number of years now. Despite the fact that growth fell from 3.7% in 2004 to 2.9% in 2005, growth in 2006 is expected to be 4.5%.

The Swedish office market is experiencing an upswing. Despite the fact that across the country the amount of available space for rent is high and stands at 10%, in Stockholm there has been a rise in rental prices for quality office space, due to the small supply.

Investor activity peaked in 2006, with investments totaling €15 billion, compared with €13 billion in 2005.

E. Finland

The Finnish economy growth more than 3% over the past three years, and it is expected to hit 5.2% in 2006.

After a number of years characterized by low demand for office space, the Finnish economy's strength led to a recovery in the office sector. Available space for rent is falling, and rental fees for quality properties are rising. Total investments in properties in 2006 grew significantly to €5 billion, compared with €2.8 billion in 2005, and €3.1 billion in 2004.

F. Switzerland

The Swiss economy increased significantly in 2006, with growth of 2.9% in GDP and growth forecasts of 2% in GDP in 2007 and 2008.

The Swiss office market took a hit due to the weakness of the economy in the first half of the decade. Supply in the office market rose, and led to a fall in rental prices. However, it appears that there has been a change in the trend. In 2006, rental fees for quality offices in Zurich rose by 6.3% (about €525 per m^2 annually). A similar trend may be seen in Geneva, where there has been a 1.4% rise in rental fees (about €444 per m^2 annually).

The rise in rental fees in Zurich and Geneva were in line with the reduction in the amount of available office space. Regarding Zurich, this manes not just office space in business centers, but also in other areas of the city.

12.2.4 Critical Factors for Success in Foreign Operations

According to Delek Real Estate estimates, the critical factors for success in activity are: finding long-term rental properties to rent to financially stable leaseholders in areas of demand, and, as far as possible, those with potential for future development; the ability to gain good financing sources and conditions to allow rental yields in excess of financing costs; financial stability enabling investment of the required shareholders' equity; proper, geographically diverse investments; Delek Real Estate carried out a series of transactions that have classified Delek Real Estate as a "deal closer."

12.2.5 Main Barriers to Entry and Exit in Foreign Activity

The barriers to entry include financial stability in order to have the shareholders' equity required to make the investments; and the need to establish an autonomous management structure in other countries.

The main barrier to exit in the real estate field stems from the often long and complicated nature of selling properties.

12.2.6 Competition and the Changes in It

Belron operates abroad in large markets where its market share is small. Because of the nature of Belron's activity in said countries, its competitors are not readily identifiable. However, the demand for real estate in the UK exceeds the supply. Therefore, Belron operates in the UK in a market where competition for specific properties is generally strong.

12.3 Details Regarding the Real Estate Assets in the UK

12.3.1 The following are additional data regarding the real estate assets in the UK:

Holdings% as of December 31, 2006 (holdings as of date of report's publication)[1] date of investment	Holdings % should contracts dependent on DGRE's going public abroad be implemented	Name of affiliated company	Name of property/Location	Description of property held by affiliated company and size in m^2 (excluding parking)	Investment in affiliated company in NIS thousands, as of Dec. 31, 2006	Name of principal Lessee /date of end of lease/% rented	Cost of property in affiliated company's books in NIS thousands, as of Dec. 31, 2006	Rental income recognized in affiliated company's financial statements in NIS thousands, for property in 2006	Delek Real Estate's share in affiliated company's profit (loss) in NIS thousands, in 2006
42.4% (45%) 11/03	59%	Linchfield Ltd.	Parking lots in UK Linchfield Company	Parking lots throughout UK (see section 2.6.5(c))	227,789	NCP until 2037	4,955,369	477,548	43,612
35.5%	No change	Shalati Ltd.	Farringdon Road, London (purchased 5/02)	Office building, ground + 5 floors, 2 basement floors, about 15,680 m^2 24 parking spots	180,777	Merrill Lynch until 29.9.2015 100% occupancy	808,119	50,929	38,836
			Stonecutter London (purchased 6/03)	Corner office building & shops, about 14,198 m^2		95% leased to Deloitte until 2019 94% occupancy	907,580	51,650	
			Mitre London (purchased 9/02)	Office Building, 7 floors, about 17,528 m^2		Leased to CMS until 26/7/2015 100% occupancy	1,036,050	65,229	
40% 9/03	70%	Rosemore Ltd.	Kinnaird, House [60] London	About 6,633 m^2 office bldg & shops	88,678	75% leased to McKinsey until 24.3.2018 100% occupancy	607,125	29,861	80,612
31.875% (33.9%) 12/04	57.5%	Quarry Town Ltd.	The Discovery Center, Dundee, Scotland	Office bldg in Dundee, east coast of Scotland about 12,280 m^2, three stories + ground floor	12,714	Leased to NCR until Nov. 15, 2026; 100% occupancy	195,192	12,964	2,665

[1] The date in parentheses represents the level of holdings correct to the date of the report, should changes have occurred compared with the balance date.

[60] Leasing fees to the amount of £566,000 were paid in 2005

Holdings% as of December 31, 2006 (holdings as of date of report's publication)[1] date of investment	Holdings % should contracts dependent on DGRE's going public abroad be implemented	Name of affiliated company	Name of property/Location	Description of property held by affiliated company and size in m^2 (excluding parking)	Investment in affiliated company in NIS thousands, as of Dec. 31, 2006	Name of principal Lessee /date of end of lease/% rented	Cost of property in affiliated company's books in NIS thousands, as of Dec. 31, 2006	Rental income recognized in affiliated company's financial statements in NIS thousands, for property in 2006	Delek Real Estate's share in affiliated company's profit (loss) in NIS thousands, in 2006
45% 12/97	No change	Major Belle	NLA Tower Croydon	Office building, 23 floors, about 14,995 m^2, 1 underground parking level for 170 cars	26,152	Building recently underwent renovation; various renters; leases from 10/2006 until 12/2014; 87% occupancy	203,924	11,279	(1,320)
45% 11/98	No change	Shatto Ltd.	City Center Atrium, Birmingham	Office building, 20 floors, about 19,254 m^2, 3 underground parking levels for 192 cars	18,921	Various lessees; various dates; from 2007-2014; 82% occupancy	323,248	19,753	(3,265)
45% 3/99	No change	Old Forge Ltd.	City Plaza, Pinfold St., Sheffield	office building, 9 floors, 10,998 m^2 , and 263 parking spots	16,444	Various lessees; various dates from 2006-2016 87% occupancy	161,001	11,519	795
45% 12/00	No change	Padwick	Sim Chem House Warren Road, Manchester	2 office buildings, 6 & 7 floors, 7,380 m^2, parking for 167 cars	7,385	Simon-Carves Ltd.; Until April 11, 2021; 100% occupancy	75,259	5,682	(271)

12.3.2 Consolidated company – one of Delek Real Estate's consolidated companies (70%) holds a property located at 1 Buckingham Gate in the center of London, a 4-building office complex next to Buckingham Palace, including basement, ground floor, six higher floors with an area of 16,554 m^2 and 11 parking spots. The property was purchased in February 2000. The property is leased to a British government office until Sept. 28, 2020. Occupancy is 100%. Rental fees for the property, recognized in Delek Real Estate's financial statements for 2006, were GBP 5,468. The lower cost of the property in Delek Real Estate's books as of Dec. 31, 2006 amounts to NIS 493,491 thousand. The above data include the 30% minority interest.

12.3.3 Leased properties in the UK – as of Dec. 31, 2006, approximately 93% of the properties of Delek Real Estate's affiliated and consolidated company properties in the UK (excluding the parking lot in the NCP deal and the hotels) were leased. There were no substantive changes in the occupancy rate of the UK properties in 2006.

12.3.4 Financing the purchase of properties in the UK – Most purchase transactions for property in the UK are eligible for financing of between 85-95% of the purchase price. As a condition for such financing, the company purchasing the property must pay the balance of purchase cost that is not paid by foreign financing. Loans are usually guaranteed by the purchaser of the property only. Since each company usually holds only that property itself, without other properties, and the lender's rights are vis-à-vis the property purchaser only, the loans are non-recourse loans (despite this, one Delek Real Estate foreign company holds shares in three companies holding three properties in the UK, and in fact have cross-collateralized between the three properties. There is also cross-collateralization between 4 properties regarding which refinancing was carried out together). The following table gives details of loans to foreign companies that hold properties (the above data relate to foreign companies that hold properties, while Delek Real Estate owns various percentages of these companies, as detailed in section 12.3.1 above):

Name of affiliated company	Amount of loan in thousands of £	Balance of the loan in Delek Real Estate's books as of Dec. 31, 2006 in thousands of £[1] (in thousands of NIS)	Annual interest rate	Final payout date	Balance of outstanding principal on final payout date in thousands of £
Shalati Ltd.	275,000	267,687 (2,218,698)	6.2%	7/2012	252,593
Rosemore Ltd.[2]	47,715	45,715 (378,904)	6.12%	5/2013	46,290
Quarry Town Ltd.	16,227	16,227 (134,496)	6.66%	9/2012	13,970
Major Belle Ltd.	80,600	77,992 (646,428)	5.92%	3/2010	77,588
Shatto Ltd.					
Old Forge Ltd.					
Padwick Ltd.					
Botly Ltd.	57,156	57,445 (467,922)	6.69%	7/2020	41,932

12.3.5 **<u>Parking Lot Transaction – NCP</u>**

Delek Real Estate holds 42.4% of Linchfield Ltd. (hereinafter: **"Linchfield"**), which on the date of this report holds 131 parking lots, through a UK company. It should be noted that Phoenix holds 5% of Linchfield. The parking lots include about 47,000 parking spots. On 10 of those lots there is a possibility of developing an additional 4,000 spots, and on another 40 lots it will be possible to develop about 250,000 m^2 of offices, commercial space and hotels. It is hereby clarified that reference is to forward looking information, and that any decision to continue said development is

[1] After deducting capital raising expenses related to the loan.

[2] Refinancing took place in January 2006.

subject to the ability to complete the required procedural processes, such as changing the city building plans, cooperation with other developers, and cooperation with the existing lessee. Beginning June 2002, the parking lots are leased in rental agreements until 2037, without the possibility of an exit, to National Car Park Limited (hereinafter: **"NCP"**), which is the UK's largest parking lot operator. As of the purchase date, the annual rental fees pursuant to the leases with NCP totaled about £41 million, and they are paid on a quarterly basis. Rental fees in 2006 totaled about 41.9 million pounds. It should be noted that the rental fees are adjusted upwards pursuant to a mechanism that was determined in the leases.

The transaction was financed by RBS, in three non-recourse loans totaling about £543.2 million, and the balance (about £56 million) from independent sources (Delek Real Estate's portion is about £22.4 million). Linchfield carried out an interest swap deal such that it set the interest rate of all of the loans at an average rate of 7.3% (non-linked). A portion of the interest is accrues to the loan principal, and is not paid on a current basis. The loan balance as of December 31, 2006 was £543.5 million, and the balance of the independent sources was about £32,707 million (Delek Real Estate's portion is £13,868 million). Pursuant to the loan agreement, RBS has an option of receiving a portion of the surplus profits that are created from the sale of the properties.

12.3.6 Details about Delek Real Estate's Properties in Europe (excluding the UK)

A. The following table gives details of holdings of Delek Real Estate's foreign subsidiary companies in companies with property in Europe (excluding the UK):

Country	Holdings % as of Dec. 31, 2006 (Holdings as of date of report's publication should a change have occurred)/ Date of investment	Holdings % should contracts dependent on DGRE's going public abroad be implemented	Name of affiliated company	Name of property/Location	Description of property held by affiliated company and size in m^2 (excluding parking)	Investment in affiliated company in NIS thousands, as of Dec. 31, 2006	Name of principal Lessee /date of end of lease/% rented	Cost of property in affiliated company's books in NIS thousands, as of Dec. 31, 2006	Rental income recognized in affiliated company's financial statements in NIS thousands, for property in 2006	Delek Real Estate's share in affiliated company's profit (loss) in NIS thousands, in 2006[61]
Germany	%47.5 05/2	%62.5	Admiralty	Celle – near Hanover	Shopping center of about 23,712m^2 13 shops 760 parking spots	37,969	Various lessees. 78% leased until 2017 and rest of the rentals for period of 5-10 years/ 100% occupancy.	240,378	14,958	12,936
	%40 (%42)06/1	%60	Farena	Mulheim – near Dusseldorf	Office building on about 12,800 m^2 and 312 parking spots	24,235	Deutsche Telekom until 2015/6 100% occupancy	200,315	13,192	14,889
	%40 (%42) 06/1	%60	Paxos Holdings SARL	Walzmuhle- near the city of Ludwigshafen	Complex incl. commercial center and office building on 41,000 m^2	146,655	Leased to 19 various lessees. Main lessee is Metro, which accounts for 70% of rental fees of the leased property, which is leasing the leased property until end of 2019	1,391,075	84,079	74,070
				Degi – in Frankfurt's financial center	Office building on overall built area of 23,900 m^2 +200 shops		Subsidiaries of Alliance Insurance Company until mid-2013			

[61] Regarding companies acquired during the year of the report, the data are only from the date of acquisition by the company.

Country	Holdings % as of Dec. 31, 2006 (Holdings as of date of report's publication should a change have occurred)/ Date of investment	Holdings % should contracts dependent on DGRE's going public abroad be implemented	Name of affiliated company	Name of property/Location	Description of property held by affiliated company and size in m^2 (excluding parking)	Investment in affiliated company in NIS thousands, as of Dec. 31, 2006	Name of principal Lessee /date of end of lease/% rented	Cost of property in affiliated company's books in NIS thousands, as of Dec. 31, 2006	Rental income recognized in affiliated company's financial statements in NIS thousands, for property in 2006	Delek Real Estate's share in affiliated company's profit (loss) in NIS thousands, in 2006[61]
	%40 (%42) 06/2	%60	Broomstead	Adidas – Nuremberg	Complex incl. five office buildings on overall built area of 22,500 m^2	16,602	Fully leased to Adidas until 2017/2	146,898	7,284	8,200
	%40 (%42) 06/10	%50	Tredegar Holdings	Grevenbroich – near Cologne	Commercial center of about 15,000 m^2, built on about 48 dunams of land.	20,812	%87 of rent fees from Real chain, owned by Metro[62]. Lease with aforesaid chain is until 12/2025. With remaining lessees, leases are until 6/2016.	213,669	12,504	2,482
	%80 06/12	(%80)	Anchor Falls	Deutsche Welle Berlin	Office building of about 9,500 m^2	23,357	%87 of rent fees from Real chain, owned by Metro. Lease with aforesaid chain is until 12/2025. With remaining lessees, leases are until 6/2016.	160,294	9,458	7,402

[62] Leading company in the European retail sector.

Country	Holdings % as of Dec. 31, 2006 (Holdings as of date of report's publication should a change have occurred)/ Date of investment	Holdings % should contracts dependent on DGRE's going public abroad be implemented	Name of affiliated company	Name of property/Location	Description of property held by affiliated company and size in m^2 (excluding parking)	Investment in affiliated company in NIS thousands, as of Dec. 31, 2006	Name of principal Lessee /date of end of lease/% rented	Cost of property in affiliated company's books in NIS thousands, as of Dec. 31, 2006	Rental income recognized in affiliated company's financial statements in NIS thousands, for property in 2006	Delek Real Estate's share in affiliated company's profit (loss) in NIS thousands, in 2006[61]
Sweden	45% (%47) 04/5	(%75)	BHM Stockholm	Building Repslagaren 31 Stockholm	5-story office building and shops and basement used for parking, in heart of traditional business area. About 4,635 m^2	23,357	%80 leased to one lessee until 3/2009 100% occupancy	160,294	9,458	7,402
Switzerland	%45 05/8	%71.5	Dubendorf Property 63	Dubendorf Zurich	Building on about 22,800 m^2 and underground parking lot	54,994	Credit Suisse until 9/2012 100% occupancy	495,567	22,251	42,287
	%45 05/11	%85	Trafalgar Property [64]	Zurich University Zurich	Building on about 21,000 m^2, 6-stories + 3 basement levels, parking with 109 spots.	50,824	University of Zurich until 12/2015 100% occupancy	518,092	21,008	36,495
	%45 06/6	%50	Yogal Holdings AG	Luna Bern	Three office buildings on overall area of about 27,000 m^2.	77,066	Leased to single lessee, Swiss Confederation, which is a government body, until 12/2023.	579,778	33,683	10,093

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Country	Holdings % as of Dec. 31, 2006 (Holdings as of date of report's publication should a change have occurred)/ Date of investment	Holdings % should contracts dependent on DGRE's going public abroad be implemented	Name of affiliated company	Name of property/Location	Description of property held by affiliated company and size in m^2 (excluding parking)	Investment in affiliated company in NIS thousands, as of Dec. 31, 2006	Name of principal Lessee /date of end of lease/% rented	Cost of property in affiliated company's books in NIS thousands, as of Dec. 31, 2006	Rental income recognized in affiliated company's financial statements in NIS thousands, for property in 2006	Delek Real Estate's share in affiliated company's profit (loss) in NIS thousands, in 2006[61]
	%40 06/6	%50	Tower Property	Bern	Commercial center on area of about 16,700 m^2	20,099	%85 of rental fees will be received from main lessee, Coop, according to lease until 2021. Regarding remaining lessees, leases end in 11/06.[65]	146,376	12,010[66]	(828)
Finland	%45 06/1	%72.5	Pomiratun OY	Helsinki, Finland	Offices on overall area of 22,500 m^2 in Vallila area.	26,175	Telia Sonera, the largest communications company in Finland. Lease on one office is until Dec. 2010, and on the other office until 2012.	282,110	18,136	12,781

[65] One of the two largest retailers in Switzerland.

[66] The commercial center began operating only in late 2006.

B. Acquisitions by subsidiaries in Western Europe during the reported period:

1. Purchase of Fuel stations by Consolidated Company

In October 2006, Belron acquired 90% of the shares of foreign companies that own 73 fuel stations and convenience stores across Finland. Each of the properties has fuel stations, a commercial building, and at some of the stations there are additional activities. The properties were purchased at a price of about €115 million. Purchase of properties was financed through non-recourse loans totaling about €109 million. Delek Real Estate's portion of the shareholders' equity totaled about €11 million. The properties are leased to two main entities: Kesko Food – a retail chain that is one of the two largest commercial chains in Finland. The lease runs until 2015, with an option to extend until 2020; Neste Oil – produces, markets and operates the largest refineries in Finland. A public company controlled by the Government of Finland, it operates 900 fuel sale stations in Finland. The lease runs until 2021, with an option for the lessee to extend until 2026.

2. Purchase of an Office Building in Berlin (Deutsche Welle Anstalt)

On Dec. 18, 2006, Belron completed the purchase of 80% of the shares of a company in possession of an office building in Berlin, Germany, on an area of about 9,500 m^2. The property is leased to a German government company that operates a radio and television station in Germany in two leases without the possibility of an exit, one until June 2016 (80% of the rental fees) and the other until June 2014 (20% of the rental fees). Annual net rental fees expected for the company holding the property for the entire property are €2.3 million. Beginning October 2008, and every 6 years thereafter, the rental fees will increase 6% annually. The shares were acquired in exchange for €30 million, and financing was done through a 28.5 million euro non-recourse loan at a fixed interest rate.

C. Rental in Western Europe

As of December 31, 2006, approximately 99% of Delek Real Estate's affiliated companies' properties in Western Europe were leased. There were no substantive changes in the tenancy rate of properties in Western Europe in 2006.

D. Financing

In most of property purchase transactions in Europe, financing of 80-95% of the purchase price can be obtained. As a condition for such financing, the company purchasing the property must pay the balance of purchase cost that is not paid by foreign financing. Loans are usually guaranteed by the company that is the purchaser of the property only. Since each company usually holds only that property itself, without other properties, and the lender's rights are vis-à-vis the purchasing company only, the loans are non-recourse loans. Part of the loans is at a fixed interest rate and part at a variable interest rate. If the loan is at a variable rate, the purchasing company purchases hedging transactions that limit its exposure to fluctuations in interest rates. The following table gives details of loans for foreign property owners (the data relate to the foreign companies that own property, while Delek Real Estate has varied holdings in these companies, as detailed in Section 12.3.1, above):

Name of company	Amount of loan, in thousands of loan currency	Balance of outstanding principal on Delek Real Estate's books as of Dec.31, 2006, in thousands of loan currency[67] (NIS thousands)	Annual interest rate	Final payout date	Balance of outstanding principal on final payout date, in loan currency
Admiralty	€28,000	€26,975 (150,097)	4.65%	2/2012	€24,750
Dubendorf	104,500 Swiss Francs	100,799 Swiss Francs (349,319)	3.07%	7/2009	96,100 Swiss Francs
Trafalgar Property	111,700 Swiss Francs	109,461 Swiss Francs (379,337)	3.12%	11/2010	103,000 Swiss Francs
Tower Property AG	[68]16,203 Swiss Francs	16,203 (56,151)	3.92%	11/2013	16,203 Swiss Francs
Yogal Holdings AG	127,328 Swiss Francs	127,328 (441,255)	3.92%	10/2013	91,330 Swiss Francs
Tower Green Property Gmbh	€61,000	59,099 (328,845)	4.51%	01/2013	€54,900
Farena Investments Limited	€23,800	23,195 (129,16)	4.47%	12/2010	€21,420
Broomstead Investment Limited	€21,600	18,071 (100,552)	4.54%	02/2013	€15,503
Regent Properties Limited	€121,000	116,476 (648,107)	5.3%	04/2011	€110,412
Tredegar Holdings Ltd.	€29,070	28,485 (158,499)	5.17%	07/2013	€29,070
Pomiratum OY	€39,500	39,500 (219,790)	4.36%	03/2011	€35,100
BHM Stockholm Repslag	154,000 Swedish Kronor	152,215 Swedish Kronor (93,612)	4.55%	06/2009	138,600 Swedish Kronor
Dalriada Holding	€108,698	107,663 (604,834)	5.15%	10/2011	€105,435
Anchor Falls	€27,823	27,823 (154,816)	5.12%	12/2013	€26,647

12.4 Details Regarding Partners in Delek Real Estate's Affiliated Companies in the UK and the Rest of the West European Countries

The composition of the partners in Delek Real Estate's affiliated companies varies from one company to the next. Delek Real Estate's partners in the affiliated companies include, among others, public Israeli companies like Electra (through the Electra Real Estate subsidiary), Giron and the Phoenix, private Israeli entities, as well as foreign companies and investors, including investment funds from South Africa, the UK, and Ireland.

12.5 Details About the Canadian Properties

12.5.1 As of the date of this report, Belron is the beneficiary of four Canadian trusteeships that hold four real estate properties in Canada, as well as a Canadian trusteeship that holds 45% of a foreign company that has a property portfolio containing 30 Canadian shopping centers, as well as an

[67] After deducting deferred expenses attributed to the loan.

[68] With handing over of the building by the seller, the full credit will be received from the bank in the amount of NIS 48 million.

additional trust that holds 45% of the share capital of a foreign company owning two adjacent commercial centers in the province of Quebec.

12.5.2 Details of Canadian Real Estate Properties:

Wholly-owned real-estate assets in Canada, leased out as office rentals:

Name and Location, and Property's Purchase Date	Description	Name of Lessee	End of Lease Date	Rental Income recognized in Delek Real Estate's financial statements 2006 (NIS thousands)[69]	Depreciated Value of Property on Delek Real Estate's books as of Dec. 31, 2006 (NIS thousands)
Bell Tower, Montreal Purchased on November 7, 2001	Office building in complex of two buildings. 28 floors and storage. Jointly managed commercial space including shared equipment, three-story underground parking with 708 parking spaces and commercial areas. The parties jointly manage the commercial areas and parking under a cooperation agreement[70]. 104,000 m^2 (excl. parking).[71]	Bell Canada, 18 floors[72], 5.5 floors leased to AON (insurance company)[5], 2 floors leased to National Bank of Canada, 1.5 floors leased to the UN airport authority, one vacant floor.	Various dates for Bell Canada. Other floors vary starting from March 2008 until March 2018.[73] AON – until June 30, 2022 (with the option of early release in 2017 with compensation)	126,965	734,163
5001 Yonge Street, Toronto purchased June 28, 2001	Office building including 20 floors and 400 parking spaces, four-level underground parking. 30,411 m^2 (not incl. parking).	About 65% to Canadian Internal Revenue, 15% to Royal Bank of Canada, remaining areas leased to 15 other parties.[7]	Internal Revenue, most of the areas until April 2012, Royal Bank of Canada, until Aug. 2011.[8]	52,108	273,351
Total				179,073	1,007,514

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69 Canadian rental income includes expense reimbursements from lessees. In 2006, this reimbursement for the office buildings totaled about NIS 43,135 thousand.

70 According to the joint agreement the company has a right to 79.2% of the revenues for the commercial space and 63% for parking. The company is responsible for expense at the same rate. As for other space with only expenses, the rates are detailed in an agreement between the sides.

71 Of the space, 95,000 m^2 are office space.

72 Bell Canada lease includes 200 parking spaces and storage of 1,250 m^2.

5 Rental agreement began in June 2006. The lessee has been given six months grace during the first year and seven months during the second year, for paying the rent.

73 The periods of the end of the lease are as follows: an area of about 9,321 m^2 (Floors 12-14) until March 2008, an area of about 9,321 m^2 (Floors 9-11) until March 2010, an area of about 15,536 m^2 (Floors 4-8) until March 2017, and the rest of the area of about 17,500 m^2 until March 2018. The lessee has an option to extend the lease periods for an additional period of five years, so long as notice of exercise the option is given at least 365 days prior to the end of the lease period. At the end of the lease period, the lessee undertakes to pay the lessor a termination fee of CAD 20 per square foot, with the amount linked to the Canadian CPI of 1998.

7 One of the lessees is under the control of the main shareholder in the Company.

8 The Royal Bank of Canada has two options for renewal – every five years, at the prevailing market price.

Rental Properties in Canada, Mostly Residential[74]

Name and Location[75]	Description	No. of Apartments	Rental Income recognized in financial statements 2006 (NIS thousands)	Depreciated Value of Property on Delek Real Estate's books as of Dec. 31, 2006 (NIS thousands)
Place Elgin, Montreal Purchased March 30, 2001	14-story building, two-level 228 space underground parking. 28 parking spaces outside. All apartments for residential use, except one for commercial use.	291	17,369[76]	92,436
The Chatel, Montreal, purchased April 30, 2001	26 stories. Residential apartments and 23 offices	300	14,683[77]	96,059
Total			32,052	188,495

[74] Lessor has protections against vacating the leased property in cases, as well as right granted for renewing the lease pursuant to the conditions established by law.

[75] The rights purchased are ownership rights. A consolidated company of the Company is the beneficiary of the Canadian trusts, which own the properties.

[76] Rental fees include repayment of current expenses by tenants – NIS 215 thousand.

[77] Rental fees include repayment of current expenses – NIS 362 thousand.

Real Estate Properties in Canada Leased for Commercial Use:

Holdings %/ Date of Investment	Name of Affiliated Company	Name of property/ Location	Description of property held by affiliated company and size in m^2 (excluding parking)	Investment in affiliated company in NIS thousands, as of Dec. 31, 2006	Name of principal Lessee /date of end of lease/% rented	Cost of property in affiliated company's books in NIS thousands, as of Dec. 31, 2006	Rental income recognized in affiliated company's financial statements in NIS thousands, for property in 2006	Delek Real Estate's share in affiliated company's profit (loss) in NIS thousands, in 2006
45%	Explorer Trust	Montreal, Canada	Portfolio of 30 shopping centers in Canada on overall area of about 70,000 m^2, located in the Montreal area (16 centers), Quebec (10 centers), and Ontario (4 centers).		[78]JEAN COUTU Group, which after the purchase is leasing a main part of the portfolio in a lease until 2020 and six shopping centers until 2025, and the rental fees are paid by it, constitute about 45% of the lease revenues for the portfolio. The rest of the areas are leased to a large number of lessees for various periods.	408,294	51,683	19,851
45% (51%)[79]	Expedition Trust	Quebec, Canada	2 adjacent commercial centers in Canada, on an area of about 43,000 m^2.		The property was leased to the Wal-Mart chain (about 29% of the rental fees for the property), and to fashion, office equipment, household goods and fast food chains. Rental agreement with Wal-Mart runs until 2023.	169,552	28,248	6,757

[78] A store chain engaged in the sale of cosmetics and medications that, according to its publications, is the largest in the Quebec area, and the second largest in Canada. According to the chain's publications, the chain's sales volume in 2005 totaled about $9.6 billion.

[79] Percentage of holdings should contract dependent on issue of foreign subsidiary take effect.

12.5.3 Lease of Properties in Canada

As of December 31, 2006, 94% of the Belron Canada office space was rented out. Occupancy on Dec. 31, 2006 of the two residential buildings owned by the group was as follows: about 98% of Place Elgin, and about 94% of The Chatel. Occupancy at the shopping centers at the aforesaid time was 96%.

12.5.4 Financing for the Purchase of Properties Owned by Delek Real Estate's Investee Companies Canada

Most purchase transactions for property in Canada are eligible for financing of 70-75% of the purchase price. As a condition for such financing, the purchasing company must pay the balance of purchase cost that is not paid by foreign financing. In most cases, foreign financing is performed through a group of banks and pension funds. Some loans have cross-collateralization between the property purchasing companies. Below are details regarding financing of the Canadian properties:

Property	Amount of loan in thousands of Canadian dollars	Outstanding balance of loan as of Dec.31, 2006[80] In thousands of Canadian dollars (NIS 000)	Annual interest rate	Final payout date	Outstanding balance of loan for final payout in thousands of Canadian dollars
Bell Tower	145,000	134,476 (489,600)	6.45%	1.1.2008	131,009
5001 Yonge Street	55,094	45,273 (164,830)	7.54%	1.7.2011	33,382
Place Elgin	25,487	24,986 (90,965)	4.18%	1.6.2010	23,687
The Chatel[81]	22,490	22,262 (81,052)	4.48%	31.1.2016	19,112
Jean Coutu	83,812	82,098 (298,902)	About 5.2%	30.11.2015	68,377
Trois Rivieres	37,920	37,418 (136,231)	5.96%	27.6.2011	35,143

12.6 Customers Abroad (outside Israel)

Belron's customers abroad are those renting the properties owned by the aforesaid companies. As is explained below, Belron's policy is to purchase rental properties that have long-term leases to high-quality and financially stable lessees. Therefore, a large number of the lessees of Belron's properties are large groups such as insurance companies, government offices and telephone companies.

It is hereby clarified that the rental fees received by Delek Real Estate as revenues from clients constitute just part of its revenues, since most of Delek Real Estate's properties are held by affiliated companies regarding which the amounts transferred by them to the company are not transferred as rental fees.

Regarding affiliated foreign companies' dependence on substantial lessees, see Risk Factors (Section 12.32.10 below).

12.7 Marketing and Distribution Abroad

As stated above, Delek Real Estate's properties are leased for long periods, and therefore there is no significant marketing and distribution activity.

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[80] After deducting deferred expenses associated with the loan.

[81] The property was re-financed in January 2006 and the data presented here are after the refinancing.

12.8 Expected Revenues from Foreign Properties[82]:

12.8.1 Following are details of the expected income from abroad from signed rental agreements (only consolidated companies and including the minority part):[83], [84]

2007				Total 2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
1Q	2Q	3Q	4Q														
51,954	51,954	51,957	51,944	207,808	176,069	162,634	154,701	149,638	126,921	118,852	118,707	113,418	94,256	88,414	57,765	48,324	41,759

12.8.2 Following are details of Delek Real Estate's part in the expected revenue from rental agreements signed by its affiliated companies abroad: [85]:

2007				Total 2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Q1	Q2	Q3	Q4														
107,114	107,104	107,060	107,007	428,285	424,982	421,440	416,644	406,625	398,200	378,037	364,973	347,564	307,709	299,497	287,976	273,478	255,118

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82 In cases where the leasing fees include fixed costs, revenues are recognized by Delek Real Estate on the basis of the anticipated average throughout the entire term of he lease and the figures were included in the backlog in this manner.

83 In addition to the information in this table, the expected revenue past 2020 totals about NIS 73.8 million. Data in the table do not include: 1) income from the affiliated companies; 2) refunds to the lessees for incurred expenses.

84 Data are subject to the following assumptions: 1) no new rental agreements are signed: 2) lessees will leave on their first opportunity awarded them according to the rental agreement, even at the cost of paying an exit fine (this fine has not been taken into account); 3) the possibility of selling property or purchasing new property has not been taken into account; 4) the exchange rate as of 31.12.06 will remain as is; 5) since the rental agreements in the residential units are generally for a period of one year, an estimated revenue period of one years only was taken into account; 6) this data does not include rent review.

85 There exists estimated revenue from associated companies past 2020, totaling NIS 83.9 million.

12.9 Additional Transactions (subsequent to the balance sheet)

12.9.1 Purchase of Holdings from Blenheim in Joint Companies – Conditional Transaction

On Dec. 5, 2006 the DGRE engaged under a MOU with the Blenheim Properties Group (hereinafter: "**Blenheim")** that jointly with DGRE holds property owning foreign companies. According to the MOU, if and insofar as there is a DGRE share issue on the London Stock Exchange by Sept. 30, 2007, it will purchase holdings in 15 different property holding foreign companies in which DGRE and Blenheim have joint holdings. The object of the engagement is to create "control" and/or "joint control" in these foreign companies for the purpose of the issue DGRE is intending to perform in London (hereinafter: "**the Issue"**). The transfer of rights will include, without additional consideration, the endorsement of the owners' loans Blenheim has given the foreign companies. This transaction is conditional upon DGRE's issue on the London Stock Exchange by no later than Sept. 30, 2007. Remuneration for the transaction will be set according to the value of the holdings sold as published in the prospectus, after deduction of various expenses according to a formula prescribed in the agreement. In accordance with a table attached to the MOU, serving as an indication only, the value of the holdings being sold comes to a total of GBP 105.5 thousand. Blenheim is entitled to decide not to perform the transaction if the remuneration received in accordance to the above is less than sums fixed in the MOU. Remuneration is to be paid by private allocation of 4.9% of DGRE shares (after issue) according to the price on the first three days of trading after the Issue, and the balance will be paid in cash[1]. DGRE has also granted Blenheim irrevocable PUT options in effect until Jan. 15, 2007, wherein Blenheim may obligate DGRE to purchase some of the shares in the aforesaid foreign companies (hereinafter: the Interim Transaction). It has further been prescribed that insofar as the transaction in its entirety (i.e., sale of all properties) is not performed, the Interim Transaction will be deemed final, and that if the transaction in its entirety is performed, the Interim Transaction will be deemed part of the overall transaction, and the value of the properties sold, if any, as part of the Interim Transaction, will be recalculated according to the overall transaction. As of the date of this report, Blenheim has realized the said option. In January 2007 the Interim Transaction was competed in a manner that the holdings in the aforesaid companies were transferred to DGRE in return for the sum of £10,453 k.

12.9.2 PUT Options for Blenheim Obligating Purchase of Properties

DGRE has given Blenheim PUT option under which Blenheim may obligate Delek Global to purchase 50% of its shares of each of the following companies (if an insofar as they may be owned by it or such shares are to its order) from it: Tower Property, Tredegar Holdings, Synergy Holdings Sarl; also 28.5% (if and insofar as such are owned by it or such shares are to its order) of Dubendorf Property Agreement (for details of the properties held by these companies see section 12.3.1 above). The options shall be exercisable until October 1, 2007[1].

12.9.3 Discovery Center Dandy Transaction

A foreign company engaged under an agreement with Dalson Investments and Properties Ltd. under which, subject to the completion of the DGRE issue, it would purchase an additional 21.25% of the company holding rights in the property known as the Discover Center Dandy (see chart in section 12.3.1 below) from Dalson. In return for the rights, the foreign company has committed to pay remuneration to be set according to the value of the company holding the property, of approximately GBP 23.3 million (after deduction of undertakings as may be at the time of closing plus cash or cash value balances as may be at the time of closing). It should be noted that the foreign company subsidiary holds 50% of Dalson.

12.9.4 Trios Rivieres Transaction

A foreign company engaged in an agreement under which subject to the completion of the foreign company's issue on the London Stock Market, an additional 6% of the rights in the company holding the property known as Trios Rivieres will be purchased. In return for a price reflecting the cost of purchase and subject to adjustment for additional capital investment, such as capital returns as performed between the time Performance purchase and the time of purchase of additional rights plus interest. See table in Section 12.5.2, above.

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[1] If the shares issued are blocked for over 90 days, Blenheim has given Belron PUT options under which Blenheim may obligate Belron to purchase the shares from it at the price at which they were traded on the date notice of exercise of the options was given. The option will be exercisable starting three months after the date of issue, until the end of the period the shares are blocked.

[1] The options are conditional upon the Delek Global's public issue on the London Stock Market by no later than October 1, 2007.

12.9.5 Road Chef Transaction

On March 1, 2007 Delek Belron engaged under an agreement for the purchase of all share capital of a British company holding 29 roadside service centers on major roads in England (Motorway Service Area) (hereinafter: "**MSA"**) under the label RoadChef, including petrol stations operated by the purchased company, 15 hotels (containing 600 rooms), restaurants, shops and coffee stands operated by the purchased company through licentiates (such as Wimpy, Pizza Hut, Costa Coffee, Burger King), convenience stores and play areas, all in a constructed area of 60,000 m^2 on an area of 2.4 million m^2.

The company's market sector purchased, according to management reports, is 23% of the MSA market including 86 stations owned/operated by 3 major operators. The purchased company is one of these three operators.

Completion of the transaction is conditional upon the fulfillment of requirements by the completion date. The expected completion date is March 30, 2007. The purchased company, value of purchase is £ 382 million, and this price includes a previous debt in the purchased company (securitization) of £ 205 million. The price to be paid for the shares (100%) including all expenses is £ 177 million.

Purchase of the shares will be performed through a foreign subsidiary that was established for the acquisition, in which 25% are held by Delek Israel and 75% by Delek Real Estate. Subject to the consent of third parties (whose consent is required for changes in control of the purchased company), Delek Israel will purchase at the closing date 25% of the shares, and will receive 25% of the rights and duties under the purchase agreement. The significance, in the event that authorization is obtained, is that upon closing, Delek Belron will acquire from the sellers 75% of the shares and Delek Israel will acquire from the sellers 25% of the shares, at identical terms and with no mutual guarantees between the companies.

12.9.6 Leipzig Transaction

On March 2, 2007 Delek Real Estate's foreign company subsidiary completed the purchase of 90% of the shares in a foreign company holding an office building in Leipzig, Germany, in an overall area of 15,000 m^2 built on an area of 4500 m^2.

The building is leased in its entirety to a German bank under one lease agreement, without exit options until 2017. The building was purchased for €24.64 million. Yearly rental fees for the building are €2.12 million per year. A €24 million long-term non-recourse loan was approved for the company for the purchase of the building, with fixed interest. The total shareholders' equity of the foreign company for purpose of financing the purchase of its portion of the property (including all expenses) is €4.76 million.

12.9.7 Intention to perform IPO on London AIM Exchange

On March 16, 2007 the DGRE announced its intention to perform share issue to institutional bodies and to register its shares for trade on the London AIM. The foreign company's intention is to issue about 22% of its share capital. The amount of shares issued may change according to resolutions passed regarding the range of prices and market conditions. DGRE announced its intention to use the issue money for the purpose of financing the purchase of additional income-generating properties in the countries it operates in, including for the purpose of a number of transactions being examined by it at this moment, and for the purpose of return capital. The range of prices for each share will vary between £ 2.225 – 2.90 per share. The above is based on the value of the company that will range between £ 623 million and £760 million, and on average, £691.5 million. The aforesaid value is after raising the money, purchase of joint shares and conversion of owners' loans given by Belron for shareholders' equity. The aforesaid DGRE value is based on value assessments performed for DGRE and its assets, and on the underwriters' valuations. Merrill Lynch International was appointed to serve as underwriter and leading adjustor for the issue, and Panmure Gordon (Broking) Ltd. was appointed to serve as advisor and co-leader manager of the issue. The expected estimate of capital gains from the issued, if and when completed, based on Delek Real Estate's reports as of Sept. 3, 2006, based on the expected price range, and without tax implications having been completely investigated, is between NIS 700 million – NIS 1.2 billion. The information contained in this section includes assessments and forecasts, and is not certain, and constitutes forward looking information. At this point, there is no certainty that the said estimates and forecasts will be realized and that the share issue will eventuate, inter alia, because of factors not in Delek Real Estate's control such as British capital market conditions and changes in the real estate market.

12.9.8 Joining the Hotel Venture Investment Fund

On March 18, 2007 Belron joined a partnership in the European Hotel Venture Investment Fund, established together with Mr. David Patel, the Dorea company and institutional factors in the Israeli capital market. The Fund will purchase 3-5 star hotels in various cities in Europe. The hotels will be managed by the Patel Hotels Europe chain. Total shareholders' equity invested in the Fund by the partners is €100 million. The remaining funding for purchase of the hotels will be through non-recourse bank loans. The rate of investment will be adapted to the rate of purchase of the hotels. The Fund's life span will be between 7 to 10 years. Delek Belron's portion in the Fund partnership will be at the rate of 21% and its investments will come to €21.33 million.

12.10 Investments in the Hotel Sector

12.10.1 Hilton Transaction

Purchase of rights – during December 2005 the Unit Trust (trust fund) (hereinafter: "the **Fund"**) purchased 16 hotels in England managed by the Hilton chain. The hotels include 3,124 rooms that were purchased including all contents thereof. Delek Real Estate's foreign subsidiary indirectly holds 17% of the rights in the Fund. It should be noted that Phoenix holds 10% of the rights to the Fund. The Fund paid £417.8 million for the hotels, including expenses. Delek Real Estate's part totaled £71 million. The Fund received a long-term non-recourse loan from a foreign banking corporation for financing the purchase, in the amount of £331.1 million, with 5.83% per year fixed interest. Delek Real Estate's foreign subsidiary provided shareholders' equity in the amount of £14.7 million. Delek Real Estate's investments in the associated companies holding the Hilton Hotels came to NIS 121,674k. Delek Real Estate included the income from dividends for this investment, in the amount of NIS 7,667k.

Management agreement with the Hilton Chain - A 30-year management agreement was signed between the Fund and the Hilton chain's management company (hereinafter in this section 12.10.1 - the "management company"). The management company was given two options for extension of the agreement, each option for a period of 10 years. The approval of the Fund is required in certain matters as defined in the agreement before contacting the management company. These matters include, among other things, cancellation of debts, deals exceeding certain amounts or certain periods prescribed, sub-letting, purchase of items bearing the Hilton trademark in places it is difficult to remove upon termination of the engagement, and other matters deviating from normal management operations. Employment will be conducted in general by the Fund, save with regard to a number of employees in various positions whom the management company may, if it so desires, employ. The Fund has the right to twice veto candidates who are proposed by Hilton to serve as general manager of the hotels. In return for fulfillment of these undertakings, the management company shall be entitled to a basic fee, at a rate derived from the income of the hotels and an incentive fee at a rate derived from the operational profits of the hotels. A fixed portion of the hotel's income will be transferred every month for purposes of equipment renewal, installation of safety equipment as required, and insurance payments. The management company may demand that the Fund perform other investments in improvements in the hotels in order to bring them up to Hilton standards as may be from time to time. The Fund undertakes to maintain the hotel building and equipment at the same standard as is at the time the management agreement was signed. The Fund will be charged for all payments necessary for performance of improvements needed under law.

12.10.2 Marriot Transaction

Purchase of rights – during December 2006 an agreement was signed under which a group of foreign companies (hereinafter: "the **Purchasing Group"**) undertook to purchase share capital of foreign companies holding 47 hotels throughout Britain (39 in England (5 in London), 5 in Scotland and 3 in Wales) (hereinafter in this section 12.10.2 – the Hotels) managed by the Marriot chain (hereinafter: Marriot) from the Royal Bank of Scotland (hereinafter in this section 12.10.2 – "the **Bank**"). The date of completion of the transaction was set for the end of March 2007. The Hotels include 8,456 rooms and were purchased with full contents. The Hotels are divided in three types: business tourism hotels, golf hotels and tourism hotels. Belron controls 17% of the final chaining via the Foreign Companies. The overall cost for the Hotels is estimated at £1,013 million not including expenses. Investment and repair expenses for the Hotels must be added to this, estimated at a total of £54 million, spread over the coming years. Belron's portion of this is estimated at approximately £180 million. The Purchasing Group is obtaining a loan from the Bank (made up of a number of various loans) in order to finance this purchase, for a period of 7 years, in

the amount of £856 million at an average interest of 6.16% per year. It has been decided that the capital will not be returned during the loan period, and interest only will be paid. Shareholders' equity made available by the Foreign Companies controlled by Belron for the purpose of the purchase is in the amount of £35 million.

An MOU was signed between the partners in the Fund. Pursuant to the MOU, the services of Vision were retained – a company specializing in supervising hotel construction companies (hereinafter: "**Vision**"). Vision's operations will be supervised by a management body that will consist of three members, above which will be appointed a consulting entity comprised of seven members. Delek Real Estate has no right to appoint members to the consulting entity.

Management agreement with Marriot chain – an agreement was signed the Fund and the Marriot management company (hereinafter in this section 12.10.2 – the Management Company) for a period of 30 years. The Management Company was given the option to extend the agreement for a further 10 years subject to the Management Company not acting in breach allowing termination of the agreement, and that the operational profit during two of the three years prior to the conclusion of the agreement rose above the profits the purchasing group has precedence over. There is an exception for the period of the agreement for one hotel where the lease ends before the agreement period, and five hotels where there is a sale option not subject to the management agreement. Regarding a number of issues fixed in the management agreement, the purchasing group must consent before the Management Company may engage. This is, inter alia, in matters such as sub-lease over a certain limit set in the agreement areas and amounts and matters not during the ordinary course of events. Workers will be employed by the Management Company, and they will be taken on, fired and transferred from place to place according to its discretion. The Management Company will consult the representatives of the purchasing group in regard to expertise and background of general managers of hotels, and the purchasing group will have a right to veto two proposals for every position of general manager. The management agreement prescribes that failure to pass the performance test, calculated according to income and profit goals set in the agreement, during two out of three consecutive years, for reasons that are in the management company's control, shall constitute grounds for termination of the agreement by the purchasing group, but the Management Company shall be given the opportunity to correct the performance test by financial payment. Remuneration shall be paid on a monthly basis. In addition, the Management Company shall be entitled to an incentive at the rate of another 1% of income, plus 10% of the clear profits. The incentive shall be given on a monthly basis, except during months the operational profits do not reach the sum the purchasing group has given preference to, and in this case, payment of the incentive shall be delayed. Beyond the aforesaid sums, the World Marriot Company shall receive an amount of between 1% - 1.5% for marketing fees for clients arriving through it. The purchasing group has undertaken to supply capital in the event income and profits do not suffice for payment of the hotel's expenses and management costs. A fixed portion of the hotel's income will be transferred monthly for purposes of renewal of equipment, installation of safety equipment required, and the like. Starting from the fifth year of the transaction, the Management Company may demand that the purchasing group perform additional investments in the hotels in order to adjust them to customary standards. The purchasing group may sell the hotels to third parties subject to the management agreement, provided the engagement with the third party does not bring about breach of the management agreement, that the third party is not a competitor of the Marriot Group, and that the third party is not a criminal or of suspicious nature. The Management Company shall be given 30 days' advance notice regarding engagement for sale of the hotels. The Management Company has undertaken that it shall not compete through other hotels in hotel business during the period and in distances from the hotels fixed in the agreement, differing from hotel to hotel.

12.11 Business Strategy and Objectives for Overseas Operations

12.11.1 Delek Real Estate's policy regarding income-generating investments in real estate property is to purchase properties in financially stable countries, in companies that have long-term high-income-generating leases from high quality, financially stable customers in strategic locations over time.

It is Delek Real Estate's intention to try in future to purchase companies holding properties in which it will hold the majority of offered share capital.

It is Delek Real Estate's intention to continue to concentrate on goals where high bank financing is available through non-recourse loans. Delek Real Estate acts to suit the properties' lease period to the periods of the financing agreements for these properties.

Delek Real Estate' frequently follows its property portfolio in order to ensure that the capital is spread in an effective manner and the investment in property yields income, at the time of investment or shortly after, according to the investment criteria it has set. If a property does not yield income as stated, Delek Real Estate will act to refinance or realize the investment when the opportunity arises, with the aim of returning the capital or using it in a more effective manner in other properties.

12.11.2 Continued examination and purchase of income-generating real estate in Europe and North America, with an emphasis on England, Canada, the United States, Sweden, Germany, Finland and Switzerland through foreign companies, according to Belron's guidelines.

12.11.3 The development of properties, with an emphasis on the foreign company holding parking lots in England, with the intention of improving their efficiency so as to sell them later for a large capital gain. This improvement includes making use of additional construction rights or changes in the use of land within existing rental agreements for those properties.

12.11.4 Issue of DGRE shares and listing on the London AIM (see section 12.9.7 above).

Not all evaluations are under Belron's control and the realization of the company's goals and strategy are also dependent on external factors. In addition, the risk factors mentioned below might have an effect on Belron's ability to realize it goals and strategy as mentioned above.

12.12 Expected Developments in the Coming Year in Operations Abroad

Belron is currently in stages of negotiations and/or checking out a number of transactions in an overall scope of about £2.2 million in Western Europe and Canada. The scope of the aforementioned transactions also includes purchase transactions for the Marriot Hotels (see section 12.10.2 above) and the purchase of rights in connection with road stations on main roads throughout England (see section 12.9.5)

One of Belron's foreign subsidiaries is in advanced stages of negotiations for issue of shares and listing on the London AIM (see section 12.9.7 above).

12.13 Real Estate in Israel

12.13.1 Structure of Operations

Residential development in Israel has many active factors performing construction projects in various scopes, starting from projects with a small number of residential units to large companies simultaneously performing a number of projects with hundreds of residential units, with large land reservoirs. Delek Real Estate operates in Israel in planning, development and construction of residential projects. Delek Real Estate's operations in Israel are performed directly and by means of joint ventures (partnerships or joint companies) with third parties. Since 2004 Dankner is Delek Real Estate's operations arm in the area of residential building in Israel. Delek Real Estate is currently in negotiations for transferring its residential operations (including Dankner) to Azorim. If this transaction is successful, Delek Real Estate does not intend to independently take on any new residential projects of significant scope in the near future.

In the income-generating real estate sector there are many developing bodies and companies, locators, planners, developers, leasing bodies and management bodies for leased properties of a variety of uses. There are a number of large companies in Israel with large yield property portfolios, and smaller developers with individual properties. Activities in the income-generating real estate sector is characterized by investment of shareholders' equity in part of the establishment or purchase costs of the income-generating properties, and financing of the balance through credit from outside sources.

Delek Real Estate has since November 2004 also operated through Delek Retail Properties (hereinafter: "**DRP**") held in equal parts by Delek Real Estate and Delek Israel.

DRP deals and specializes in identification and purchase of petrol stations and land where it develops, plans, establishes and operates real estate ventures including petrol stations and commercial centers. As of the date of the report, DRP has purchased 8 sites where it plans to act (two already have active petrol stations and commercial centers, three stations are expected to begin operations by May 2007 and three properties are in planning stages)

12.13.2 Changes in the Scope of Operations in Israel and Profitability Thereof

According to statistics from the Ministry of Construction and Housing, the market growth trend that had been seen over the past two years continued in 2006 (despite the war in the North in the summer of 2006 and the rise in government spending caused by such).

At the same time, the improvement in market growth and fall in short term interest rates and mortgage rates have not been felt up to now in the construction sector, and mixed trends have been felt throughout 2006, as opposed to 2005. On the one hand, there has been a recovery in independent construction, luxury apartments and individual projects throughout the country. On the other hand, no recovery has yet been felt in most cities in the center of the country, in the periphery and among weaker and middle class populations. Despite this, because of the recovery in the market and creation of good conditions for apartment purchase, as opposed to the past, it is possible that demand will increase in the construction sector as well, at least in the center of the country.

The income-generating real estate sector in Israel suffered a severe drop in rental prices (mainly offices in the central area), a drop in occupancy and in income from invested equity, a rise in interest rates for loans for projects and a limitation on long term banking resources. The main causes for the recession in income-generating real estate derive from the general recession in the country, the hi- tech crisis and the security situation. Over the past two years there has been significant improvement resulting from a general improvement in the market, significant growth rate drop in interest rates. The passing of the new REIT Law (Amendment 147 to the Income Tax Regulations) has given rise to a new interest in purchasing income-generating real estate by financially stable companies and a rise in the prices of some of these properties. Delek Real Estate intends to transfer the shares of all the companies holding income-generating real estate properties to its sister company, Delek Real Estate Income-generating Properties Ltd. After the transfer, Delek Real Estate will consider performing a issue on the Stock Market of the company in which income-generating properties are held.

Delek Real Estate intends to concentrate all its development activities in income-generating real estate properties in Vitania Ltd., in which Delek Real Estate has the option to convert the loan it granted into purchase of half of its shares (see section 12.15.4 below).

12.13.3 Key Success Factors and Changes

The critical success factors for developing residential projects are: 1) Financial stability that allows financing for projects; 2) Proper geographical distribution of projects in areas of demand; 3) Reducing risk by partnering with other developers and partners; 4) Reputation, experience and professional knowledge; 5) Profits from proper planning; 6) The reputation and situation of Delek Real Estate as a financially stable company with a reputable name in construction (via Dankner).

The critical success factors for the income-generating real estate sector are: 1) Locating suitable lots for the projects; 2) Financial stability that enables investment of shareholders' equity and suitable financing terms for implementation of projects; 3) Providing long-term leases to financially stable lessees; 4) the location of a property has a significant influence on demand and on rental fees 5) property management on a high professional level.

12.13.4 Main Barriers for Entry and Exit and the Changes

The main barriers to enter residential and commercial real estate in Israel are: 1) Financial stability and shareholders' equity necessary for investment, and banking financing performance/purchase of projects on good terms; 2) Knowledge and experience in developing projects.

12.13.5 Competition in Israel

See section 12.19 below.

12.14 Residential Development

12.14.1 As of Dec. 31, 2006, the revenues for projects (or defined stages of projects) of residential units in Israel, whose construction has been completed, totaled NIS 124,695 k, costs stood at NIS 113,167 k and profits stood at NIS 11,528 k.

12.14.2 As of December 31, 2006 Delek Real Estate had 14 projects (or defined stages of projects) for residential units in Israel in the process of building. As of Dec. 31, 2006 a total of NIS 248,105 k had been invested in these projects, the balance of the investments not yet credited to the P L

report stood at NIS 118,187 k, the overall expected cost for the projects is NIS 373,715 thousand[86]. 494 residential units will be built in total in these projects, out of these, as of the date of the report, 360.63 units had been sold.

12.14.3 Delek Real Estate has various holdings in land held for residential development, that possess valid Urban Building Plans (and are not yet in the construction stage or are in the early construction stage). The total number of residential units slated for construction under these projects is 3,800 and the overall cost, as at Dec-31-2006 amounts to NIS 408,000 thousands.

12.14.4 As of Dec. 31, 2006, Delek Real Estate owns land designated for development of residential housing, with no valid Urban Building Plans. The depreciated cost in the Delek Real Estate books is NIS 54,266 thousand as at Dec-31-2006.

12.15 Rental Property Operations in Israel

12.15.1 As of Dec. 31, 2006, Delek Real Estate owns real estate rental properties in Israel as detailed below:

	Description of Property	Delek Real Estate's part in property	Income for 2006 (NIS thousands)[87]	Decreased cost for property in Delek Real Estates financial statements for Dec-31-2006 (NIS thousands)
Haifa Mall	52,400 m^2, 95,742 m^2 built, including commercial and services for lease on 29,000 m^2 at the southern entrance to Haifa[88]	50.225%	7,651	122,363
Drorim Mall	Commercial center – 4,100 m^2 adjacent to garage, of which Drorim Mall's owner owns 51%. Building permit for additional floor 2,700 m^2	75%[89]	6,480	33,112
Areas in Beit Gibor, Tel Aviv	1,800 m^2 – offices + 23 parking spaces	100%	719	4,132
Fuel stations[90]	6 fuel stations, rented out to a sister company	See footnote[91]	6,053	58,264
Paris Square, Haifa[92]	Car park – 4,000 m^2 + 563 m^2 commercial area.	100%	474	8,148
Rishon installation	Shelter for garage + 3,300 m^2 and car park on plot of 10,596 m^2 in Western Rishon Letzion	100%	1,222	14,337
Kfar Neter	Approx. 5,000 m^2 in office	100%	1,770	55,772

86 The expected overall cost could change as this is only an assumption based on the assessment made by Delek Real Estate on the basis of its experience and financial statements. Said assessment could change because of risk factors set out in this chapter, among other things.

87 If Delek Real Estate's part in the property is less than 100%, the stated income represents Delek Real Estate's income from the property.

88 Dankner and other owners of the land are checking the possibility of extending construction rights so that they can build offices and/or housing units next to the mall. They are currently preparing their plan, but this has not yet been submitted to the relevant planning committees.

89 Of which 13% are for powers of attorney received from holders of 13% of the project for the implementation of any action in regard to their part in this land and endorsement of all rights to the company.

90 Hakoah-Turim – 100%; Ein Yahav, Megido, Saadon – 50%. Part of the station areas also include construction rights not yet utilized.

91 including the area of the Turim fuel station, whose reduced cost in the books on Dec. 31, 2006 was NIS 2,344K

92 There is land in the project with no approved UBP, included as stated in section 12.15.2 below

	Description of Property	Delek Real Estate's part in property	Income for 2006 (NIS thousands)[87]	Decreased cost for property in Delek Real Estates financial statements for Dec-31-2006 (NIS thousands)
	building plus 150 parking spaces. The building is part of a complex owned by Belron, and will include another 11,500 m^2 office blocs[93].			
Beit Adar	Building with offices and commercial facilities on 17,130 m^2 and 433 parking spaces[94]	70%	7,329	52,939
Ziv Towers, Raul Wallenberg Street, Ramat Hachayal	Office areas – 19,000 m^2 + 353 parking places, storage 2,900 m^2, and 50% commercial area on 2,800 m^2 on the ground floor	50%	9,929	120,437
Commercial and office center, Acre[3]	Commercial center – 13,100 m^2	75%	4,094	42,892
Ramla-Lod Mall	Commercial center – 14,750 m^2 and fuel station leased to sister company. 8500 m^2 attached land property for development	50%	845[4]	51,994
Center Hagalil Mall – Rosh Pina[6]	Commercial center – 6,300 m^2 including commerce and offices[5]	100%		

12.15.2 As of Dec. 31, 2006 Delek Real Estate owns land reserves with 74,405 m^2 of approved UBP for commercial and office areas. Delek Real Estate also has a number of properties in an overall area of 1,000 m^2 having no approved UBP's yet, which Delek Real Estate is currently trying to get approved for construction of commercial and office areas.

12.15.3 In addition, the Company has land reserves (most currently for agricultural use) in an area of 30,000 m^2 regarding which no planning has yet begun.

12.15.4 **<u>The Vitania Transaction</u>**

Vitania Ltd. (hereinafter: "**Vitania**") is a company dealing mainly in the establishment and maintenance of income-generating real estate in Tel Aviv and Herzlia in a scope of 34,000 m^2, unrealized building rights in a scope of 48K m^2, and additional potential building rights. On Sept. 26, 2006 Delek Real Estate signed an agreement with Vitania and its shareholders, which went into effect on Dec. 4, 2006 after prerequisites set out therein were fulfilled. Under this agreement, Delek agreed to provide a $47.39 million loan to Vitania for a period of 10 years. The loan is convertible to Vitania company shares at any time, in a manner providing that after such conversion, the allotted shares will be half of all issued paid out share capital in Vitania. The agreement set out cases where Vitania may order Belron to convert the loan to shares. Delek Real Estate and all other

93 UBP approved for two basements built without permits. The company is acting to receive the permits necessary to open the parking lots.

94 An area of 3,360 m^2 of the building is leased to companies owned by the controlling bodies of the company.

3 Property purchased in Feb. 2006. income from rental from this time. The company also purchased options

4 Property purchased in Nov. 2006. income from rental included starting from this date

5 Center contains two underground parking areas to be built by the previous owners without permits, these are sealed.

6 Property purchased after the date of the balance, at a cost of NIS 71 million

Vitania shareholders undertook to allow Vitania first offer right in any new income-generating real estate transaction and project in the area between Hadera in the north and Gedera in the south.

12.16 Customers in Israel

In the residential sector – revenues from Delek Real Estate come from a large number of individual apartment buyers.

Income-generating Rental Properties – Delek Real Estate rents its Israeli properties to a wide range of businesses. Fuel stations are generally leased for a period of 25 years. Commercial areas are generally leased for a period of between one to five years.

12.17 Marketing and Distribution in Israel

Residential units are sold by outside agents who are paid commissions as is customary in the sector, and Delek Real Estate grants exclusivity for projects. Agents may be changed at any time at almost no cost.

Delek Real Estate sets up sales offices in the areas of the large projects themselves. Advertisements in the local and national media are also taken out.

Delek Real Estate markets its properties designated for lease through its marketing department and through its agents not granted exclusivity. Agents are paid fees based on their success, and may be immediately changed without causing any substantial loss to Delek Real Estate.

12.18 Backlog Revenues in Israel

Balance of revenues from units that have yet to be recorded on the P&L is, as of December 31, 2006, NIS 207,783 K.

The expected revenues from rental properties, according to signed contracts for 2007-2020, are as follows (data includes only the part of Delek Real Estate in rental fees out of the total rental fees earned where there they are jointly owned)[1]:

Year	Q1	Q2	Q3	Q4	2008	2009	2010	2011	2012
Backlog	13,431	13,073	12,584	11,571	36,592	24,276	16,947	11,267	9,178
Year	**2012**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	
Backlog	7,875	7,694	7,514	6,710	6,646	6,646	6,610	6,091	

12.19 Competition in Israel

Competition in the Israeli real estate market is highly decentralized. In the building sector there are a small number of large companies, such as Africa-Israel, Shikun Ovdim and Azorim. In addition, there are a large number middle and small sized developers and contractors working in areas where Delek Real Estate has projects under construction. Despite the high level of competition, Delek has a good reputation in the industry, stemming from financial stability and vast experience. Competition in the area of residential development focuses both on the identification of appropriate land for the projects and marketing the projects where the developer is exposed to competition from geographically nearby projects in the area. Competition comes from large companies, and from small developers performing projects at the same site. There is also competition from the second hand residential market in certain cases.

The income-generating real estate market in Israel is greatly competitive. A large number of companies are active in the market. Over the last few years there has been surplus supply, causing a fall in prices.

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[1] There is backlog data for beyond 2020, up to 2027 in the scope of NIS 26,500k. Data does not include rental fees from associated companies. Data is according to the following assumptions: 1) There will be no monthly leases; 2) the occupants will leave at the first opportunity even if they need to pay an exit fee (exit fees not taken into account); 3) Sale of properties are not taken into consideration, or of the purchase of new properties 4) the currency rate as of Dec. 31, 2006 will remain unchanged.

12.20 Raw Materials and Suppliers

Delek Real Estate uses "turn-key project" subcontractors for many of its projects, which gives the contractor the responsibility to turnover a building ready for occupancy. Remuneration is fixed after negotiation between Delek Real Estate and the contractor, and payments are made at certain points in the construction process according to the sub-contractor's progress in the works. Delek Real Estate has no direct activities of purchase of raw materials or any stock of raw materials.

12.21 Financing

For residential projects performed by Delek Real Estate, the company engages with banks for the purpose of financing the purchase of the property and financing the construction and guarantee expenses under the Sales to Residents Law. The financing agreements are under the "closed project" method, under which a special bank account is opened for the specific project credit is being given for, where all earnings from purchasers of the flats are deposited., and the money from such is released to Delek Real Estate for project expenses. In the agreement with the bank, the bank grants a credit framework to Delek Real Estate for the purpose of purchasing the land and implementing the project.

Within the framework of the engagement between Delek Real Estate and the bank, there are demands for fulfillment of various terms including the sale of flats at predetermined prices, rate of sales, rate of construction progress, issue of a building permit by a set date, and in the event of failure to fulfill these terms, the bank may become involved in the management of the project, up to the point of actually taking over and/or demanding immediate payment of credit. As of the date of this report, there have been no demands made to Delek Real Estate from any lending bank regarding Delek Real Estate's failure to fulfill objectives set in the bank agreements.

In the area of income-generating real estate, Delek Real Estate usually engages in financial agreements with banks for each project separately, as is customary in the construction sector. Delek Real Estate attaches its rights in the land, as well as the earnings from the leased project properties rental agreements.

12.22 Legal and Regulatory Limits to Operations

12.22.1 Construction and Planning Law

The Construction and Planning Law of 1965 sets various provision regarding construction, including, inter alia, forbidding building without receiving a permit from the authorities.

12.22.2 Apartment Sale Law

All residential housing construction falls under the Apartment Sales Law of 1973 and includes various regulations regarding both the specifications attached to the sales contract, warranty period and repair period during which the purchaser is responsible for correction of defects as well as guarantee of the purchaser's money until the period of occupancy and registration purchaser's rights.

12.22.3 Contractor Licensing Law

All work done in residential housing units must be done by licensed contractors, as defined by the Contractor Licensing Law. A licensed contractor under the Contractor Licensing Law is a contractor registered by the Contractors' Registrar in the Contractor's Registry. The Contractor Licensing Law prescribes the conditions for the purpose of registering a person as a licensed contractor. In addition, regulations enacted under the Contractor Licensing Law fix different categories according to branches and scope of work.

12.22.4 Requirements of the Standards Institute

Buildings and materials must be up to the standards that are published by the Israeli Standards Institute.

12.23 Land Taxes

The dealings of Delek Real Estate in the purchase and sale of real estate, falls under the Land Tax Law (Improvement, Sale and Purchase) of 1963 and regulations pertaining to this law, and therefore Delek Real Estate is likely to bear various obligations arising from the provisions of such.

12.24 Goals and Strategy for Israeli Operations

As set out above, Delek Real Estate is currently under negotiations for the sale of its holdings in Dankner, \ was built. In the Hof Carmel Project, two buildings were built so far, consisting of 474 residential units of various sizes, as well as a commercial area, on the main 41,000 m^2 lot. The building rights in this area allow the construction of hotel-apartments on a lot of 64,000 m^2 (net), not including parking and storage areas. As a result of the court's decision on January 15, 1998 and appeals following, the Pnina building was forced to be used as a hotel and was opened to the general public (whether through an apartment reservoir or in any other manner) throughout most of the year, in other words, more than half a year cumulatively. This order does not apply to apartments purchased before the date of the court's decision.

The Hof Carmel Project was financed by shareholder loans and external bank debts. Delek Real Estate guarantees 34% of the total debts and 78% of the exposure to interest transactions and currency transactions conducted by the Hof Hacarmel companies from time to time. The total guarantee shall not exceed a sum in NIS equal to $30 million. The outstanding credit provided by the financing bank to the Hof Hacarmel companies amounted to NIS 365 million as at Dec-31-2006. The bank also provided Sales Law guarantees to apartment buyers in the sum of NIS 3 million.

The Hof Hacarmel companies have an equity deficit of NIS 172 million and a working capital deficit of NIS 399 million. Delek Real Estate is currently conducting negotiations with the shareholders in the Hof Hacarmel companies to purchase their shares in the Hof Hacarmel companies. As an inseparable part of the agreement, Delek Real Estate is holding advanced negotiations with Bank Leumi to finance the purchase of shares and totally annul all guarantees given by Delek Real Estate to Bank Leumi to cover Hof Hacarmel's debts to the bank.

Joint Issues for Israeli and Foreign Operations:

12.25 Human Resources

As of the date of the report, Delek Real Estate and its subsidiaries employ 37 position holders, as follows: CEO, Assistant CEO, 4 Activity Coordinators Executive VP's, Company secretary and Legal Counsel, Engineer, four managers of different departments, and assistant CEO and head of Human Resources and logistics. There are also employees in administration, accounting, control, legal services, economics, housing company and secretarial services. Delek Real Estates employees are employed under personal contracts. Delek Real Estate receives advisory services on a part time basis from Mr. Rami Naor (son-in-law of the controlling member of the group) former CEO of Delek Belron (regarding options Mr. Naor received in January 2006 see remark 9(A)(4)). Issue of Options for Employees - in January 2006 Delek Real Estate approved the allocation of 7,317,474 options not registered for trading on the Stock Market, that may be realized to 7,317,474 ordinary Delek Real Estate company shares for senior employees of the company (including CEO of the company, who is also a member of the board of directors), in accordance with section 102(B)(2) of the Income Tax Ordinance (New Version) of 1961.

12.26 Working Capital

Delek Real Estate had a working capital deficit of NIS 328,209 thousand as of 31.12.2006, deriving mainly from current rises in long term expenses taken for financing long term projects that are to be realized in the coming year. Delek Real Estate's management estimates that the company will be able to receive additional long- or short-term loans to finance its investments and repay its obligations. In the rental properties sector credit is rarely given to customers since they usually pay rent in advance. When the lessees do not pay in advance, the amounts of credit given are usually negligible. In the residential housing market, the monies received for apartments usually match the pace of building. Regarding credit to/from suppliers, Delek Real Estate receives 30-90 days of

credit from its suppliers (usually works contractors). The average number of days for credit in 2006 was 90.

12.27 Financing

12.27.1 Following are the average interest rates on loans from bank and non-bank sources that were in effect for 2006 and are not intended to be used exclusively by Delek Real Estate:

	Average Interest Rate	
	Short Term Loans	**Long Term Loans**
Bank Credit	6.4% foreign currency index-linked/non-linked	5.71% foreign currency non-index linked
Non-Bank Credit	----	6.11% only index-linked

12.27.2 Credit Limitations

In the January 2004 framework agreement for the issuing of debentures to institutional investors, Delek Real Estate undertook to maintain certain financial criteria of a specific ratio between independent cash sources of Delek Real Estate and the "recourse" loans. It must also maintain a specific ratio between the cash flows from current operations of Delek Real Estate and its recourse loans.

For bank loans the company committed to maintain certain financial criteria regarding the equity it maintains and the rate of equity to the balance sheet.

Delek Real Estate's debentures were rated by Maalot prior to a public issue in June 2005 (see 12.27.4 below). The ratings are contingent upon maintaining the financial criteria determined in the Maalot report. According to the Maalot report of July 2006, Delek Real Estate committed to keep within additional restrictions regarding an adjusted debt, and undertook to keep within restrictions from its financial statements of March 2007.

Additional credit restrictions were set in the issue for institutional investors of Feb. 27, 2007.

12.27.3 Credit Facilities and their Conditions

As of the end of 2006 Delek Real Estate had credit facilities equal to NIS 2,343 million, and at the time of this report NIS 2,599 million. From this, the company utilized NIS 1,481 million as of the end of the year and NIS 1,555 million as of the date of the report.

12.27.4 Credit Rating

The debentures issued by Delek Real Estate were given an AA- rating by Ma'alot for the Secured Debt "A" series and an A+ for the "B" , "C", "D" and "E" series non-secured debt.

12.28 Liens on Delek Real Estate Assets

12.28.1 All of Belron's rights in properties abroad, including rental income, proceeds from sales in the future or from insurance policies, are collateralized for the sake of those financial institutions that financed the purchase of the properties, in order to ensure the rights of the aforesaid financial institutions. Belron, inter alia, pledged its rights to the property.

12.28.2 In the agreement signed by Delek Real Estate and Delek Belron, Delek Real Estate committed not to create any negative pledges on its properties, and not to create any second charge except securities for the debentures (series A) and a lien on company shares holding Linchfield shares. However, the aforesaid does not apply to attachments for specific projects and/or specific properties to secure only the loan granted.

12.28.3 For the purpose of financing Delek Real Estate's Israeli projects, Delek Real Estate mortgages said projects and all future earnings expected from this project.

12.28.4 In the matter of additional attachments and in the matter of third party guarantees given for Delek Real Estate's guarantees see remarks 25 and 26 of the financial statements.

12.29 Taxes

12.29.1 Taxation in Israel - Regarding tax laws pertaining to Delek Real Estate's activities in Israel, see reference 33 in the financial statements. In the matter of taxation of contractors, according to the provisions of section 8A of the Income Tax Ordinance, profits from the sale of apartments are recognized for tax purposes at the time of completion of construction, if the conditions prescribed in section 8A of the Income Tax Ordinance are fulfilled. According to the provisions of section 18D of the Income Tax Ordinance, financing expenses, administrative and general expenses are loaded on the cost of the projects during the course of the construction period, and are recognized after deduction for tax purposes as part of the cost of the project, with recognition of profits for tax purposes. Losses from the sale of apartments are recognized on the basis of de facto realization and with the fulfillment of the conditions set out in section 8A of the Income Tax Ordinance. Delek Real Estate had final tax assessments for all years up to and including 2001. Belron and its subsidiaries in Israel had final tax assessments until and including the year 2002. Dankner had final tax assessments until and including the year 2001.As part of its activities, Delek Real Estate enters land purchase/sales deals, and must therefore, bear its obligations according to the Land Taxation Law (Improvement, Purchase and Sale) – 1963 and regulations enacted under this law. On August 4, 2002 the Amendment to the Law of Income Tax (no. 132) – 2002 (hereinafter: the Amendment) came into effect, determining that as of 2003 income from dividends and interest from associated companies require taxes, even if that income was not initially received in Israel. It was also determined that under certain conditions an Israeli resident who held a foreign company, whose main income was passive income (as defined in section 2a of the Law of Income Tax) will be obligated to pay tax (at the rate of 25%) on this income, as if the amount was earned in Israel, and will be credited for this amount abroad (hereinafter: Foreign Company). Dividends received in Israel from companies held abroad, as set out above, will be charged tax in Israel at the rate of 25% with credit, in certain cases where the conditions set in the Income Tax Ordinance are fulfilled, for tax paid abroad on the same income.

12.29.2 Taxation of Real Estate Properties in England - The real estate holdings in England are under the ownership of foreign companies that are incorporated in Gibraltar, Guernsey, Jersey and Luxembourg. These companies are required to pay income taxes in England of 22% on their rental income. Taxes in England are on rental income with deduction allowances for all direct expenses, including interest paid on loans for properties, the cost of raising capital to purchase properties, maintenance expenses and depreciation (varied levels depending on the property).There are no capital gains taxes for the sale of real estate that is owned by foreign registered companies in England, as long as the purchase was a long term investment. On these matters the Israeli tax authorities ruling regarding foreign controlled companies shall apply in Israel (see section 12.29.1 above).

12.29.3 Taxation of Real Estate Properties in Canada -The main taxes in Canada are as follows: The profit from rental income after deductions for expenses which include interest and depreciation is taxed at a rate of between 39-46%, depending upon the physical location of the property and/or place of registration of the trust holding the property (hereinafter: the Trust). Expenses paid by the trustees to Canadian residents do not require withholding in Canada. Capital gains from the sale of real estate in Canada requires effective capital gains tax on the portion of the property not depreciated, at a rate of 22-23% according to the location of the property. The Canadian trustee is taxed at a rate that is discussed above and the profits of the beneficiaries, that are a foreign company, are not taxed in Israel, in accordance with the provisions of the Income Tax Order in the matter of a foreign controlled company (see section 12.29.1 above). In dividing the profits of the trusteeship from a beneficiary that is not a resident of Israel as distributed in a dividend to the company in Israel, taxes will be 25% or alternatively the corporate rate on the entire income, minus the capital gains taxes paid in Canada, in Israel and tax credit deducted at source in a foreign country.

12.29.4 Taxation of Real Estate Properties in Germany - Income on rental payments of the associated companies in Germany is taxed at a rate of 26%. This tax is applicable on income, after deduction of expenses directly related to the property, including devaluation and interest. Regarding the sale of real estate by the associated companies in Germany, a rate of 26% capital profit tax is imposed. If the property holders' shares are sold, and if certain requirements exist, this tax will not be imposed in Germany.

12.29.5 Taxation of Real Estate Properties in Sweden - Income on rental payments of the associated companies in Sweden is taxed at a rate of 28%. This tax is applicable on income, after deduction of expenses directly related to the property, including devaluation and interest. Regarding the sale of real estate by the associated companies in Sweden, a rate of 28% capital profit tax is imposed. If

the property holders' shares are sold, and if certain requirements exist, this tax will not be imposed in Sweden.

12.29.6 Taxation of Real Estate Properties in Switzerland - Income on rental payments of the associated companies in Switzerland is taxed by a Federal Tax (8.5%), Canton Tax (according to each canton) and capital tax at a total rate of 18.5-27.5%. This tax is applicable on income, after deduction of expenses directly related to the property, including devaluation and interest, with certain limitations. Regarding the sale of real estate by the associated companies in Switzerland, a capital profit tax is imposed. If the share of the Swiss companies are sold, and if certain requirements exist, this tax will not be imposed in Switzerland.

12.29.7 Substantial differences between statutory and effective tax rates – the companies' main joint operations abroad are the lease of properties in England and Canada, and therefore the main tax rates applicable to Delek Real Estate's operations jointly are the statutory tax rates in England and Canada, as described in Sections 12.29.2 and 12.29.3 above.

12.30 Legal Proceedings

12.30.1 For details regarding legal procedures to which Delek Real Estate was a party, see reference 25A of the company's financial statements.

12.30.2 Criminal Offences in Planning and Construction -Delek Real Estate was convicted in a plea bargain on 16.3.2005 at the Magistrates Court in Netanya of violating the Law of Planning and Construction regarding the building of a 10,000 m^2 car park without a permit in the Grand Netter project, near Kfar Netter in the Sharon area. Delek Real Estate was made to pay a fine of NIS 1,500,000, and the car park was sealed. The implementation of the order was delayed by 12 months.

12.30.3 Investigation - During February 2006 the head of the Hof Hasharon Regional Council, head of the local council for planning and construction, and others, were interrogated by the police in Bat Yam regarding suspicions of bribes in the Grand Netter project. The CEO of Delek Real Estate was interrogated under warning. Delek Real Estate expressed is faith that after all details are clarified, it will be proven that there are no real claims against Delek Real Estate and its CEO.

12.31 Risk Factors

Delek Real Estate exposes itself to the following risk factors:

12.31.1 Inability to Identify Appropriate Income-generating Properties

Delek Real Estate's ability to create good returns are dependent, among other things, on its ability (and its subsidiary company's abilities) to find and purchase properties at appropriate prices, leased to lessors who fulfill criteria Delek Real Estate has set itself, and such properties must be leased at rental fees income-generating good returns for the company. Delek Real Estate in its search for properties could be exposed to competition on the part of competitive bodies with better economic capacities than its own.

12.31.2 Changes in Various Factors Influencing Rental Fees

Delek Real Estate is exposed to risks including: a fall in demand for rental areas, a fall in rental prices, a rise in capital raised, the strength of the major leasing bodies. Delek Real Estate is also exposed to changes in operating costs it bears in connection with its properties. A rise in costs could bring about a fall in profits.

12.31.3 High Degree of Leverage

Delek Real Estate finances a large part of its activities via bank financing, and will continue to do so in future. Its continued ability to rely on high leveraging depends, among other things, on the lending bodies' assessment in the matter of Delek Real Estate's cash flow from its properties, which could be influenced, among other things, by changes in interest and changes in the value of the properties. Keeping good relations with the lending bodies is also important for safeguarding the capacity to raise credit.

12.31.4 Price Risks

Delek Real Estate is exposed to fluctuations in the income-generating real estate in England, Canada, Sweden, Germany, Switzerland and Finland. In order to reduce this exposure, Delek Real Estate purchases properties leased under long term lease to quality tenants. Fluctuations in prices of real estate are caused, inter alia, by factors that are not in Delek Real Estate's control in countries it operates in such as the economic situation, changes in the law, the political situation, the financial situation of the renters, interest rates and inflation. Changes in the value of the properties could, inter alia, prevent Delek Real Estate's refinancing the properties it has purchased. In addition, assessments of the value on the basis of which estimates are performed for the foreign companies are by nature not certain, and are performed on the basis of assumptions that could turn out to be mistaken. There is no certainty that the valuator's assessments actually reflected the sales prices of the properties. In addition, there is exposure in relation to Delek Real Estate's properties such as offices, related to aging and wear of property and the need to renew and adapt in order to uphold new office standards.

12.31.5 Management of Properties by Management Companies

The manner in which management companies managing Delek Real Estate's properties are administered, and their relations with tenants, could have influence on the prices of the properties and the rental fees for such properties.

12.31.6 Cross Collateralization

Some of the properties abroad have cross collateralization between a number of properties for the sake of the lending bodies, so that failure to fulfill the conditions of the loan with regard to one of the properties could affect other properties as well, and bring about even realization of such by the lending bank.

12.31.7 Non-Completion of Transactions under Negotiation

As Delek Real Estate has a number of large scale negotiations for transactions, there is a chance that a substantial part of the transactions Delek Real Estate is negotiating will not be concluded with Delek Real Estate's purchase of the properties.

12.31.8 Currency Risks

Delek Real Estate's future cash flow from rental fees regarding rented income-generating real estate properties are exposes to changes in the rate of exchange of the currencies in which the rental fees are paid, and changes in the indices for rental contracts in which rental fees are linked to an index.

12.31.9 Interest Risks

Some of the properties Delek Real Estate has purchased and investments made are exposed to changes in cash flow as a result of changes in interest rates in the national markets it operates in. In order to reduce such risk, Delek Real Estate's management has made a policy of taking long term loans with fixed interest in the property companies. Where non-fixed interest loans are taken, Delek Real Estate performs defense transactions in order to reduce exposure to changes in interest rates. Changes in interest rates affect the value of properties for associated companies that show their investment in income-generating real estate according to the fair value.

Exposure to changes in interest in Israel could affect loans given to the company by banking institutions in Israel, and could effect Delek Real Estate's cash surplus deposited in shekel accounts linked to foreign currency.

12.31.10 Single Lessee in Significant Properties

One associated company held by Delek Real Estate (NCP), rents out all car parks in a long term rental agreement to one tenant. (See Section 12.3.5, above). One of Delek Real Estate's consolidated subsidiaries in Canada (Bell Tower) has a lessee who rental payments comprise 27.4% of Delek Real Estate's total income (see section 12.5.2 above). Termination of the lease for any reason whatsoever will damage Delek Real Estate's income.

12.31.11 Derivative Financial Instruments

Delek Real Estate makes use of financial derivatives in order to reduce currency risks and is therefore exposed to changes in the prices of the derivatives.

12.31.12 Accounting Exposure

Certain foreign affiliates present their financial statements according to IFRS, including the implementation of IFRS 40, whereby income-generating real estate is presented at fair value. Changes to fair value are carried to the statement of income. See Note 9j(a)(8) to the financial statements.

12.31.13 Key Personnel

Termination of the employment of personnel belonging to the senior management of the company and/or failure to find appropriate replacements could have negative influence on the company. In this context, it should be noted that there is currently an investigation against Delek Real Estate's CEO (see section 12.30.3 below).

12.31.14 Changes in "Residency'" for Tax Purposes

Changes in residency for foreign companies holding properties could affect Delek Real Estate and Belron's results.

12.31.15 Delek Real Estate is Dependant on its Partners in its Foreign Subsidiary Companies

Delek Real Estate's capacity to create profits and returns is dependant on its subsidiary companies, and in some of these Delek Real Estate is not the controlling factor. Delek Real Estate also is a partner with others in properties or property companies. The fact that Delek Real Estate is dependant on the consent of its partners for matters resolved upon could restrict its ability to manage its affairs properly.

12.31.16 Economic and Security Situation in Israel

The demand for residential housing is influenced, among other things, by the growth rate of the economy in Israel, which, in turn, is influenced by the security situation. The security situation could also affect the supply of workers in the construction market in Israel, and as a result, affect sub-contractor's ability to perform their work. The residential housing construction market can be influenced by government building policies, including the amount of public and private building for residence, the policy of selling lands from the ILA, the pace of planning and licensing new projects and changes in government policy regarding grants and subsidies to home buyers in certain regions of the country.

A recession in the Israeli economy and its influence on the strength of companies in the market, especially hi-tech companies, could have negative influence including a decline in rental prices and occupancy or commercial and office space.

12.31.17 Level of Interest and Mortgage Rates

The rate of mortgage interest for apartment purchasers and changes in the banks' position regarding the rate of shareholders' equity and securities the banks required from apartment purchasers could have negative influence on the demand for residential apartments.

12.31.18 Changes in the Prices of the Raw Materials

Changes in the prices of the raw materials necessary for building, such as concrete, cement and iron, can lead to higher construction costs and influence future profits of Delek Real Estate.

12.31.19 Monetary Policy of the Bank of Israel

Fluctuations in the Bank of Israel's monetary policy are indicated by changes in currency rates and exchange rates that influence the level of inflation in Israel. These factors have a significant influence on the demand for apartments. It is not possible to currently estimate the long term monetary policy and its influence on the economy in general and the building sector in particular.

12.31.20 Financing Risks

Delek Real Estate finances a great part of its residential activities via bank financing. It is not possible to guarantee that the company will find the necessary financing at the proper conditions to carry out the projects it wants to. The directives of the Supervisor of Banks in Israel includes restrictions influencing Israel banking corporations' ability to provide credit beyond certain scopes, including restrictions regarding the total debt of one group of borrowers and to total debts of the six larges banking corporations in Israel. Delek Real Estate, companies controlled by Delek Real Estate, and the group are considered belonging to "one borrowing group" for this purpose. Delek

Real Estate could be restricted, from time to time, in receiving credit from banking institutions because of the aforesaid regulations.

12.31.21 Risk Factors in the Hotel Sector

There are several unique risk factors in the hotel sector, whose realization may impair the Delek Real Estate results, including dependence on the volume of tourism and business and commerce travelers; dependence upon business conferences and events held at hotels; difficult political or security situations, adverse climatic conditions or other events that may adversely affect travel patterns; recession in global markets; escalating competition in the hotel sector; increased hotel operating expenses as a result of various factors; disputes with the hotel management companies; difficulty in obtaining appropriate insurance policies and inadequate coverage of such policies.

12.31.22 Risk Factor Table

Following below is a summary of the risk factors that were described above according to influence (macro, industry, specific to Delek Real Estate), rated according to Delek Real Estate's management, according to their influence on the operations of Delek Real Estate – large, medium, small influence:

	Influence of Risk Factors on Delek Real Estate		
	Large	**Medium**	**Small**
Macro-level Risks	changes in interest rates	changes in economic environment Government Building Policy	changes in exchange rates
Industry-wide Risks	changes in real estate prices in the market inability to identify appropriate properties changes in factors influencing rental fees price risks	Economic slowdown Bank interest rate changes changes in prices of raw materials Risk factors in the hotel sector	Changes in Mortgage interest rates Security Situation
Delek Real Estate Specific Risks	derivative financial instruments	Bank Credit	high leveraging accounting exposure key personnel -cross collateral -single lessees in large properties -bank financing

The measure of influence of risk factors on Delek Real Estate's operations is an estimate only. The true risk factor levels may in fact be different.

13. The Biochemical Segment

Delek Group's activities in the biochemical sector are conducted by Gadot Biochemical Industries Ltd (hereinafter: "**Gadot**").

In May 2005 Gadot held its initial public offering of shares and debentures convertible for Gadot shares. The total amount received for the issue amounted to NIS 119 million (net).

Gadot produces products using different chemical and biochemical processes under the following two main categories: (a) Crystalline fructose, which is manufactured, marketed and sold only to the food industry in Europe (hereinafter: "**fructose**"); (b) Citric Acid, salts and other products, mainly for the food, pharmaceutical and detergent industries in the US and Europe.

13.1 General Description of the Sector

13.1.1 Structure of the Sector

All of Gadot's fructose sales are made in Europe. Therefore, these operations are seriously influenced by regulations applicable in Europe, and in particular by the European agricultural protection policy applicable in the European Union countries, including the "Sugar Regime" (see section 13.2.1 below). Nevertheless, under Gadot's contract with a European company set forth in section 13.18 below, about 50% of Gadot's fructose output is protected against changes to the Sugar Regime through September 2007. Citric acid is produced in the western world by a small number of major producers, and in China by a number of major producers and other small factories whose total output is equal to that of major producers in this area in the West. Production of citric acid in the USA and in Europe is based on different raw materials, therefore the positioning of citric acid produced in the west is different from that of Chinese-produced citric acid (see section 13.6 below.

13.1.2 Limitations, Legislation, Regulations and Special Constraints

For description of legislative restrictions, standards and special constraints applicable to the sector, see sections 13.2.1, 13.16 and 13.17 below.

13.1.3 Changes to Volume of Operations in Sector and its Profitability

The fructose market in Europe grew by 10% annually between the years 2002-2006. The new Sugar Regime has been effective since mid-2006, and this may cause changes in the market (for details of changes and their implications, see also section 13.2.1 below). The global market for citric acid and salts has seen growth over the past two years due to macro-economic changes reflected in a higher standard of living and in economic growth, primarily in East Asia. At the same time, Gadot's income from citric acid and salts over the past two years was not materially impacted, in light of Gadot's policy to focus on products having relatively higher added value.

13.1.4 Main Barriers to Entry into the Sector and Changes Therein

In the opinion of Gadot, the main barriers to entry into the biochemistry industry in the niche that Gadot occupies are as follows:

A. Unique knowledge and long term experience in basic biotechnology and chemical processes and the ability to produce products under specific orders by customers.

B. Resources- Large capital investments with high technology risk.

C. Standards, human resources and infrastructure investments – obtaining and maintaining high standards of quality in the food industry requires skilled human resources as well as considerable investment in infrastructure.

13.1.5 Structure of Competition in the Sector and the Changes Therein

The competition in Europe in the manufacture of fructose is influenced by the Sugar Regime and changes thereto (see section 13.2.1 below).

The citric acid market is influenced by the growing world population, global economic development and the fact that citric acid is a product for an advanced standard of living. On the other hand, we are witnessing the competition amongst western manufacturers and Chinese manufacturers who

are the largest source for this product today (for details of conditions of competition in products, see section 13.6 below).

13.2 Products

13.2.1 Crystallized Fructose

Fructose (fruit sugar) is a monosaccharide. Gadot manufactures Crystalline Fructose (hereinafter: "**Fructose**" or "**Crystalline Fructose**") for two major uses: As a premium sweetener and as the raw material in the manufacture of sugar substitutes.

Fructose as a "Premium Sweetener"

Fructose has properties that make it preferred over the other sugars (sucrose) for the following reasons: It has a more concentrated sweetness than sugar; it breaks down in the digestive system at a slower rate and is reminiscent of the taste of fruit. Due to the unique characteristics of fructose it is used as a premium sweetener (hereinafter: "premium sweetener") in the food industry, especially for candies, jams, baked goods, ice cream and other products. Food products based on fructose contain fewer calories than products based on sugar of a similar sweetness level, and in certain countries, such as Germany, due to local regulation they are deemed good products for use by diabetics because of the slow pace at which fructose is digested in the body.

Fructose as Raw Material in Production of Sugar-Substitutes

White sugar is made of two ingredients: glucose and fructose; therefore, by combining glucose and fructose it is possible to create a glucose/fructose blend with a sweetness level that is identical to sugar or is different than it, by regulating the amount of fructose in the blend (hereinafter: "sugar substitute"). Due to the high price of sugar and the excess supply of glucose in the world (as a by-product of starch production) there is economic justification for using the excess glucose to produce sugar substitutes. The most commonly used method to produce sugar substitutes out of glucose is through a chemical process named isomerization which converts part of the glucose to fructose to create the sugar substitute (hereinafter: "the main process"). Another method, which is only used in Europe due to the Sugar Regime which is explained below, is to blend glucose with Crystalline Fructose (hereinafter: "blending process").

"Sugar Regime"

As part of the EU policy of protecting the agricultural sector, EU countries maintain quotas for the production of sugar and sugar substitutes using the main process. Therefore high tariffs have been imposed on the import of sugar (except import quotas for developing countries and recently for the Balkan countries as well), and on import of sugar substitutes produced using the main process. In addition, there are minimum prices for sugar (government intervention prices – prices at which the government bought any quantity of sugar offered) which are significantly higher than its price on the international commodity market. However, according to the Sugar Regime there are no quotas for the manufacture of sugar substitutes using the "blending method", and the import of Crystalline Fructose into Europe from several countries having trade agreements with the EU, including Israel[95] are not subject to protective tariffs.

As a result of the above, one may export from Israel to Europe fructose used in the blending process with no quotas or tariffs. Therefore, it is economically viable for Gadot to produce Crystalline Fructose as a raw material for the production of sugar substitutes.[96]

The price in Europe for sugar substitute is linked to the price of sugar, and is only slightly lower. A blend with an equivalent sweetness level to sugar contains glucose (58%) and fructose (42%), and therefore, due to the fact that the price of glucose is usually significantly lower than the price of sugar, a ton of crystallized fructose can be sold to the European blend market at a price higher than a ton of sugar in Europe. Any change in the price of sugar and/or that of glucose, may therefore influence the price of crystallized fructose.

Following a decision by the World Trade Organization on Apr-28-05, stipulating that the EU should change the Sugar Regime so as to comply with the EU's commitments under the WTO agreement

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[95] In actual fact, the only two countries that produce crystallized fructose and may export to Europe without tariffs are Turkey and Israel.

[96] Note that the trade agreement between the EU and Israel is not time limited, yet each party may rescind it with six months notice to the other party.

on agriculture, discussions were held during 2004-2005 at EU institutions which have led to decisions regarding changes to the Sugar Regime, such that starting on Jul-01-06 the new Sugar Regime is effective, which is supposed to ultimately reduce sugar production levels in Europe and significantly decrease the market price of sugar in Europe.

The main points of the new structure of the Sugar Regime are:

A. Changing the main support mechanism for the price of sugar from intervention price to reference price – a threshold price such that when the market price for sugar falls to that level, producers have the option of storing quantities of sugar until the following production year. Concurrently, production quotas would be reduced for the following year. The intervention mechanism will remain in effect for a limited quantity of 600,000 tons at a price level of 80% of the reference price.

B. Reduction of the reference price by about 36% will be made in two stages, through Oct-01-09.

C. Encouragement of producers to stop production and waive production quotas by granting significant monetary compensation to be funded by tariffs on producers choosing to continue production.

D. Initiation of compensation and support mechanisms for farmers impacted by the changes.

E. Support and financial aid to countries having quotas for export of sugar to Europe (developing countries in Africa, in the Caribbean and in the Pacific), impacted by the changes.

F. A sharp reduction in quotas for export of sugar from Europe, until their complete elimination in 2010.

The Sugar Regime in its new format will be in effect through the 2014/2015 production year.

The changes to the Sugar Regime could significantly impact sugar prices in Europe and by consequence fructose prices as well. It is almost certain that the reduction in sugar price in Europe would cause a similar reduction in the price of fructose-rich blends which are a substitute for sugar, and consequently may reduce the price of fructose intended for such use. The degree of impact of reduction in blend prices on the price of fructose is unclear, since the price of glucose (the other component of the blends) is also a major factor. Nevertheless, one may assume that the price of fructose would decrease by a similar rate to that of sugar prices. However, since sugar is not a substitute product for premium sweeteners, the long-term impact on the fructose price for the premium sweetener market cannot be estimated at this stage, but one may assume it will be more moderate. Nevertheless, in view of market conditions now prevailing in the premium sweetener market (excess demand over supply); Gadot does not anticipate, in the near term, a significant decline in the price of fructose for the premium market.

The reference prices according to the new Sugar Regime are set to go into effect in October 2008. Yet a situation wherein market prices of sugar in Europe will fall below the reference price before October 2008, in case the quantity of sugar produced would not decrease due to low response or non-response to waiving production quotas in return for compensation. In this case, production surpluses may be created and then, should producers prefer to sell at lower prices than the reference price rather than store sugar, market prices may fall below the reference price.

Following the WTO ruling and changes to the Sugar Regime, sugar availability from Europe as raw material for Gadot's products declined starting in 2007. Since Gadot has contracts for sugar delivery through the first half of 2007, the impact of this decline on Gadot is not yet noticeable. Starting in Q4 of 2007, Gadot intends to source sugar from the sugar refining facility located on Gadot's premises (see section 13.18.2 below). Importing sugar from alternative provenances farther away (such as Brazil, Thailand, South Africa and Australia) would increase Gadot's cost of transporting sugar as raw material.

In summary, there is great uncertainty regarding the extent of impact the changes in the Sugar Regime would have on the price of sugar for the consumer in Europe, and on the rate of reduction in sugar production volume in Europe and the continued export of sugar from Europe to Israel. A significant reduction in sugar prices and reduced availability of sugar from Europe for Gadot could have material negative impact on Gadot's business. In addition to the Sugar Regime, the policy of opening the European market to free trade from 49 developing countries, wherein the sugar market will also be opened to free import from these countries starting in 2009, could bring about a decline in sugar prices, and therefore a decline in fructose prices.

13.2.2 Citric Acid

Pure citric acid is the most commonly used acid in the food industry (specifically in production of soft drinks) and is also used as raw material in the detergent and pharmaceuticals industries and for other applications.

Gadot produces pure crystalline citric acid using a biochemical process to ferment a white sugar solution rich in glucose (arriving from the fructose production facility, which creates synergies between Gadot's two production sectors). Currently, most of the glucose-rich solution is diverted back to the isomerization facility for fructose production, and the balance is transferred to production of citric acid and salts. Most of the Gadot's raw citric acid serves in production of citric acid salt (Trisodium Citrate - see below), and the balance is purified and turned into pure citric acid, serving both as raw material for creating other citric acid salts as described below, and for sale as finished product on the free market. Following the drastic increase in sugar prices on international commodity markets, Gadot is preparing for the possibility of using starch in production of citric acid and salts, and has established the capacity to use starch, should sugar prices reach such level as to justify this. Furthermore, in view of high sugar prices Gadot has limited consumption of sugar as source material for production of citric acid and citric acid salts, and has increased the quantity of citric acid imported from China, used primarily as raw material in production of citric acid salts (except for production of Sodium Citrate which is a by-product of the fructose production process.

13.2.3 Salts

Gadot produces citric acid salts and phosphoric acid salts, as follows:

A. Citric Acid Salts

Gadot produces various citric acid salts using a chemical reaction of citric acid with various bases (mostly potassium hydroxide and caustic soda). The citric acid salts can be divided into two main categories:

1. Simple citric acid salts – salts that are not differentiated by their quality, chemical or physical composition from similar products of other producers and are therefore considered almost a commodity in nature. In this category are found Tri-Sodium Citrate (TSC), the main product in this category and Tri-Potassium Citrate (TPC), used mostly in the food and detergent industries.

2. Special citric acid-based salts – salts used for food enrichment as well as in the production of food additive essences which are sold "over the counter" in vitamin and health stores.

B. Phosphoric Acid Salts

Gadot produces three different types of phosphoric acid salts, used mainly in the food industry (for soft drinks, calcium enrichment and for other applications).

13.2.4 Other Products

Gadot produces fumaric acid soluble in cold water and invert sugar in small amounts. The fumaric acid produced by Gadot is sold to one major customer in the USA, who produces soluble, powdered soft drinks.

13.3 Accounts Receivable - Trade

13.3.1 Most fructose produced by Gadot is sold as raw material for the production of a sugar substitute using the blending process to EU countries, primarily to the Roquette Freres Group (hereinafter: ("**Roquette Group**") under contract described in section 13.18 below. Some of the fructose is sold as premium sweetener to Galam Ltd. (as described in section 13.4.1 below) and the rest is sold directly by Gadot to customers in Europe, and Gadot has no certain knowledge regarding its use. Towards the end of the term of the contract with Roquette Group (on Sep-01-07), Gadot would try to locate other customers to whom it may sell the fructose volume currently sold to the Roquette Group. Gadot will select the target market for sale of fructose (the premium sweetener market or the blend market) by economic viability.

Customers purchasing fructose from Gadot are regular customers under current contract.

Citric acid is sold by Gadot to dozens of customers under annual contracts.

The special citric acid-based salts generally have a relatively small market, thus Gadot is involved in application of its product as part of the customer's production process. Gadot also usually customizes the product with the various physical qualities, as required by the customer.

13.3.2 Gadot estimates that it has no dependence on any of its customers. Since currently fructose prices for the premium market are higher than fructose price under the contract with the Roquette Group, Gadot estimates that it has no dependence on the contract with the Roquette Group.

13.4 Marketing and Distribution

13.4.1 Fructose

Most of the fructose as a premium sweetener is jointly marketed by Gadot with Galam, Ltd. (hereinafter: "**Galam**"). Pursuant to the contract between Gadot and Galam, Gadot supplies crystalline fructose to Galam for sale by Galam to customers in Europe.

The agreement is a four year agreement, from Dec-01-02 through Dec-31-06, unless terminated sooner under the provisions set forth in the contract or by law. The contract defines volumes to be purchased by Galam from Gadot for sale to customers in Europe and the price Galam will pay Gadot is based on the average price actually obtained by Galam for its fructose sales in Europe (as premium sweetener), minus the costs associated with the export and care of the fructose, and minus an agreed upon profit margin prescribed in the contract.

The contract with Galam is non-exclusive and may not be construed to prevent Gadot or Galam from selling the fructose they produce directly to any customers (including Galam customers) in any region, when they lawfully compete against each other. As of the date of this report, Gadot and Galam continue to operate under terms of the said contract, even though its term has expired.

According to legal opinion obtained by Gadot, as of the date of the report, the said contract complies with the European Union's anti-trust legislation. Nevertheless, it should be noted that should Gadot's market share in Europe, or Galam's sales volume increase beyond the threshold level prescribed by the European anti-trust discussions, the agreement may fail to comply with said terms.

Marketing of fructose for the blend market is primarily to the Roquette Group (under the contract described in section 13.18 below, which expires on Aug-31-07).

The rest of the fructose (after sales to Galam and Roquette Group) is directly marketed by Gadot staff to other customers in both the premium and blend market.

13.4.2 Citric Acid

In the USA, Gadot markets its citric acid and salts to all customers via a main representative who promotes sales of Gadot products by himself and via different distributors around the USA. Gadot and its agents in each country mutually commit that Gadot would distribute its products exclusively via these agents, and not by itself or via other agents.

Marketing, sales and distribution activities of citric acid and salts in Europe are made through Gadot's sales team, while the remaining sales are made through a network of distributors across European countries, some of which have exclusivity in their regions of operation.

In Israel, Asia and South America, Gadot markets citric acid and salts primarily through Gadot's sales staff.

13.5 Order Backlog

Pursuant to contracts for fructose sale, which Gadot has signed with Roquette Group, Galam and another customer, Gadot's expected revenues from sales of fructose to these customers in 2007 (NIS in thousands) are as follows:

For 2007			
Q1	**Q2**	**Q3**	**Q4**
35,810	35,810	30,542	20,007

Gadot's order backlog as of Dec-31-05 amounted to NIS 162,698 thousand.

13.6 Competition

13.6.1 Crystallized Fructose

Global Fructose Market[97]:

To the best of Gadot's knowledge, the annual global production of crystalline fructose is approximately 345,000 tons while global fructose consumption is, to Gadot's best knowledge, about 340,000 tons. The geographical distribution of global fructose production is as follows: The USA produces 200,000 tons per year; Israel 65,000 tons (by Gadot and Galam); Europe produces 35,000 tons per year; Turkey 40,000 tons' and Japan 5,000 tons per year.

The use of crystalline fructose globally is different from its use in the EU, with regard to the sugar substitute market, as a result of the Sugar Regime specific to Europe.

In the USA and East-Asian markets, crystalline fructose is used mainly as a premium sweetener for the food industry, due to its unique characteristics described above. In the USA, for example, fructose-rich corn syrup (used as a sugar substitute) is mostly produced using the main process.

In the EU, a little over half of fructose produced and imported is intended for the food industry as a premium sweeter, while the rest is used to produce sugar substitutes using the blending method. The total EU fructose market, for both uses, is estimated by Gadot to be currently at about 125,000 tons. The premium sweetener market is estimated at about 70,000-75,000 tons and has been growing at 10%-15% annually over recent years. The price of crystalline fructose as a premium sweetener is 10%-20% higher than that of crystalline fructose for the blend market.

Towards the end of 2006 prices at the global premium market trended higher than the European premium market (especially in East Asia and in South America). The price of fructose obtained by Gadot in sales to the premium market is about 20% higher than the price under Gadot's contract with Roquette Group.

Gadot estimates that its share of the global market in 2006 was 8%-9% and in the European market about 24%, while its main competitors outside of Israel are ADM and Tate & Lyle (USA), Dansico Sweeteners (Western Europe) and Amylum (Turkey). Competition between these producers and Gadot is influenced by the Sugar Regime, such that Amylum competes with Gadot directly (due to European trade agreements with Turkey and with Israel), while Dansico Sweeteners competes as a European producer. American producers pose no real competition for Gadot in the European market, both due to tariffs applicable under the Sugar Regime and to the fact they product fructose based on genetically-engineered crops. Changes to the Sugar Regime impact fructose producers in Europe as well as fructose producers exporting to Europe.

Gadot estimates that the aforementioned changes to the Sugar Regime would have an impact on the European fructose market, which may result in one of the following:

- Stop of fructose exports out of Europe and diverting crystalline fructose for marketing within Europe, at a volume estimated by Gadot to be 6-8 thousand tons.

- Complete stop to production of liquid fructose (at a volume of about 160,000 tons), based on the agricultural produce, chicory, which until the recent change to the Sugar Regime, as set forth in section 13.2.1 above, has been supported by subsidies which have been cancelled. Possibly, the stop to production of liquid fructose as per the above may create demand for crystalline fructose for production of blends, which may moderate the impact of sugar price decline on the fructose market.

Gadot's estimate with regard to the impact of changes to the Sugar Regime on the European fructose market is forward-looking information, based on Gadot's estimates relying on estimates by fructose market players. This forward-looking information may not materialize, since Gadot's estimate is uncertain and may change, *inter alia*, due to occurrence of events opposed to Gadot's expectations.

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[97] To clarify, all data for the global fructose market are to the best of Gadot's knowledge and are taken from various information sources, including: official import/export data from Israel, Europe and the USA published by Customs and VAT authorities, official Japanese import/export data published by the Japanese Ministry of Finance – Japanese Customs, other publications by the EU Commission located, among others, on the Commission's official website as well as publications of the US Department of Agriculture (USDA). Gadot also relies on information obtained from market sources (customers, chicory producers etc.), and which Gadot has not verified.

13.6.2 Citric Acid and Citric Acid Salts[98]

A. To the best of Gadot's knowledge, citric acid is produced in the western world by five large producers owning 12 plants having total production capacity of 700,000 tons.

In addition, citric acid is produced in China by several plants producing over 50% of global consumption, having an estimated production capacity of some 800,000 tons. In addition, there are a number of small plants in Asia. (Chinese citric acid is typically sold at lower prices than that produced in the Western world, due to inferior positioning associated with quality issues in the production process and reliability of delivery). The production capacity of other producers around the world is at about 100,000 tons.

To the best of Gadot's knowledge, the world demand for citric acid and citric acid salts (based on citric acid) is at 1,420,000 tons per year. Gadot's maximum production capacity for citric acid and citric acid salts (based on citric acid) is about 29,000 tons per year while the total global production capacity is 1,600,000 tons annually.

The difference in production methods of citric acid between the USA and Europe (in the USA – using glucose produced from corn, and in Europe – using molasses and glucose) cause changes in the price of one raw material to affect the competitive position of Gadot vs. its competitors who use different raw materials. In light of the rise in sugar prices in the international commodity markets, Gadot's competitive edge vs. its competitors in the citric acid market who do not use sugar as a raw material in the production of citric acid may be prejudiced.

Gadot estimates that its share of the global crystalline citric acid market is less than 1% (as a finished product, by actual production). Nevertheless, in the citric acid salts market Gadot's market share is more significant and reached 11-12% in 2003-2006. Gadot estimated that in 2003-2004 it was ranked 2nd-3rd in the world in production and marketing of citric acid salts, and in 2005-2006 it was the global leader in this sector, with a market share of about 11%-13.5%.

B. Gadot is the only citric acid producer in Israel and competes with importers who import citric acid from China, such as the Chinese corporation BBCA and other Chinese producers. In Israel, as in the rest of the world, there has been a sharp increase in citric acid imports from China due to its low price. Gadot estimates that its share of the Israeli in 2006 was about 25%-30%.

C. In Israel, Gadot's advantages in competing with local importers are: availability of citric acid for its customer, due to Gadot being a local producer; the fact that Gadot produces Kosher for Passover citric acid; and its ability to store the citric acid it produces. Outside Israel, Gadot enjoys competitive advantages due to the flexibility of its production processes; its ability to produce in small batches; and other logistical advantages over its competitors.

D. In light of the fact that production of special citric acid-based salts is based on a process specifically adapted to the customer (as opposed to off-the-shelf products), competition for these products is smaller. Gadot estimates that it is among the four largest producers of special citric acid-based salts marketed in the USA.

13.7 Production Capacity

Gadot's potential production capacity for fructose is about 30,000 tons annually. Gadot actually utilized 100% of the above production capacity.

The maximum production capacity of raw citric acid at Gadot's plant is about 30,000 tons per year. The volume of annual production stands at 29,000-29,500 tons of raw citric acid annually. Out of the total annual production of raw citric acid, about 10,000 tons under go processing for production of pure crystalline citric acid, intended for sale on the open market. The remaining raw citric acid

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[98] For the sake of clarity, the information regarding the market for citric acid and its derivatives is to the best knowledge of Gadot and is taken from various sources, including the European organization of citric acid producers of the European Chemical Industry Organization; official Chinese import/export data (via China Chemical Reporter); the USDA Foreign Agricultural Services unit as well as the International Trade, Office of Trade and Economic Analysis (OTEA) of the US Dept. of Commerce; and for Europe (by European Community, Eurostat) and various publications in trade magazines which Gadot has not verified.

serves as raw material for production of citric acid salts and other salts. There is some flexibility in use of raw citric acid, allowing a choice between turning it into pure crystalline citric acid and using it for production of citric acid salts, primarily tri-sodium citrate. The choice is made according to economic parameters and production constraints.

The potential production capacity of citric acid salts and special citric acid-based salts is about 30,000 tons per year, while Gadot currently actually produces 26,000 tons of these products annually.

Gadot has the ability to increase production capacity of special citric acid-based salts. Gadot has production flexibility, which enables it to switch between production of citric acid and production of Tri-sodium Citrate, as well as the ability to disconnect the fructose production process from the citric acid production process, in line with changing market conditions. Gadot establishes its production levels for various products according to orders for its products, and according to financial profitability, thereby utilizing to the maximum its production capacity.

13.8 Fixed Assets and Facilities

Gadot's plant is located on land it owns in Haifa Bay, near the Kishon stream, with total area of 54,548 m^2. All of Gadot's production facilities are at the above location, including the fructose production facility and facilities for production of citric acid, salts and other products.

Currently Gadot is constructing a raw sugar refining facility on its premises, in cooperation with Tate & Lyle Corp. (for details, see section 13.18.2 below). According to a decision by the Court for Municipal Affairs in Haifa dated Dec-14-2000, a demolition order was handed down for sewage-treatment containers constructed by Gadot. On Dec-26-2000 a caveat was filed with regard to the above demolition order. In September 2003, the Haifa City Hall granted a construction permit for the phase 2 sewage-treatment facility, including the containers subject to the aforementioned demolition order. As of the report date, Gadot is working to have the caveat regarding the aforementioned demolition order erased. Needless to say, these containers have been built to comply with environmental standards regarding sewage.

The fructose production facility is relatively new. Its construction was completed in June, 2002 and it was expanded in 2004. Gadot also has an isomerization facility allowing full flexibility in operation of Gadot's facilities according to profitability deriving from changing market conditions. Some of Gadot's other production facilities are more than 40 years old. Nevertheless, all facilities are properly maintained, operational and are used for production.

13.9 Product Development

Gadot's product development is combined with quality control, staffed by employees with higher education in chemistry or chemical engineering (undergraduate and graduate degrees) as well as by outside consultants.

The development operations are in two main avenues:

– New product development in the salt category, specifically specialty salts.

– Development of applications for specialty salt products according to market demand.

Furthermore, Gadot strives to improve its production processes in order to make them more efficient so as to reduce production costs and/or increase yield and production.

The costs of development do not constitute a substantial outlay.

13.10 Intangible Assets

Gadot's knowledge of production of fructose and citric acid is not patented and is therefore not protected as a patent. Gadot's intangible assets are its knowledge, which is not quantifiable.

Gadot has its senior employees and sub-contractors, who have access to this knowledge, sign non-disclosure agreements. Gadot's special collective bargaining agreement also includes non-disclosure and fiduciary provisions.

13.11 Human resources

Gadot currently employs 162 employees, as follows:

Department	No. of Employees
Management	4
Production Management	13
Production	59
Maintenance	27
Laboratory	21
Facilities and Warehouses	4
Packing and shipping	6
Commercial Administration & Purchasing	5
Personnel	3
Projects and Technical Office	1
Environmental Protection	1
R&D and Quality Control	4
Accounting	5
Marketing	4
Finance & Economics	2
IT	3
Total	**162**

An additional 20-30 workers are employed at Gadot's facilities by personnel contractors and packing service providers, mostly for the packing, maintenance and production departments.

In 2006 there have not been material changes to Gadot's staffing levels and the employment terms of its employees.

66% of the Gadot's workers are employed under a special collective agreement between Gadot, the Histadrut Trade Union, Haifa branch, and Gadot's employees committee, in effect until the end of 2007. The agreement is applicable to the factory and all other workers expect senior employees, employed under special contracts (personal contracts), temporary employees, interns and students (that are employed in the summer months in student employment programs). The agreement was registered on May-18-03 according to the Collective Employment Agreements Law, 1957.

Gadot's remaining employees are employed under individual contracts. Gadot traditionally pays bonuses to its employees based on their performance and subject to approval by Gadot's board of directors.

13.12 Raw Materials and Suppliers

The main raw material used in the sector is white sugar, which Gadot purchases in Europe, mainly in England. White sugar is a commodity and its price is determined on the commodity exchange in London. Changes to the Sugar Regime, as set forth in section 13.2.1 above, including a significant decrease in sugar export quotas from Europe to countries eligible for subsidy, will bring about reduced availability of European sugar for export as well as reduced availability of sugar used by Gadot as raw material for producing its products. Under such conditions, Gadot would need to purchase sugar from alternative sources further afield, which would increase Gadot's sugar shipping costs. Note that in 2006, sugar prices on international commodity markets have sharply increased, attaining in June 2006 a 25-year high (a 38% increase since Jan-01-06 and an 80% increase since Jan-01-05). Since June 2006, prices of white sugar and raw sugar have declined on international commodity exchanges. However, despite the aforementioned decline, sugar prices today are still 55%-60% higher than Gadot's average sugar price in 2006. Gadot's policy is to enter into futures contracts for supply of sugar in order to ensure regular supply of sugar at steady prices, in order to hedge increases in the cost of sugar for Gadot, thereby minimizing fluctuations in its profitability. As part of this policy, Gadot had ensured sugar supplies through 2006 at prices lower

than the price of sugar in the commodity markets. The changes to the Sugar Regime made it impossible to enter into futures contracts for extended future periods. Gadot has contracted to purchase all the sugar it requires for the first half of 2007. The price of sugar is fixed on the day the contract is signed. As of the date of this report, the average price of sugar under Gadot's contracts for the first half of 2007, contracted at the market price, is about 60% higher compared to price of sugar purchased by Gadot in 2006.

Contracting with sugar suppliers is based on annual contracts, with delivery of sugar made over the entire year.

There is no correlation between the price of white sugar on the commodities market and the price of fructose or citric acid produced by Gadot. Therefore Gadot's profits could be significantly impacted by sugar price fluctuations, should Gadot fail to fix the price of sugar under its aforementioned long-term contracts. In light of the rise in sugar prices over recent years, and the fact that Gadot has not fixed sugar prices beyond the first half of 2007, the purchase of sugar at current market prices will materially increase the company's cost of sugar by about 60% compared to 2006, which may have a material negative impact on Gadot's business results and on the scope of its citric acid and salt production operations. Starting in Q4 of 2007, Gadot intends to purchase sugar from the sugar refining facility located on Gadot's premises in cooperation with Tate & Lyle, as its completion progresses (for details of contracts with Tate & Lyle, see section 13.18.2 below). Delay in operation of the sugar refining facility would require Gadot to continue importing sugar from Europe or from other locations, at a higher cost than that incurred by Gadot in purchasing from the aforementioned refining facility. Gadot estimates that the cost for Gadot of purchasing Sugar from the above refining facility would be 10%-15% lower compared to current white sugar prices for Gadot. Gadot's estimates with regard to the cost of sugar from the refining facility is forward-looking information, based on estimates of all costs associated with import and processing of liquid sugar. This information may fail to materialize due to unexpected costs.

Gadot is able to switch to using starch in production of citric acid and citric acid salts, depending on economic viability of using starch vs. sugar.

Citric acid is used as raw material for production of citric acid salts. In order to complete the volume of citric acid required as raw material in the production of salts, Gadot imports citric acid from other manufacturers (mainly from China) who produce it at the required quality level.

The remaining raw materials needed for production of Gadot's products are purchased on the local market under periodic agreements with local suppliers.

Gadot purchases its major raw material – sugar – from two of its main raw material suppliers at shares of 15% and 10% of total raw material purchasing, respectively.

Gadot has an agreement with Israel Oil Refineries Ltd. (hereinafter: "**ORL**") (an interested party in Gadot) for the supply of steam for a 15-year term commencing October, 2001. As of Jan-01-03, each party may terminate the agreement with prior written notice to the other party. Upon such written notice, the agreement will terminate 30 months later. There is no free market for purchasing steam other than steam produced by ORL. Currently, any alternative by which Gadot produces its own steam, would be more expensive than purchasing steam from ORL. Gadot is dependent on ORL for steam supply. On Jan-23-06, following a strike called by ORL employees, the steam supply to Gadot was interrupted for one day. Gadot's plant operated partially on that day, based on Gadot's independent steam producing facilities. In the period from Oct-14-06 to Nov-07-06, ORL reduced steam supply due to planned bi-annual maintenance of its steam production facilities. From Nov-07-06 to Nov-14-06, steam supply from ORL was stopped altogether. The reduction and stoppage of steam supply impacted Gadot's productivity for the aforementioned period and hence its profitability. Gadot used this period for maintenance of its facilities.

13.13 Working Capital

13.13.1 Raw Material Inventory Policy

Gadot holds almost no inventory of sugar at its plant, yet the sugar suppliers are contractually obligated to maintain an inventory of at least one month's supply for Gadot. Supply of other raw materials is based on Gadot's current needs.

13.13.2 Finished Product Inventory Policy

It is Gadot's policy to stock an operational inventory of 1-1.5 months' production for most of its products or even more (for fructose - less than one month). This policy is primarily based on

geographical distribution of Gadot's customers in the USA and Europe, whose lead time is similar to the above time period. Upon request of specific customers, Gadot would maintain for them an even longer term inventory of its products.

Gadot stores its products at its production facility prior to shipping them to customers, as well as at storage facilities in Europe (Holland) and in the USA (five warehouses spread throughout the country) in which Gadot leases storage space.

13.13.3 Product Return Policy

It is Gadot's policy to accept the return of defective products where Gadot is responsible for the defect. If the product is damaged during shipment – this is an insurance event.

In actual fact, product returns are negligible, and most credit given to customers for defective products is the result of damage to products during shipment. These cases are covered by insurance.

13.13.4 Warranty Policy

Gadot guarantees its products (mostly for freshness and damage caused to customer's product as a result of a defect in Gadot's product) and it insured under product liability insurance. Liability was not exercised by any Gadot customers in 2006.

13.13.5 Credit Policy

Gadot extends customers credit of net + 30-90 days, and receives credit from its suppliers (except sugar, for which payment is made usually by the end of the current month) of net + 60-90 days.

13.14 Financing

13.14.1 Interest

The following table lists the average interest rate for bank- and other, non-bank loans (debentures issued to the public) which were in effect in 2006, and which Gadot has not designated for specific use:

	Average Interest Rate
	Long-Term Loans
Bank Sources USD Linked	Libor + (0.9-1.25%)
Non-bank sources (CPI-linked debentures)	4.45% (linked to the index)

13.14.2 Credit Limits

In the framework of loans and credit provided by banks, Gadot has committed to the following terms:

A. Not to place a lien on its assets or part thereof for as long as Gadot has debts and/or obligations to the banks, without the banks' consent, except for placing a lien on new assets purchased by Gadot to benefit the entity providing full or partial financing for purchasing of said new assets.

B. Not to sell fixed assets in any way for a cumulative price greater than $1,000 thousand during any 12 consecutive months prior to such sale to others, without the prior written consent of the banks.

C. Not to provide guarantees to any third party, other than to service debts and/or obligations of subsidiaries, without prior written consent of the banks.

D. Not to perform any change of ownership or control of Gadot without prior written consent of the banks. For this matter, a change of ownership or control means that the holding share of Delek Investments in Gadot's issued and paid-up share capital would not be less than 51%. Notwithstanding the above, should there be such a change in control, then Gadot is obligated to create permanent first-degree charges to benefit of the banks on Gadot's fixed assets to ensure all Gadot's obligations and debts to the banks. In addition, an agreement will be

signed between all banks for which liens were made with such wording as to their satisfaction, whereby monies obtained from the realization of the liens shall be split between the banks benefiting from these liens pro-rated to the balance of Gadot's debts to them.

E. Not to make any changes and/or corrections to the ABR agreement and/or to Gadot's incorporation documents without prior written consent of the banks.

As of Dec-31-06 Gadot has complied with its aforementioned obligations.

For obligations to certain financial benchmarks by a company affiliated with Gadot, see section 13.18.2 below).

13.14.3 Credit Facilities

As of Dec-31-06 Gadot has credit facilities amounting to NIS 165 million. Gadot has not utilized these facilities as of the aforesaid date.

13.14.4 Credit at Variable Interest Rates

Below are details of credit at variable interest rates utilized by Gadot as of the balance sheet date:

Variance Mechanism	Range of Interest Rates	LIBOR Interest Rate as at Mar-13-07
USD Libor +	0.9%-1.25%	%5.5

13.15 Taxation

Effective tax rate – The difference between Gadot's tax amount in 2004, calculated for pre-tax profits based on the regular tax rate for 2004 (35%) and Gadot's effective tax rate, results primarily from the initial creation of a tax asset due to net losses and timing differentials for which no deferred taxes have been created before. The difference between Gadot's primary tax rate in 2005 (34%) and Gadot's effective tax rate (25%) results from updates to deferred taxes balance due to changes to tax rates. In 2006 there was no material difference between Gadot's primary tax rate and its effective tax rate.

For further details on taxation, see Note 33 to the Company's financial statements.

13.16 Environmental Protection

13.16.1 Gadot's operations are subject to environmental protection laws, regulations and ordinances. The main such laws deal with hazardous materials and industrial sewage, such as the Hazardous Materials Law, 1993 (hereinafter: "**Hazardous Materials Law**"); the Nuisance Prevention Law, 1961; the Water Law, 1959; and the regulations enacted under these laws on the above matters. Gadot holds a hazardous materials permit under the Hazardous Materials Law, effective through Sep-02-07, under which Gadot stores and consumes hazardous materials it requires in production of its products.

Gadot has a sewage treatment system that purifies the sewage from the factory to a level compliant with all laws, regulations and ordinances applicable to industrial sewage. As of the date of this report, the quality of treated sewage is up to standards set by the Environmental Protection Ministry. The treated sewage flows into Haifa's municipal sewage treatment facility, as well as into the sea via the Kishon stream pursuant to an industrial brine sea-bound flow permit granted to Gadot by the Environmental Protection Ministry, and which is effective through Dec-31-09. Pursuant to the aforementioned permit, Gadot flows brine to the brine removal site of the SHAFDAN facility. Periodic audits by the Environmental Protection Ministry at Gadot's facility have not discovered any material disagreements.

As of the date of this report, Gadot is in full compliance with all requirements of entities responsible for environmental protection. In 2001 an inter-ministerial committee was established, headed by Dr. Yossi Inbar, Deputy General Director of the Environmental Protection Ministry; the committee's mandate was to establish a new standard for the quality of sewage in Israel, while examining the economic feasibility of the proposed standard for the national market (hereinafter: "the Inbar Committee"). The Inbar Committee prescribed a new standard allowing irrigation using sewage with no restrictions, as well as a standard for discharge into rivers. The Committee set up a basic

implementation program stating priorities and operations required to upgrade all relevant purification plants in order to achieve the standard. Currently the Environmental Protection Ministry is promoting government preparation for implementation of the standard and for its legislation. In April 2005 the Ministers' Committee on Environmental Protection decided to adopt the recommendations of the Inbar Committee report. On Mar-27-06 Gadot received a letter from the Haifa District of the Environmental Protection Ministry, demanding that the company select one of two alternatives with regard to the discharge of purified waste water (effluent) into the Kishon River: (1) continued discharge of treated waste water into the Kishon River based on standards set by the Inbar Committee; or (2) discharge of treated waste water under current standards directly into the sea, via a marine discharge pipe to be laid for this purpose by any industry choosing this option.

Gadot is examining the different alternatives with assistance from experts and from the Chemical Division of the Industrialists' Association. Each of the above alternatives would require investment, either in upgrading Gadot's waste treatment facilities or for participation in the construction of the marine discharge pipe. Gadot is unable to estimate the required investments arising from the above changes. Nevertheless, it is possible that the investments required may amount to material amounts.

13.16.2 Gadot estimates that its investment in environmental issues in 2007 and in the following year will reach about half a million dollars each year (taking into account current regulatory requirements). The company estimates that the major investment will be in improving sewage monitoring processes. Gadot's estimate of the extent of its investments in environmental protection issues is forward-looking information, based on Gadot's estimate which relies, *inter alia*, on contracts signed and on regulations and requirements of the Environmental Protection Ministry. This forward-looking information may not materialize, since Gadot's aforementioned estimate is uncertain and may change due to changes in requirements of the Environmental Protection Ministry as well as due to the fact that complex chemical processes are involved.

13.17 Restrictions and Supervision of Company Operations

13.17.1 Business Licenses

A. Gadot's operations require a business license under the Business Licensing Law, 5728-1968. As of the date of this report, Gadot has a business license. According to further requirements for obtaining a business license, Gadot needs to comply with various standards, including: operation of sewage collection and disposal facility; operation of a waste water purification system in accordance with Environmental Protection Ministry requirements; storage of hazardous material containers in spill containment pallets (dedicated containers); obtaining permits; and compliance with other statutory standards.

B. Gadot has a manufacturer's license under the Supervision of Goods and Services Ordinance (Food Trading, Production and Storage) for production of citric acid and salts, phosphate salts, fumaric acid and fructose.

13.17.2 Standards

Countries to which Gadot exports its products have certain mandatory standards for the chemical composition of these products. In the EU, for example, there are EU regulations regarding food-related products marketed in EU countries. In the US, following the 9/11 terrorist attacks, there are new food safety standards aimed at preventing biological terrorism. Gadot complies with these standards which are mandatory for exportation to such countries. The said standards include the BP, FCC, USP and JP standards. Beyond these standards, Gadot is accredited under the HACCP standard for product manufacturing process safety.

There is no Israeli law requiring Gadot to comply with any standard. Yet Gadot complies with requirements of the Health Ministry for its products, which are a pre-condition for granting the standards approval obtained as set forth below. In the market there are competing products to Gadot's which do not indicate their compliance with quality ratings or other standards. All of the standards Gadot complies with are solely of its own choice and are not the result of binding regulation by any authority. Still some customers require compliance with specific standards as a prerequisite for purchasing from Gadot (customers differ in terms of the standards they require).

Compliance with standards under Gadot's policy requires qualified Quality Control staff for testing finished products. Gadot's Quality Control team tests the finished product anyhow, and no special expenses are incurred to ensure compliance with standards.

Gadot products are produced according to international food industry standards such as USP (United States Pharmacopoeia); EP (European Pharmacopoeia); BP (British Pharmacopoeia); and FCC (Food Chemical Codex). Gadot was also awarded the ISO 9001:2000 standard compliance approval for quality of the management process in support of production; the ISO 14001 standard compliance approval regarding environmental protection during production of its products; and the HACCP (Hazard Analysis and Critical Control Point) accreditation for proper food production conditions, which it received from the Israeli Standards Institute. Gadot was also awarded the GMP (Good Manufacture Practice) standard compliance approval by the Health Ministry, with regard to ensuring proper production conditions in the food industry. These are all international standards for safety and production conditions of food industry products. As of the report date, there are no standards with regard to products produced by Gadot with which Gadot is not in compliance or which otherwise restrict the Company.

13.18 Cooperation Agreements

13.18.1 Agreement with ABR

Gadot established the crystalline fructose production facility under a cooperation agreement with ABR Foods Ltd. dated Dec-07-99. (hereinafter:" **ABR**"[99]"**ABR**"), which is a major starch producer in Europe. The agreement stipulates the return of most of ABR's investment in the facility plus appropriate return on the investment, even in case of changes to the Sugar Regime. ABR, being a glucose producer, produces sugar substitutes using the main process up to the volume permitted by its quotas. Therefore ABE was interested in regular supply of crystalline fructose in order to allow it to utilize additional glucose it produces for production of a sugar substitute under the blending process. Therefore Gadot and ABR have signed a cooperation agreement with the following highlights:

A. Gadot will build a crystalline fructose production facility and ABR will build a facility for fructose treatment and production of sugar substitutes at its UK plant.

B. Gadot committed to supply to ABR, and ABR committed to purchase from Gadot crystalline fructose at such volumes and prices so as to ensure that Gadot recuperated its production costs plus 70% of the basic investment cost (hereinafter: ("**the basic price**") (excluding the expansion component and isomerization facility) incurred for construction of the crystalline fructose production facility within 5 years, starting on Sep-01-02. (The contract start date was actually determined in 2003 after Gadot successfully proved consistent levels of fructose production). In addition, Gadot is entitled under the agreement to receive a share of ABR's profits (according to formulas set forth in the agreement) from its sales of the sugar substitute. (After the contract was signed, a disagreement with ABR emerged regarding interpretation of the economic model which determined the price of the fructose payable to Gadot. In October 2004 the parties signed a compromise agreement with regard to the basic price for 2002-2003, and adjustments may be made for 2004 onwards which Gadot estimates would not be significant. As for the price derived from ABR's profits from sale of sugar substitutes, there is a material dispute between Gadot and ABR. Should Gadot fail to reach consensus with ABR on this matter, it would have to resort to the arbitration clause set forth in the contract.)|

C. ABR's commitment to purchase crystalline fructose in the first 5 years under the aforementioned conditions absolute and independent of changes to the Sugar Regime and of the economic viability of purchasing the crystalline fructose.

D. The agreement is for a 5 year term through Sep-01-07, subject to the parties' right to terminate the agreement upon prior written notice in exceptional cases set forth in the agreement. The agreement grants ABR an option to extend its term by a further 5 years. On Jan-17—07 Gadot received notice from Roquette indicating that the latter would not be exercising the aforementioned option.

It should be noted that the fructose production facility constructed by Gadot can produce larger volumes than the volumes ABR has committed to purchase from Gadot. In fact ABR has purchased 58% of the fructose sold by Gadot to date. Gadot estimates that by the end of the

[99] In September 2000, ABR was acquired by Roquette Freres S.A. (a major European starch producer, which also produces sugar-substitute blends composed of glucose it produces on its own and fructose purchased from Gadot pursuant to the contract set forth below), and it was renamed Roquette UK.

agreement term, the remainder of the volume ABR has committed to purchase from Gadot will constitute about 50% of the plant's estimated production capacity over that term.

13.18.2 Agreement with Tate & Lyle

On Sep-28-06, Gadot signed a set of contracts with Tate & Lyle Investments Ltd (hereinafter: ("**T&L**") (a major producer of food and ingredients for the food industry, headquartered in the UK with shares trading on the London Stock Exchange) and with its affiliated companies to establish a joint venture to construct and operate a raw material refining facility on the premises of Gadot's plant. The facility is currently being constructed by Tate & Lyle Gadot Production Ltd (hereinafter: "**Talgam**") which is owned by T&L (65%) and by Gadot (35%) (T&L and Gadot will be referred hereinafter in this section 13.18.2: "**the shareholders**" or "**the parties**"). The plant will refine imported raw sugar which each of the parties to the venture would purchase for its own requirements, and which would in fact provide all of Gadot's sugar requirements and would replace the refined sugar supply coming from the European market, whose availability to the Israeli market may be impacted by changes to the Sugar Regime. The balance of sugar not purchased by Gadot will be sold by a local company held by it on the local market in Israel. The establishment of this plant would reduce Gadot's cost of purchasing sugar compared to the cost of importing refined sugar from other sources, which will in future increase in price as a result increased sugar transport cost.

The set of contracts to which Gadot is party includes, among others, a shareholders agreement between Gadot and T&L which establishes the relationship between the partners to the venture; a land lease contract for construction of the plant between Gadot and Talgam, under which Talgam would lease from Gadot the land on which the plant is to be constructed for a 24-year term; an owner's loan agreement between the shareholders and Talgam, establishing the terms of owner's loans provided and/or to be provided by the shareholders to Talgam; and a contract for supply of refined sugar between Gadot and T&L group companies under which Gadot committed to purchase minimum volumes of refined sugar each year at a price based on the cost of sugar production, accounting for the price of raw sugar plus shipping and refining costs.

The shareholders' agreement stipulates that the parties anticipate the cost of setting up the plant, until it goes live, would amount to US $18 million. Should the plant setup cost exceed US $18 million, T&L alone would finance the additional cost, without diluting Gadot's share of the joint venture. The plant is financed, and will be financed, by working capital provided by the shareholders and bank loans. As of the report date, most of the capital provided by the shareholders was via an owner's loan to Talgam, with Gadot's share of the loans amounting to NIS 9,869 thousand. The shareholders' agreement further stipulates, inter alia, provisions regarding non-compete and non-disclosure; dividend distribution policy; restrictions on transfer of Talgam shares; cases wherein a party is eligible to acquire the other party's shares in Talgam etc.

Furthermore, a financing contract was signed by Talgam and a foreign banking corporation, under which the bank consented to extend to Talgam credit amounting to US $15.85 million. As of the report date, the foreign bank has extended loans amounting to US $6,000 thousand bearing interest at LIBOR + 1.17%. The loans are for a 5-year term and are repaid from the joint venture's operating cash flow. Under the financing agreement, the estimated cost of setting up the plant is US $21 million. Note that under the shareholders' agreement, as set forth above, any cost over and above US $18 million will be borne entirely by T&L, without diluting Gadot's share. Pursuant to the financing agreement, Talgam committed to the foreign bank to create first-degree fixed and floating liens on Talgam's assets. Under the financing agreement, Talgam committed to maintain certain financial benchmarks with regard to the current ratio (current assets divided by current liabilities); the ratio of financial liabilities to working capital; positive cash flow; and positive net after-tax profit. The financing agreement further sets forth the cases wherein the bank may terminate the financing agreement and/or demand immediate repayment of the loans, *inter alia*, in case of change of control of Talgam or if Gadot should hold less than 35% of Talgam's share capital. In addition, Gadot and T&L intend to provide the foreign bank with a guarantee to ensure performance of all Talgam commitments under the contract for operation of the sugar refinery. Under terms of the aforementioned guarantee, each shareholder's liability would be pro-rated to their share of Talgam's share capital.

Note that the pace of setting up the plant is not in line with the schedule set forth in the agreements. Nevertheless, Gadot is not entitled to compensation for any delay in completion of the plant setup. Gadot estimates that the plant should be completed by the end of 2007. Gadot's estimate of the completion date of the plant is forward-looking information, based on estimates of the project managers. This forward-looking information may not materialize, since Gadot's estimate

is uncertain and may change, *inter alia*, due to disruptions to execution and deviations from the original schedule.

13.19 Cooperation Agreement with a Chinese Partner

An agreement was signed March 23, 2007 between Gadot and a Chinese partner that owns an old plant for the manufacture of citric acid (hereinafter: "the **Chinese Partner**", for the establishment of a joint venture in China for the construction and operation of a citric acid and citric acid salts. The joint venture will be performed through a company incorporated in China, that will be owned by the Company (51%) and by the Chinese partner (49%) (hereinafter: "the **Joint Company**"). The Joint Company's board of directors would include five directors, of which the Company would appoint three directors (including the chairman of the board). The agreement stipulates directives regarding decisions demanding a special majority at the board, the right to appoint a CEO and CFO, plant construction, equipment purchasing and recruiting personnel for its operation, non-competition and non-disclosure agreements, limitations on the transfer of shares, etc. Both parties would transfer the technology required for plant operation to the Joint Company. The plant would be created on about 267,000 m2 of land in a chemical industrial park that was created by the Park management for the Chinese partner, and that will be transferred to the joint venture at cost. The agreement calls for most of the output capacity to be intended for export outside of China. Product marketing will be made by the Joint Company for the Chinese market, and by Gadot for export markets, pursuant to an exclusive marketing agreement that will be signed between the Company and the Joint Company. Gadot will also enter into a licensing agreement with the Joint Company, regarding the use of the trademark that includes the Gadot name. The agreement stipulates that the Joint Company will operate for 50 years, starting with the date it will obtain an operating license. The legal venue applicative to the agreement is the People's Republic of China.

The overall investment in the plant construction and operation is estimated at $30 million, with up to $12 million being financed by shareholders' equity that will be provided by the parties (pro rata) and the rest via bank financing. The estimated annual output of the venture is about 60,000 tons per annum of citric acid and citric acid salts. Gadot estimates that plant construction should be completed by the earlier of the first half of 2008, or within a year from start of its construction.

The total expected investment in plant setup, the estimated annual output for the venture and Gadot's estimate of its completion date is forward-looking information, based on Gadot's estimate which relies on initial planning and estimates by the Chinese partner. This forward-looking information may not materialize, due to more detailed and accurate planning and other unforeseen circumstances.

The said agreement is subject to the approval of the Chinese authorities. In the event that such approval is not obtained within three months of March 16, 2007, or that the Chinese authorities demand that the agreement be amended in a manner that will be unacceptable to either party, then each party may terminate the agreement and the agreement will then be null and void.

13.20 Negotiations to Acquire a Company in North America

Gadot is in negotiations, and did sign MOUs on Dec-04-06 and on Feb-28-07, with a company in the USA (hereinafter: "**the acquired company**") to acquire 85% of the acquired company's share capital in exchange for about $11.3 million. Under the MOU, each of the remaining shareholders (who would hold about 15% of the acquired company's share capital after acquisition of shares by Gadot) would have an option to sell to Gadot all (and not part) of their shares in the acquired company at any time after 18 months from the date of signing the share acquisition agreement by Gadot (hereinafter: "**the put option**"). Furthermore, Gadot would have the option to acquire from each of the remaining shareholders all (and not part) of their shares in the acquired company at any time after the earlier of: (1) 3 years from the date of signing the share acquisition agreement by Gadot; or (2) upon termination of employment of such a shareholder by the acquired company for any reason whatsoever (hereinafter: "**the call option**"). In case where the put option or the call option should be exercised with regard to both the remaining shareholders, Gadot would pay additional consideration amounting to the higher of: US $2 million or another amount set forth by a formula based, *inter alia*, on financial results of the acquired company for the year preceding the sale. Gadot has exclusivity with regard to acquiring the acquired company for a period of 60 days from the date of signing the second MOU.

The acquired company is engaged in production of materials and processing for the food additive industry and has an annual turnover of $38 million (as of 2006). Should the aforementioned

transaction be completed, Gadot intends to include the acquired company in its North American operations, and to create synergy with Gadot's operations in the areas of food additives, health food and food enrichment for Gadot's customers in North America and in Europe. Should negotiations be successfully concluded, the acquisition is expected to close in the first half of 2007.

13.21 Legal Proceedings

For material legal proceedings to which Gadot is party, which are primarily claims for damages associated with the Kishon River, see Note 25a to the company's financial statements.

13.22 Business Objectives and Strategy

13.22.1 Gadot strives to maximize flexibility in production of its products so as to increase the share of high added-value products over that of lower added-value products. This means: Increase in the share of fructose and special citric-acid based salts out of Gadot's revenues.

13.22.2 Another of Gadot's strategic objectives is to increase its scope of operations outside Israel.

Since most of Gadot's sales are intended for target markets outside of Israel, Gadot sees the importance in development and expansion of its production capacity closer to its target markets in Europe and/or in the USA. Gadot has started taking steps to identify suitable candidates for strategic acquisition, with assistance from international investment bankers. As set forth above, Gadot is in negotiations to acquire a company in the USA (see section 13.20 above).

As of the report date, Gadot has no plans for material investments in expansion of its production capacity in Israel.

13.22.3 Due to the changes in the EU Sugar Regime, which might negatively impact price levels of Gadot's fructose being marketed to EU countries, Gadot is considering transition to other geographical markets and adjustment of its products to demand in such markets, as well as development of new, fructose-based and other products. Subsequently, Gadot intends to act to develop its operations in Asia Pacific, primarily in Japan and South Korea, as well as in niche markets in the USA. Gadot will focus its efforts in these markets on marketing its fructose, produced from non genetically engineered raw materials (GMO free), which would give it a certain competitive edge over competitors which do not have the same distinction (fructose produced from genetically-modified raw materials, such as corn). To Gadot's best knowledge, fructose consumption in its target markets in Asia Pacific stands at 50,000 tons annually and is mainly supplied by US producers (who produce fructose from GMO raw materials).

13.22.4 Gadot's policy is to create flexibility in the use of various raw materials, according to economic viability based on relative prices of alternative raw materials. To this end, Gadot is developing technology that would allow for use of alternative materials. This policy has been successfully implemented with respect to materials such as caustic soda and acerbic soda. With the drastic increase in cost of the principle raw material – sugar - Gadot has proven the feasibility of technologies to replace the sugar in production of citric acid with alternative raw materials.

13.23 Anticipated Development over the Next Year

As a plan outside the company's normal course of business, it is noted that Gadot is reviewing investment options in a custom company which produces products integrated in its operations as set forth in section 13.21.2 above. There is no certainty that the aforementioned deal would be realized at all, particularly in the next year. Furthermore, Gadot will review raising capital in the next year, in order, *inter alia*, to finance the aforementioned investments in sections 13.19 and 13.20 above, inasmuch as said transactions should be completed.

13.24 Risk Factors

One may note several risk factors facing Gadot's operations as follows:

13.24.1 Changes in EU Sugar Regime – Crystalline fructose, which is Gadot's leading product, is sold in European markets, taking advantage of local sugar prices that are significantly higher than the international market price, due to import restrictions, such as: Tariffs, quotas and minimum prices. The changes to the Sugar Regime, as described in section 13.2.1 above, could under certain

circumstances have material negative impact on Gadot's business, especially with regard to sales of fructose starting in October 2008.

13.24.2 Changes to international sugar prices – the primary raw material used by Gadot is sugar (about 18% of Gadot's turnover), which is traded on commodity exchanges around the world. Since prices of Gadot's products are not directly correlated with the price of sugar on international markets, and in view of the fact that Gadot has contracted to purchase sugar through the first half of 2007, any share upward volatility in sugar prices may materially impact Gadot's business starting in the second half of 2007. Gadot intends to purchase raw sugar from the sugar refining plant starting in Q4 of 2007, assuming construction of said plant is completed by then (see also section 13.12 above). Current sugar prices on international commodity markets are about 60% higher than prices of sugar consumed by Gadot in 2006. Purchasing sugar at current market prices for the second half of 2007 would materially increase the cost of sugar to Gadot by 60% over 2006 and by 75% over 2005, which may have a material, negative impact on Gadot's business results and on the scope of its operations to produce citric acid and citric acid salts. See also section 13.12 above.

13.24.3 Price Volatility in the Citric Acid and Salts Markets – The citric acid and tri-sodium citrate markets have seen volatile price swings over the last six years. From the mid 1990's and until 2002 there was a sharp drop in prices. In 2003, due to closure of some factories and increased demand for citric acid, prices started stabilizing and in 2004 prices started to rise. Since a significant part of Gadot's operations is in production of critic acid and citric acid salts, downwards price fluctuations could have a material impact on Gadot's business.

13.24.4 Legal proceedings with regard to Kishon River pollution - Gadot is party (whether directly or as third party added to the lawsuit by another defendant) to legal proceedings with regard to pollution of the Kishon River, which may amount to NIS hundreds of millions (see Note 25a to the company financial statements). Gadot may also be liable for some of the above legal proceedings against Gadiv Petrochemical Industries Ltd. (hereinafter: "**Gadiv**"), a subsidiary of ORL, pursuant to the agreement for sale of Gadiv to ORL, in which Gadot committed to indemnify Gadiv for any third party claims prior to Jan-31-94, for which Gadiv is found liable. In letters sent to Gadot by Gadiv and ORL between October 2000 and February 2004, Gadiv and ORL have notified Gadot that in some of the aforementioned legal proceedings, Gadiv was among the defendants and inasmuch as Gadiv is found liable in said claims for cause (in whole or in part) prior to Jan-31-94, Gadot would be liable for the claims and their cost for a proportion thereof. Furthermore, Gadiv and ORL filed third party notices on Gadot in some of the claims. Should Gadot be required to compensate the plaintiffs at substantial amounts, this may have a drastic negative impact on Gadot's business.

13.24.5 Changes to LIBOR Interest Rate - The long-term credit granted to Gadot by banks is denominated in USD and bears variable interest at LIBOR plus margin as described in section 13.14.1, above. Therefore, changes to LIBOR interest could increase Gadot's financing expenses and decrease its profits. Nevertheless, it should be noted that Gadot also uses hedging transactions to hedge the LIBOR interest rate. In December 2001 Gadot purchased an option to swap the three-month LIBOR interest rate for a fixed rate (in order to protect its cash flow from variable rate loans) for a period from January 2004 to October 2007. The cost of this option (US $112,000) is depreciated over the life of the option.

13.24.6 Changes in the Consumer Price Index – The debentures issued by Gadot under the prospectus published in May 2005 are linked to the Consumer Price Index. Therefore changes in this index could cause an increase in Gadot's financing expenses and a decrease in its profits.

13.24.7 Changes to Foreign Currency Exchange Rates - Most of Gadot's purchasing and sales and are denominated in foreign currency and/or linked to foreign currency. Most of Gadot's obligations are denominated in NIS (including index linked) and USD. A large part of customer debt to Gadot is in Euro (27%) and USD (68%) or linked to the above currencies, with the remainder in NIS. As a result, changes in the USD and Euro exchange rates may influence Gadot's business results. Therefore, Gadot has contracted future hedging transactions using derivatives such as forward transactions, purchase of options and option strategies in order to ensure the USD value of customer debt (minus liabilities) which are denominated in currencies other than USD. Gadot's financial statements are currently presented in NIS.

13.24.8 Stricter Environmental Protection Regulation - Gadot's operations are subject to laws, regulations and ordinances regarding environmental protection, as set forth in section 13.16 above. Since environmental protection is an evolving issue, the risk exists that in the future, harsher

requirements may be stipulated which would require Gadot to make further investments at amounts which cannot currently be estimated.

13.24.9 Rise in Energy Prices - Over 27% of Gadot's variable costs are for energy consumption (electricity and steam). Significant increase in energy costs may impact Gadot's business.

13.24.10 Challenge in finding customers for Gadot's products, *inter alia* due to termination of contract with Roquette Group – Gadot typically contracts with its customers with regard to sale of its products for a short term of one year or less (except for the contract with Roquette Group which was for a long term, but expires on Aug-31-07). Therefore Gadot may, from time to time, face challenges in finding customers for its products. Note that Roquette Group purchases about 50% of Gadot's annual fructose production. The contract with Roquette requiring it to purchase a specified annual volume will expire on Aug-31-07. Should Gadot fail to find customers for its products, including for the volume of fructose currently sold to Roquette group, this would decrease Gadot's revenues and profitability.

	Impact level of risk factor on Gadot's business		
	Major Impact	**Medium Impact**	**Minor Impact**
Macro economic risks		• Changes to foreign currency exchange rates • Increase in energy prices	• Changes to LIBOR interest rate. • Increase in Consumer Price Index
Industry-wide risks	• Changes to EU Sugar Regime • Changes to global sugar price	• Price volatility on the citric acid and citric acid salt market • Challenge in finding customers for Gadot's products, inter alia due to termination of contract with Roquette Group	
Gadot's company-specific risks	• Legal proceedings regarding pollution of the Kishon River	• Increased environmental protection regulation	

The impact levels of the above risk factors are based on estimates only and may differ in actual fact.

14. The Insurance and Financial Sector in Israel

14.1 Purchase of Holdings in the Insurance Industry in Israel

In 2005 the Delek Group acquired two Israeli insurance companies: the Phoenix[100] and Menora. In 2006 the group increased its holding in Phoenix and became controlling shareholder of the company. In 2007 the group sold most of its shares in Menora. Below details of these purchases and the group's holdings in insurance companies in Israel:

14.1.1 The Phoenix: On 4 December 2005, Delek Investments completed a transaction to acquire 25.01% of the Phoenix's shares that were held by Shlomo Eliyahu in consideration for a sum of NIS 720 million. As part of the transaction, Delek Investments was given a call option whereby it is entitled to acquire an additional 8.04% of Phoenix's shares in consideration for approximately NIS 222 million (plus index linkage differentials and annual interest of 5%, subject to adjustments). The call option was exercised on 7 June 2006 and as a result Delek Investment's share in the Phoenix rose to 33.04% of the capital and 31.33% of the voting rights.

On 26 August 2006, Delek Capital engaged with the Mayer Group (Mayer Cars and Trucks Ltd. and Mayer Holdings (the Phoenix) Ltd., (hereinafter: "the Sellers", which was a controlling party in Phoenix, in a transaction to purchase 28.5% of the Phoenix's shares, in return for a sum of 214 million US dollars (approx. NIS 940 million). After receiving the required approvals, the transaction was completed on 17 November 2006 and the Delek group became the controlling shareholder of the Phoenix. As of this date, and after private allocation of the Phoenix shares to institutional investors, the Delek group holds about 55.5% of the Phoenix shares and about 53.4% of the voting rights. In the acquisition agreement it was determined that for as long as the Sellers hold the Phoenix shares that grant 20% or more of the capital rights and voting rights in the company (hereinafter: Holding A) or less than 20%, but not less than 10% (hereinafter: Holding B), Delek Capital and Delek Investments will use their control to ensure that the company's Board of Directors will include two directors in the case of Holding A, or one director in the case of Holding B. The directors will be recommended by the Sellers, and shall be acceptable to Delek Capital and Delek Holdings.

14.1.2 Menora: On 13 March, 2005, Delek Investments acquired 9.99% of the issued capital of Menora in a private allocation in return for 44 million US dollars. In addition, Delek Investments was given an option that is exercisable to acquire up to 5% more of Menora's issued share capital, which was exercised on 2 April 2006 in return for approximately 23.3 million US dollars, which were paid on 9 April 2006. Delek Investments also signed an agreement with the owners of Menora, which included various provisions on the issue of sales of shares and protection of minority rights of Delek Investments.

The Antitrust Commissioner approved acquisition of control in the Phoenix on condition that part of Delek Investment's holdings in Menora were sold to an unaffiliated third party approved by the Anti-Trust Commissioner, by 13 May 2008, in a way that Delek Investments would not hold 5% or more of Menora's share capital, would not have the right to appoint officeholders in Menora and would not have the right to receive benefits from Menora, with the exception of the right to a dividend. Given the above mentioned, in January 2007 Delek Investments sold approximately 8% of Menora's shares in return for NIS 251 million and it granted options for purchase of approximately 4.4%, which was exercised in return for NIS 140 million in February 2007. As of this date, Delek Investments holds 2.2% of the shares in Menora. The aggregate profits (before taxes) for sales of the holdings in Menora totaled NIS 142 million.

The description of the insurance industry below relates to the activities of the Phoenix, which are consolidated in the statements of Delek Investments. For further details of the investment in Menora, presented in the statements of Delek Investments on the basis of cost, see clause 14.21 below.

[100] In this part, the Phoenix is the Phoenix Holdings Ltd. and all the consolidated companies in its financial statements.

14.2 General Information on the Field Activities

14.2.1 Structure of the Sector of Operations and the Changes Therein

The Phoenix was incorporated in 1949 as a private company, and became a public company in 1978. As of this date Phoenix 1 shares are traded on the TA75, TA100 and TA Finance 15 index. The Phoenix engages in all areas of insurance: most kinds of general insurance, including sickness and hospitalization insurance, and all the various types of life insurance that are common in the Israeli insurance sector, including nursing care insurance and pension insurance. In addition to its insurance activity, Phoenix invests in property, works of art, venture capital and other investments through the Phoenix Investments and Finances Ltd. (hereinafter: "**Phoenix Investments"**)[101] .

Vertical Split of the Phoenix's Business On April 10, 2006, a structural change was completed whereby the Phoenix's insurance business was split vertically into its subsidiary company, The Phoenix Insurance Company Ltd.[102] (hereinafter: "**Phoenix Insurance"**) pursuant to Section 105 I of the Income Tax Ordinance, and the Phoenix's holdings in the companies that engage in investments were transferred to the subsidiary company, the Phoenix Investments pursuant to Section 104 a of the Income Tax Ordinance, such that on completion of the structural change, Phoenix has an unit for coordinating its investment activities and an unit for coordinating its investment activities.

Acquisition of Excellence: On 5 January 2006, Phoenix Investments and the controlling shareholders in Excellence Investments Ltd. (hereinafter: **"Excellence"** and the **"Controlling Shareholders"**) signed an agreement whereby the Controlling Shareholders would sell part of their holdings (approximately 16% in the first stage) in Excellence to the Phoenix Investments at a basic value of NIS 775 million and pursuant to the following principles:

A. Upon completion of the transaction, the Controlling Shareholders and The Phoenix Investments would be joint controlling shareholders at Excellence.

B. The Controlling Shareholders are given a Put option for one year (beginning on the closing date) to sell all of their holdings in Excellence, at this basic company value. From 1 January, 2009 until 31 January, 2010, Phoenix Investments will have a Call option, and as of 1 February, 2009 through to 31 December, 2010, the Controlling Shareholders will have a put option to sell all of their holdings in Excellence according to previously agreed price formulas derived from Excellence's future performance. The first option was cancelled in an amendment to the agreement on 20 June 2006, and as part of the amendment the price formulas of the call and put options were also updated.

On 7 February 2006 the Phoenix Investments and Mizrahi Tefahot Bank Ltd. signed an agreement for acquisition of all of its shares in Excellence, which constitute approximately 25% of the share capital of Excellence, for NIS 197 million (according to the same company value which the transaction with the Controlling Shareholders at Excellence was implemented).

Subsequent to receiving all of the approvals required by law, both transactions were finalized on 9 April 2006. As of the report date the Phoenix holds approximately 40% of Excellence share capital. For further details of Excellence activities see Section 14.13, below.

The Phoenix operates in various insurance sectors:

A. **Life insurance and long-term savings**: coverage for insurance events stemming from various risks during the individual's life. The insurance may also include a long-term savings component. The Phoenix also manages pension funds and provident funds.

B. **Compulsory vehicle insurance:** insurance coverage for bodily damage as a result of vehicle use. The coverage is required by law.

C. **Comprehensive vehicle insurance:** third-party liability for property damage and vehicle insurance for self-inflicted damage.**Other general insurance:** property, liability and other general insurance

E. **Health insurance**: including nursing care and dental insurance

Financial data for the Phoenix's insurance sectors
(in NIS thousands)

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[101] The company used to be called Atara Investment Company Ltd., and its name was changed in April 2006.

[102] The company used to be called Hadar Insurance Company Ltd., and its name was changed in April 2006.

	2006	2005	2004*
Profit from life insurance and long-term savings	365,974	403,857	366,040
Profit (loss) from compulsory vehicle insurance	51,174	(10,111)	35,302
Profit (loss) from comprehensive vehicle insurance	38,906	480	(24,273)
Profit (loss) from health insurance	69,364	40,584	(81,991)
Profit from other general insurance	30,698	22,028	52,342
Total profit from sector of operations	556,116	453,838	347,420
Adjustments:			
Revenue (losses) from investments and other revenue not included in the insurance business statement, net	66,565	71,541	24,544
Interest expenses on long-term liabilities	(38,877)	(43,130)	(24,481)
Net revenue (expenses) from insurance agencies and other companies	26,726	1,614	(8,370)
General and administrative expenses not charged to insurance business statements	(36,536)	(39,516)	(26,232)
Expenses for amortizing original difference	(6,622)	(11,961)	(11,961)
Profit before taxes on income	567,372	432,386	300,920
Taxes on income	(206,417)	(181,850)	(134,351)
Phoenix's share in results of associated companies	23,682	54,369	10,062
External shareholders' share in results, net	(2,806)	(766)	(225)
Net income	381,831	304,139	176,406

* Reclassified

14.2.2 Legal Restrictions, Standardization and Special Constraints

The insurance and long-term saving sector is subject to comprehensive legal regulations and supervision by the supervisor of the capital market and the supervisor of insurance (hereinafter: "**the Supervisor**") The widespread regulation is the most significant factor influencing the activities and in recent years it has grown significantly and changed the character of the activities and the competition in life insurance and long-term savings. For details of regulation for insurance in general, see Section 14.16 below. For details of regulation for life insurance and long-term savings, see Section 14.3.1(b) below. For details of regulations for finances (Excellence) see Section 14.3.6(c) below.

Restrictions on dividend distribution:

Pursuant to the permit for control and ownership of control means at the Phoenix, which was given to the Delek Group (Delek Investments and Delek Capital) on 16 November 2006, no more than 50% of the Phoenix's annual profits will be distributed as a dividend for three years from the date of the permit. This restriction will apply as long as Phoenix Insurance's shareholders' equity falls below 120% of the required shareholders' equity according to the minimum capital regulations as defined in Section 14.16.2 below.

In January 2007 the Phoenix's Board of Directors decided on dividend distribution at a rate of at least 25% of the Phoenix's distributable net income every year. The distribution policy is subject to fulfillment of the terms specified in the Companies Law, the restriction in the said permit of control, and provided that the distribution will not harm the Phoenix's businesses and/or activities. [103] The dividend policy will not take into consideration the profit component originating from the transfer of the reserve for extraordinary risks to shareholders' equity, against which a capital demand will be added at Phoenix Insurance.

[103] On 9 November 2005 the Phoenix 's Board of Directors decided on dividend distribution amounting to NIS 250 million. The distribution was approved at the shareholders meeting, and was executed on 11 November 2006. On 20 March 2007 the Phoenix's Board of Directors decided on dividend distribution of NIS 150 million. The dividend distribution is subject to approval at the Phoenix's shareholders meeting.

14.2.3 Changes in the Scope of Activity and Profitability in the Sector

The most significant changes in the insurance industry occurred in the sector of life insurance and long-term savings, including as a result of the Bachar Legislation that was approved in 2005. For details, see Section 14.2.1 below.

The Phoenix's profits from insurance during 2006 totaled approximately NIS 564 million, compared with NIS 457 million and NIS 346 million in 2004 and 2005, respectively. The increase in the net income in 2006 stemmed mainly from the increase in profitability in the general insurance sector (in particular in the vehicle sector) and from an increase in profits from health insurance. Most of the growth in profits from insurance in 2005 stemmed from the health sector. In this sector, the Phoenix went from a large loss in 2004 (approximately NIS 82 million) to a profit in 2005 (approximately NIS 41 million). In addition, the Phoenix's profits in life insurance rose in 2005 in comparison to the corresponding period in 2004, mainly as a result of increased income from investments. The net income in 2005 included gains from the sale of the Shagrir Towing Services Ltd. operations, in the amount of NIS 45 million.

14.2.4 Developments in Markets in the Sector

In July 2005, legislation for implementing the Bachar Committee's recommendations was approved. The Law for Increasing Competition and Reducing Concentration and Conflict of Interest in the Israeli Capital Market (Legislation Amendments) 5765-2005 (hereinafter: the **"Competition Law"**); the Supervision of Financial Services Law (Pension Funds) 5765-2005 (hereinafter: the "**Pension Law"**); the Supervision of Financial Services Law (Pension Funds) 5765-2005 (hereinafter: (Engagement in Pension Advice and Financial Marketing) 5765-2005 (hereinafter: the **Advice Law**). These laws (hereinafter: the "**Bachar Legislation"**) aim to implement the Bachar Committee's recommendations, the main points being as follows:

A. Structural change in the capital market with the aim of separating activities with competition potential, in particular prohibiting banks from holding a provident fund, mutual fund or insurer

B. Dispersing the centrality and reducing the conflicts of interest in the capital market, in particular due to the holdings of the large banks in mutual funds, provident funds and underwriting companies

C. Distinguishing between advisor and marketer and regulating their tasks and liabilities opposite the customer

D. Establishing a new sales model and the duty of best advice, intended to customize the product to the customer's needs

E. Allowing banks to consult and distribute pension savings products

F. Formalizing the employee's exclusive right to choose a provident fund or pension plan

For further details regarding the Bachar Legislation, see Section 14.6.3 below.

The laws came into effect during the fourth quarter of 2005 and the first half of 2006, and led to significant developments on a number of levels:

A. The banks sold most of the provident and mutual funds that they owned. Most of the provident funds were purchased by the various insurance groups: Clal purchased Discount funds, Harel purchased the large Leumi funds, Migdal purchased Kahal, and Excellence purchased Mizrahi funds. Another player that joined the market is the Markstone fund. Markstone established the Prisma investment firm, which manages assets totaling NIS 51 billion.

B. Apart from separating the provident funds and mutual funds from the banks, the Bachar Legislation enabled the banks to enter into the field of advice and distribution of financial products. Most of the banks are currently completing their preparation for distribution of these products, and are expected to start distributing them during 2007.

C. The institutional bodies developed best advice support models, together with the banks, and trained their workers to comply with the licensing requirements for pension market.

D. There was growing public awareness of yields of the financial products, inter alia due to media coverage, and publication of monthly and annual yields, and the Pension-Net project introduced by the Ministry of Finance, which made information more accessible to the public.

E. Entry of foreign parties into long-term savings in Israel: The Markstone fund purchased provident funds and pension funds, York fund purchased the Psagot-Ofek investment

company and Bank Leumi's mutual funds, Sampoerna (Singapore) holds 20.2% of Harel shares, and Bear Stearns hold 50% of Migdal's financial services. At the same time, Israeli insurance companies started to make foreign acquisitions: Harel acquired a Greek company, Clal acquired an insurance company in the USA, and the Delek Group acquired the Republic insurance company in the USA.

Following developments, competition between the insurance, pension and provident products grew, and today the life insurance industry can be regarded in the wider aspect of long-term saving.

14.2.5 Critical Success Factors in the Sector of Operations

The critical success factors are: response to the changing requirements of the public – adaptation of existing products and development of new products and tracks related to insurance, provident and pension funds; support of the marketing system and development of new marketing systems; long-term quality service, which ensures a high level of product retention and customer loyalty; high yields, given growing public awareness of the importance of yield for the saving received from the policy and the fund; tax benefits for savings that affect the scope and manner of public savings for retirement; operational efficiency; development of supportive information systems; underwriting quality and the employees' professional level; retention of current customers; achieving a large market share that enables providing a solution to customers' needs and activities in distribution channels, while maintaining higher profitability.

14.2.6 Main Entry and Exit Barriers in the Sector of Operations

The main entry barriers are licensing of the company under the Supervision of Financial Services (Insurance) law, equity requirements, establishment of an information system, sales and service system, establishment of investment capacities, forming of work relations with reinsurers, and complying with various regulation requirements. As a result of the Bachar legislation, employees working in certain sectors require licensing, which constitutes an entry barrier from the aspect of human capital. The main exit barriers are the long-term liabilities toward the policyholders and the long period required in some of the sectors to pay run off claims.

14.2.7 Alternatives to the Products in the Sector and the Changes Therein

Alternatives to the Phoenix insurance products are mainly similar products of other insurance companies. In the field of long-term saving, there are competitors that hold pension funds and provident funds, and there are of course other options for investment and long-term saving that constitute alternatives for life insurance, pension and provident.

14.2.8 Structure of the Competition in the Sector of Operations and the Changes Therein

In the insurance sector, there are five main insurance companies (Clal, Migdal, Harel, Menora and the Phoenix). Insurance companies holding pension and provident funds and other bodies are active in the long-term savings sector. On the basis of the publications of the Association of Insurance Companies in Israel, on the basis of the data for September 2004, 2005 and 2006, Phoenix represented approximately 12.7%, 12.1% and 11.9% of the general insurance market in Israel and 16.4%, 15.6% and 15.6% of the life insurance market, respectively. See competition structure below in the description of the different sectors.

14.3 Products and Services

Financial information for insurance branches (in NIS millions)

	Life insurance [104]			Compulsory car insurance			Comprehensive vehicle insurance			General other			Health care		
	2006	**2005**	**2004**	**2006**	**2005**	**2004**	**2006**	**2005**	**2004**	**2006**	**2005**	**2004**	**2006**	**2005**	**2004**
Gross insurance fees	2,534	2,426	2,335	302	330	413	631	636	740	784	763	739	428	374	267
Insurance fees less reinsurance (residual)	2,469	2,317	2,202	290	322	404	631	636	740	452	441	410	358	309	202
Profit before taxes	373	404	364	51	(10)	35	38	0.4	(24)	487	22	52	69	40	(81)
Gross claims	1,319	1,221	1,176	309	455	402	429	495	589	486	567	452	235	223	154
Claims - residual	1,226	1,127	1,066	294	394	388	430	495	581	303	308	259	202	185	123
Total gross insurance liabilities	21,088	18,975	16,657	1,805	1,907	1,784	432	433	472	304.2	1,875	1,788	284	237	157

[104] The financial figures in this column do not include details regarding the management of pension funds and provident funds, that are presented in the following table.

14.3.1 Life Insurance and Long-term Savings

A. General:

The Phoenix deals in all types of life insurance. Life insurance gives coverage for events stemming from various risks, such as: accident, disease and disability risks (hereinafter: "**Risk"**), nursing care and long-term loss of working capacity. As part of the insurance plan, there are tracks that include a financial accumulation component (hereinafter: "**Savings"**). Policyholders have the option of choosing the mix most suitable for them between the Risk component and the Savings component, according to their needs. As part of the Risk component, the company offers two tracks for withdrawing money, and the policyholder has the option of choosing one of them or a combination of the two. In the capital track, the policyholder can withdraw pension funds in a one-time withdrawal. In the allocation track, the policyholder can withdraw pension funds at retirement age by means of a monthly allowance.

The company's life-insurance activities combine sales of new policies with services to holders of existing policies that have been sold since the beginning of the Phoenix operations.

The life insurance sector has undergone highly significant changes since 2000 from a number of aspects, such as the types of plans implemented in it, the taxation rules that apply to the insurance plans, and the way of investing the policyholders' funds. The year 2005 was characterized by many regulatory changes, including Knesset approval of the Bachar legislation in August 2005, which led to a comprehensive structural change in the capital market in general, and in the long-term savings sector, in particular.

In the life insurance sector, the Phoenix markets private insurance, directors insurance and group insurance, and offers a range of insurance plans, which are approved by the Supervisor every year. In addition, the Phoenix markets insurance plans for fatal diseases, loss of working capacity and nursing care insurance, as well as other types of coverage common in the sector.

The Phoenix also manages pension funds and provident funds, currently in a marginal scope. For details see Section 14.3.1(j) below.

B. Regulation

The long-term savings sector operates within two main legal frameworks:

The first one, the Insurance Contract Law, 5741-1981, the Financial Services Supervision Law (Insurance), 5741-1981, regulations, orders and the Supervisor's circulars, which were issued by virtue of the Financial Services Supervision Law (Insurance), insurance business, as well as the Competition Law. These regulate fundamental issues in the Phoenix's activities in the area of insurance contract, obligation of the parties to an insurance contract, the operation methods of the insurer and the insurance agent, investment rules, recognition of expenses, conditions in insurance plans, proper disclosure to the policyholder and more.

The second one, the Income Tax Ordinance and, primarily, the Tax Regulations (Conditions for Approval and Management of Provident Funds) 5724-1964 (hereinafter: Provident Funds Regulations). Provident Funds Regulations grant a special status to provident funds, including insurance funds, for the matter of tax credits and deductions and capital gains tax exemptions, which motivate the public to save for their retirements by means of provident funds and insurance funds. Life insurance plans include a savings component and which are recognized as insurance funds (and known as directors policies and benefit policies for self-employed individuals) , also benefit from the special status granted to provident funds in the Income Tax Ordinance and the Provident Funds Regulations. The Income Tax Ordinance and the regulations that were promulgated by virtue thereof , basically establish rules concerning insurance plans marketed by the Phoenix and the tax provisions for them.

In 2006, the implications of the amendments to the legislation following the Bachar Committee started to become apparent. The capital market, insurance and saving department in the Ministry of Finance published circulars and provisions for institutional bodies, including the insurance companies, pension funds and provident funds. These define rules for uniform management and reporting, with the aim of increasing transparency of the results of the institutional bodies' activities and the supervision over them in all matters related to the assets of the policyholders and/or the investors.

Also published in January 2003 were draft regulations for supervision over financial services (provident funds) (transfer of monies between funds) – 2006 and a draft circular referring to the transfer of savings (including insurance coverage for disability and death) between provident. The aim of these drafts is to allow consumers to move their accumulated long-term pension savings between the different bodies that manage pension savings, thereby resulting in increased competition and market sophistication. It is unclear whether the draft regulations will be approved as is and it is impossible to estimate the behavior of the saving public following such publication. Phoenix is therefore unable to forecast the implications thereof at this stage.

C. Changes in the scope of activity and profitability:

Profitability in the life insurance sector is greatly affected by the results of the capital market investment. During 2005, there were relatively high yields in the capital market and the total industry profitability rose. In mid-2006 yields in the capital market started to drop as a result of the war in the north, and this significantly affected income from investments, however the year ended with a rise in the capital market, which balanced the drop. In 2005 and 2006 total premiums from life insurance rose by 3.9% and 5.5%, respectively. Profit from life insurance business rose by 10.1% in 2005 and dropped by 7.6% in 2006.

D. Competition

The competition in the life insurance sector is reflected primarily in the level of management fees paid by policyholders, prices they pay for the various kinds of coverage, service level, yields and benefits of distribution channels (in particular agents).

In Israel, there are five main groups operating in the life insurance sectors: the Phoenix, Migdal, Clal, Harel and Menora. According to data from the Association of Insurance Companies for the first nine months of 2006, the Phoenix is in fourth place in terms of gross insurance fees, with a market share of 16%, as compared with 15.6% and 16.4% in the years 2005 and 2004, respectively.

E. Investment management of the life insurance sector:

Investments within life insurance are investments that are intended for covering the commitments of the insurance company according to the insurance policies as estimated by the Phoenix's actuary and grossed up in its insurance reserves. Concerning most of the life insurance plans marketed by the Phoenix through to and including 1990, annual agreements were signed with Israel's government known as Hetz Agreements, regulating the investments of insurance reserves in special linked, interest bearing debentures issued by the Bank of Israel. Through to 2001, some of these Hetz debentures were redeemed early (up to a limit of 50% of the reserve). The balance of the sums, including sums thus redeemed, is invested in properties whose investment is permitted as specified in the Insurance Business (Control) Regulations (Ways of Investing an Insurer's Capital and Reserves and Management of His Obligations) 5761-2001 (mainly concern-related government debentures, long-term deposits in commercial banks and mortgage banks) with yields that include a proper risk margin above the guaranteeing of yields for policyholders.

F. Main products in the sector:

The Phoenix markets private insurance, directors insurance and group insurance, and offers a range of insurance plans, which are approved by the Supervisor every year, and which are conventional in this sector:

Managers insurance: originates in employer and employee provisions for ensuring the social rights of the employee to compensation, rewards and incapacity insurance. For these premiums, one may purchase a saving scheme for retirement, capital or pension based insurance in the case of death or incapacity. The target market is employers who purchase managers insurance for their employees.

Individual insurance: two types, intended for the self-employed and private individuals:

Policies pursuant to the law of self-employed worker compensation insurance, i.e., that enjoy tax benefits; policies with provisions that do not enjoy tax benefits, apart from a 25% credit for premium paid for death coverage.

Other insurance plans offered by the Phoenix are pure risk life insurance, severe illness insurance, incapacity insurance, nursing insurance, serious disease insurance and more.

G. Customers:

The Phoenix addresses a wide range of customers through agents - small, medium and large customers, private customers, business establishments and groups. In 2006 the premiums between life insurance customers had the following distribution: Employers (managers insurance) - 67%, self-employed and private policyholders - 24%, collectives - 9%. In 2005: Employers - 64%, self-employed and private policyholders - 28%, collectives - 8%. In 2004: Employers – 62.9%, self-employed and private policyholders – 28.3%, collectives – 8.8%.

H. Agents and commissions:

The life insurance policies of the Phoenix are marketed in the great majority of cases through agents, who are paid commissions at varying rates. The commission rate is determined by the product type, scope of yield of the agent and the profitability of the insurance portfolio of each agent, following negotiations with each agent. The commissions are paid on various dates - sometimes spread over the life of the policy and sometimes as an advance in the first year – in accordance with the policy and the agent. Some of the agents operate exclusively with Phoenix, while others also market insurance polices of other companies.

Some of the agents are paid additional commissions for office upkeep, supervision expenses, advertising and portfolio retention.

From January 1, 2004, there have been changes in life insurance plans based mainly on a reduction in the premium component that is intended for covering expenses and profit. Reducing the premium component for expenses as stated above led to a change in the commission agreements with agents that mainly involved a significant reduction of the commissions paid to agents in the first year of the policy life and extension of the spread period for the commission. As a result of these changes, a sharp decrease in commission payments may be discerned.

The Phoenix holds agreements with all its agents in which the relationship between it and the agent is determined. Most of these agreements also include the scope of the agents' target output, the commissions they are entitled to and additional details.

Phoenix life insurance agents work mostly with a team of supervisors who are employed by the Phoenix and who serve as mentors on issues of sales and solving routine problems.

With the aim of assisting agents in cash flow in their first years, due to the changes in commission payment, the Phoenix, at the request of agents, tends to give them loans or advances on the account of future commissions. In addition to this, the Phoenix acts by giving loans of various sums to its agents (regardless of their commitments to output). The loans are given pursuant to restrictions specified in the regulations.

I. Pension and provident funds:

General: The Phoenix maintains pension funds through its subsidiary Phoenix Pension and Compensation Fund Management Ltd. (hereinafter: "**Phoenix Pension"**). Phoenix Pension has a license to engage in pension insurance. Phoenix Pension manages a comprehensive[105] pension fund called Phoenix Comprehensive, a general pension fund[106] called Phoenix General, and Amit Pension and Provident Fund, which is a veteran pension fund.

Phoenix also manages pension funds through its subsidiary company Phoenix Provident Ltd. (hereinafter: "**Phoenix Provident**").

[105] A Comprehensive pension fund is characterized by a right to receive designated debentures totaling 30% of the investment portfolio, and limited to deposits of up to twice the average salary in the economy.

[106] A general fund is not entitled to designated debentures but there is no restriction for deposits.

Aggregate data of the Phoenix pension and provident funds (in NIS millions):

	2006	2005	2004
Income from management fees			
Management fees from assets	7.3	3.4	1.6
Management fees from contribution fees	14.1	10.1	5.9
Management fee refunds	(2.2)	(0.5)	-
Pretax profit (loss)	(7.9)	(3.8)	1.2
Compensation fees collected from pension	258	166	106.6
Total managed assets	1,721	1,303	850

Regulation: There have been far-reaching changes in the pension sector in recent years, following the application of structural reforms in pension products and the holding structure as of 2002. These reforms included transfer of part of the veteran funds for special management by the government, and sale of the new funds to different bodies in the economy, mainly to insurance companies. In 2006, the Bachar legislation came into effect, and the process of opening the pension market to competition continued. A draft circular was published, as well as regulations with provisions that intend to facilitate transfer of the policyholders' and members' money between pension products.

The provident branch, which was highly centralized up to 2005, with 70% of its assets managed by bank-owned organizations, experienced significant changes following the sale of bank provident funds. As of 31 December 2006, 50% of provident fund assets are still owned by banks, 18% are privately owned and 9% are owned by insurance companied. In addition, 2006 was a year of transition when the banks could prepare to distribute provident and pension products. Another change in 2006 was the coming into effect of the amendment to the Income Tax Amendment (Regulations for Approval of Provident Fund Management) (Amendment 3), 5724-1964 (hereinafter: "**Amendment 3"**), which creates preference for deposit in a group fund over a capital fund.

Competition: The pension fund market has become highly competitive following the sale of the managing companies, widespread marketing of pension products and increased public awareness of the subject. According to Ministry of Finance data for 2006, Mivtachim (owned by Menora) has a market share of about 40%, Makefet (owned by Migdal) about 27% and Meitavit (owned by Clal) about 16%. The other players in the market are Harel – 7%, Gilad – 3%, and the Phoenix – 3.6%. The change in legislation positioned the pension funds as a competitive alternative for managers insurance, with the exception of group pension insurance, as the management fees for pension funds are lower, the cost of disability and survivors insurance is lower and there is a safety net for investments for 30% of the assets portfolio.

Marketing: The marketing units of the pension funds are composed of agents and a direct marketing channel. The marketing unit of Phoenix Provident is based on agents. In both cases the agents are not exclusive. The commissions of the agents in the branch are a certain percentage of the management fees collected from the end customer. Following the Bachar legislation, which allows banks to distribute pension and provident products, the company is engaging with the banks and in 2006 distribution agreements were signed with two commercial banks. As of this date, one bank has received a license for pension advice for self-employed individuals only, and another bank is in the process of receiving a license.

14.3.2 Compulsory Vehicle Insurance

A. General:

Compulsory vehicle insurance is required for all vehicle owners in accordance with the Motor Vehicle Insurance Ordinance of 5730 - 1970 (the "**Motor Vehicle Insurance Ordinance"**), and covers physical injuries sustained due to vehicle use. The insurance plan corresponds with the provisions of the Motor Vehicle Insurance Ordinance and the insurance compensation is in accordance with the Road Accident Casualty Compensation Law of 5735-1975.

Until March 31, 2001, insurance fees in the compulsory vehicle insurance sector were determined by law and were uniform for all insurance companies and all insured parties. Starting April 2001, a database operator that was established by virtue of the Motor Vehicle Insurance Regulations (Creation and Management of Databases) – 2004, is responsible for managing a database and determining the pure risk cost, on the basis of which the basic fee is set. Insurance Services Offices of Israel Ltd. was selected as the database operator. ("ISO").The operator receives information from all insurance companies in order to conduct its duties and recommends the maximum fees to the Insurance Supervisor who is responsible for setting them.

The Supervisor circulars determine parameters that can be used by insurers in order to determine the fee, such as engine volume, gender, age and driving experience of the driver. The Phoenix determines fees considering only some of the parameters ("differential fee"). According to the instructions of the Superintendent, insurance companies may use different fee formulas for vehicle fleets and collectives.

In January 2007, the ISO actuaries submitted a recommendation for a further reduction of 6% in the compulsory vehicle insurance fees, starting April 2007. Phoenix is examining the implications of the recommendation, which may serve to increase competition in the sector and result in an additional decrease in fees.

In the sector of compulsory vehicle insurance, apart from insurance companies, the following parties are active: (a) The Pool – the Israeli Vehicle Pool, whose partners include Karnit and all the insurance companies operating in the sector, which share its profits and losses based on their proportion in the sector. The Pool provides insurance to all vehicle owners that a commercial insurance company is unwilling to insure. The proportion of the Phoenix in the Pool for the years 2005, 2006 and 2007 was approximately 10%, 8.7% and 8%, respectively. (b) Karnit - a corporation duly established for paying compensation to road accident casualties who cannot claim compensation from the vehicle that caused the injury or the vehicle in which they were passengers. According to the provisions of the Road Accident Casualty Compensation Order (Financing of the Fund) (Amendment) 5763-2003, as of 1 November, 2003, the insurance companies are required to transfer to Karnit 1% of the net insurance fees for insurance policies taking effect from that time.

B. Regulation:

In 2006 a committee established by the Ministry of Justice started work, with the intention of proposing amendments to Road Accident Casualty Compensation Law. At this stage, it is not possible to estimate the impact of the possible changes on the compulsory vehicle insurance sector resulting from the committee's work.

C. Characteristics of compulsory vehicle insurance:

A fixed, uniform insurance format among the insurance companies. The characteristics are absolute liability, a compensation ceiling, effective date of insurance only after full payment of the premium and ongoing payment of claims over an extended period.

D. Customers:

Most of the Phoenix's customers are private business customers. Collectives insuring more than 1,000 vehicles constitute about 15.4% of the gross insurance fees.

E. Competition:

In accordance with the figures of the Association of Insurance Companies for the first nine months of 2006, the share of the Phoenix in the compulsory vehicle branch dropped from 8.19% in 2005 to 7.8% in gross insurance fees, and is ranked seventh following Clal Insurance Company Ltd. (15.8%) Harel Insurance Company Ltd. (13.9%) Eliyahu and Ayalon (9% each), and Migdal Insurance Company Ltd. (8.4%). There is a recent trend among some of the controlling shareholders in the leasing companies to establish insurance companies or to acquire control in existing insurance companies. This trend could lead to a growth in the scope of activities of insurance companies affiliated with leasing companies at the expense of the other insurance companies.

14.3.3 Property Vehicle Insurance

A. General:

Property vehicle insurance insures for liability towards third parties for property damage resulting from the use of the insured vehicle and damage to the vehicle.

In recent years, the sector of property vehicle insurance has been affected by increasing competition over profitable policyholders, which has led to a decrease of prices in this branch. According to figures from the police, the vehicle thefts dropped by 5.5% in 2006 compared to 2005, however the number of thefts increased in the fourth quarter of 2006 and this trend is continuing at the beginning of 2007.

B. Characteristics of property vehicle insurance:

The Phoenix markets property vehicle insurance that covers damage sustained to the vehicle. The terms of insurance for a vehicle weighing up to 4 tons are based on the standard policy terms that have been determined in the regulations and include a basket of insurance coverage clauses.

Policies may be purchased that include, at the choice of the policyholder and in accordance with the insured damage event, full comprehensive coverage, comprehensive coverage without self-inflicted damage, comprehensive damage without theft and third party coverage.The Phoenix offers various expansions for coverage such as criminal trial defense expenses and offers paid ancillary services such as towing services, replacement vehicle in the case of an accident or theft and windshield repairs. The property vehicle insurance tariff is regulated and adapted from time to time. The Phoenix also has a range of insurances for commercial vehicles weighing over 4 tons, under customary conditions in the economy, at rates that are periodically examined.

C. Customers:

Most of the customers of the Phoenix are private policyholders and small business customers. Some 3.4% of the gross insurance fees result from collectives.

D. Competition:

The property vehicle branch is highly competitive. The Phoenix copes with competition by reducing its premium for profitable policyholders and agents with superior results in this sector and increasing premiums for young policyholders and those who have filed claims in the preceding year.

There is a continuing trend in the past several years, whereby large companies are leasing their vehicles or managing their vehicle fleet using the services of leasing companies. Leasing companies tend not to insure their vehicle fleets and this trend possesses a certain effect on somewhat reducing the demand for comprehensive vehicle insurance.

According to data from the Association of Insurance Companies, for the first nine months of 2006, there was a decline in the market share of the large insurance companies and an increase in the medium-sized insurance companies. Phoenix is ranked third place in this branch in gross insurance fees at 12.1% (compared to 12.31% in 2005), after Harel Insurance Company Ltd. (15%) and Clal Insurance Company (14%)

14.3.4 Other General Insurance

A. General: These insurances include property, liability and other general insurances. The Phoenix usually sells to policyholders in the sector an insurance package that includes coverage for property and liabilities.

Property insurance: Property insurance provides policyholders with coverage for physical damage to their property. The main risks covered by property insurance are risks of fire, explosion, break-in, earthquake and damage by natural forces. Property insurance sometimes includes coverage for consequential damage (loss of profits) due to the physical damage to the property. Property insurances constitute an important part in insurances for apartments, businesses, engineering, cargo (sea, land and air) and more. In most cases, property insurance policies are issued for one year. In most cases, claims for these policies are made close to the time that the insurance incident occurs.

Liability insurance: The purpose of liability insurance is to protect policyholders against liability for damage that may be caused to any third party. The main types of insurance are third party liability insurance, employee liability insurance and other liability insurances such as professional liability, product liability and director and officeholder liability. Liability insurance policies are usually issued

for one year. However, there is a longer period of claims management in the branch, which could continue for a number of years. In some of the liability insurances, coverage is event-based, i.e., given to events that occurred during the insurance period and claims can be submitted after the end of the insurance period, subject to limitation. In another part of liability insurances, coverage is usually based on the time the claim is submitted, i.e. coverage is only given to claims submitted during the insurance period, even if the cause occurred before it.

Other sectors: Other branches include personal accident insurance or other risk insurance, such as insurances for contractor work, money in transit and in safes and more.

The general insurance sector is given to fluctuations in profitability stemming, inter alia, from competition, reinsurer capacity and reinsuring conditions as well as fluctuations in the capital market.

B. Customers: Most of the Phoenix customers are private policyholders and small business customers. Some 5.7% of the gross insurance fees come from collectives and large factories.

C. Financial data for other general insurance products (divided by sectors – in NIS millions):

Other property insurance products

	2006	2005	2004
Gross insurance fees	492	464	471
Insurance fees less reinsurance (residual)	229	218	209
Gross claims	247	373	212
Residual claims	122	115	122

Liability insurance products

	2006	2005	2004
Gross insurance fees	233	241	226
Insurance fees less reinsurance (residual)	185	198	180
Gross claims	198	157	219
Residual claims	170	180	117

Other branches

	2006	2005	2004
Gross insurance fees	58	52	41
Insurance fees less reinsurance (residual)	38	24	20
Gross claims	41	37	21
Residual claims	11	13	20

D. Competition: Most insurance companies operate in the general insurance branch and some also market policies directly to private customers. According to the Association of Insurance Companies data for the first nine months of 2006, the Phoenix is ranked third in this branch in gross insurance fees at 13.8% (compared to 12.05% in 2005), after Harel Insurance Company Ltd. (26.9%), Clal Insurance Company Ltd. (22.7%) and Migdal Insurance Company Ltd. (11.7%).

14.3.5 Health Care Insurance

A. General: The health insurance market is a developing sector, and the number of private health insurance purchasers among the public is constantly increasing. The Phoenix markets health, nursing and dental insurance policies. The Phoenix concentrates on individual insurance and collective insurance in the private sector. The Phoenix provides nursing insurance for members of one of the national healthcare services. The Phoenix markets health insurance under the Kav Habriut brand. The Phoenix also operates a service center bearing this name for running health insurance schemes.

The sector of health insurance is affected by legislation, secondary legislation, the instructions of the Insurance Supervisor and the Ministry of Health and principal decisions of the Superintendent concerning complaints that have been filed to his office.

In recent years, the Insurance Supervisor has been publishing circulars that are aimed at increasing the transparency in the way health insurance is sold and determining standardization in terms of the policies of all the insurance companies. These circulars set minimum conditions in the wording of individual and collective policies that insurance companies are required to fulfill.

The Insurance Supervisor is authorized to clarify and settle complaints that are filed to his office and give the claimant operative resources that bind the insurance company against which the claim was filed. In the case of the decision being given by way of a principal decision, it binds all the insurance companies.

There were a number of substantial changes in 2004 in the health insurance sector, mainly through secondary legislation of the Insurance Supervisor, which determined how health insurance policies should relate to preexisting medical conditions and continuity in nursing policies. The secondary legislation has significantly affected the health insurance market by compelling the insurance companies to estimate underwriting risks before the policyholder enters the insurance scheme and not to perform retroactive underwriting at the time of a claim. In the years 2005 and 2006, there was an improvement in the business results of the health insurance sector, this being mainly due to an improvement and expansion of business in the sector of collectives, particularly in dental insurance, a decrease in commission payments due to the transition of commission payment through the entire life span of the policies and a decrease in claim payouts.

B. Principal products: The Phoenix sells a number of health insurances and dental insurances at various coverage levels. Health insurances include, inter alia, compensation and/or indemnification for expenses at the time of an operation, transplants and/or special treatments abroad, coverage for drugs that are not included in the state health basket, alternative treatments, compensation for severe illnesses, medical services with advanced technologies, and more, in accordance with the insurance schemes purchased for and/or by each policyholder. Health and nursing insurances are marketed both to private customers and as collective insurance. The schemes are usually long-term. In 2005 and 2006 the Phoenix launched a number of new health insurances that positioned it as an innovative, leading company in this sector.

   Health insurance products can be divided into a number of coverage layers: insurance coverage that constitutes an alternative to the services given by the health basket and gives coverage from the first shekel of expenditure; insurance coverage for services that are not included in the basic basket or within the additional health services; insurance that gives coverage beyond the coverage given by the health basket.

C. Customers: Phoenix has three health service customer groups: private policyholders who have purchased individual Kav Habriut health policies (usually for life); collective insurances with organizations, employee committees and the larger companies in the economy; and members of healthcare services that purchase further healthcare services. One of the healthcare services purchased nursing insurance from the Phoenix as part of collective insurance that is renewed every few years, as an addition to the health basket, and in 2007 Phoenix won a tender for the Maccabi healthcare organization for insuring medicines that are not included in the health basket. About 50% of the gross insurance fees are from collectives and large factories and about 50% from private policyholders and small business customers

D. Competition: There are insurance companies competing with the Phoenix that offer health insurance to the general public and collectives. The healthcare services also offer complementary health services for their members. However, the limited health basket that is offered to the general population according to the State Health Insurance Law, the deficits of the healthcare services and the state of the public system, including restricted availability of services, lead to higher public awareness of the necessity of private health insurance. These processes resulted in an increase in the scope of the medical and nursing insurance market and most of the competition is over securing new customers for private and collective insurance and competition over existing policyholders with collective insurance. In 2006, some of the healthcare services started to purchase third-level insurance for their members, which includes coverage currently given by the insurance companies. The ensuing implications on the private insurance market in Israel are uncertain.

The factors that affect the competitive position in the sector of health insurances are correct pricing, the availability of high quality information concerning risks, maintaining sufficient margins and aggressive marketing.

According to the Association of Insurance Companies data for the first nine months of 2006, the Phoenix is ranked second in this branch in gross insurance fees at 21.6% (similar to 2005), following Harel Insurance Company Ltd. (42.2%), Clal Insurance Company Ltd. (17.4%) and Migdal Insurance Company Ltd. (10.4%).

The alternatives to the products in this sector of activity are free medical insurance pursuant to the State Health Insurance Law, complementary medical insurance marketed by the healthcare services and various products that are offered by other insurance companies.

14.4 Customers

The customers of the insurance sector are many and diverse. There is no single customer in the insurance sector which constitutes 10% or more of the Phoenix's income. For further characterization of the customers of each of the sectors, see above in the product description.

14.5 Marketing and Distribution

The insurance policies that Phoenix sells are mostly marketed through agents. At the time of the report, the Phoenix had business ties with about 1,000 active agents. Most also market the policies of other insurance companies. The insurance agents operate directly with the Phoenix, and some of them have the authority to produce policies in accordance with the tariffs and authorizations of the Phoenix. The Phoenix is also active through insurance agencies that employ sub-agents. These agencies generally work with a number of insurance companies and have production and underwriting authorities of the Phoenix with various authorizations. In most cases, when the Phoenix contracts with insurance companies with sub-agents, it also has agreements directly with the sub-agents that they employ. Usually, the Phoenix forwards additional commission to agencies that employ sub-agents for sales of their sub-agents.

The Phoenix has agreements with agents according to the law and the agents act at the rates and under the underwriting instructions that the Phoenix disseminates from time to time in the various insurance branches. The relationship between the Phoenix and agents are determined in these agreements. The agents are paid commissions at varying rates for their services.

In November 2005, the Phoenix declared an organizational change within which a customer division was established for the sales and service in all sectors of activity and products. At the same time, a dedicated unit for working with banks was also established

14.6 Seasonality

In the general insurance branch, the first quarter of the year is the outstanding one, mainly due to renewal of policies that are usually made at the beginning of the year. The seasonality in the insurance fee is neutralized by a system of reserves for risks that have yet to elapse, and therefore does not affect profitability. No seasonality is evident in life insurance.

The following is an outline of general insurance fees, by quarter:

	2006		2005	
	In NIS thousands	%	In NIS thousands	%
Q1	719,476	33.49	733,014	34.82
Q2	479,767	22.33	470,512	22.35
Q3	485,343	22.59	446,853	21.22
Q4	463,658	21.59	455,073	21.61
Total	2,148,244	100	2,105,452	100

14.7 Reinsurance

The Phoenix performs reinsurance to disperse its insurance risks. Reinsurers of the Phoenix have an influence on insurance capacity, insurance terms, tariffs and profitability. The insurance companies insure some of their business affairs with reinsurance, mainly general insurance, which is performed through reinsurers overseas. However, reinsurance does not exempt the direct insurers from their liability towards the policyholders according to the insurance policies, Consequently the stability of the reinsurers affects the business outcomes of the insurance companies.

The reinsurance law has experienced upheaval in recent years due to damages reaching huge sums, leading to the collapse of a number of reinsurers and a reduced rating of others. This upheaval resulted in reduced capacity of reinsurance. In 2004, the reinsurance market stabilized, and in 2005-2006 the market strengthened and insurance capacity in the global market increased. The Phoenix does not work with reinsurers with a rating lower than A minus.

For additional details regarding reinsurance, see Note 38 to the financial statements.

14.8 Suppliers and Service Providers

The Phoenix signs service agreements with suppliers and service providers in the different insurance sectors, mainly relating to claim settlement, such as lawyers, assessors, experts and medical consultants. In the property vehicle sector, the Phoenix contracts with suppliers for towing services, replacement vehicles, repair of windshields and other services. Until February 2005, the Phoenix held a third of the shares of Shagrir, the main supplier in this sector. The Phoenix is committed to further contracting with this supplier under identical conditions for another five years, unless the suppliers sells an identical service to another customer at a lower price. In the other general insurance sectors, the Phoenix signed agreements, inter alia, with suppliers for repair of electronic household appliances and plumbing (for apartment insurance) and with a search and rescue company abroad (for overseas travel insurance). In the health insurance sector, the Phoenix contracts with hospitals, doctors, investigation offices and more. In the information systems sector, the Phoenix contracts with hardware and software suppliers.

14.9 Actuary and Risk Management

The Phoenix uses actuary models to calculate various data. Under the Financial Services Supervision Law (Insurance), 5741-1981, the insurer, including a pension fund management company, will appoint an actuary for each insurance branch in which it engages, and the insurer, and each pension fund managed by the insurer, will appoint a risk manager. The task of the actuary is, inter alia, to make recommendations for the Board of Directors and the general manager regarding the level of insurance liabilities of an insurer or of the actuary balance of the pension fund that it manages. To task of the risk manager is, inter alia, to advise the Board of Directors and the general manager of the risks facing the insurer and any pension fund that it manages. In October 2006, the Supervisor published a circular determining regulations relating to the tasks, authorities, and work method of the appointed actuary and risk manager at an insurance company and a pension fund management company. The directives of the circular are effective as of its publication, except for directives regarding issues related to the task of the risk manager of an insurer, that shall enter into effect in the future.

14.10 Fixed Assets and Equipment

Beit Havered, property on Hashalom Road, Givatayim: The Phoenix is the direct and indirect owner of about 15 office floors in the building, covering a total area of 18,683 sq.m gross and another 308 parking spaces in an underground parking lot at 53 Hashalom Road in Givatayim. The adjusted value of the building as of the financial statements for 31 December, 2006 stands at NIS 214.9 million. The Phoenix owns additional real estate with an insignificant adjusted value according to its financial statements.

Information systems: The Phoenix has information systems with hardware, software and other equipment, with a reduced cost of approximately NIS 265.6 million. In 2004-2006 the Phoenix invested approximately NIS 70, 77, and 136 million, respectively, in computers. The Phoenix is in the middle of applying a computerization plan that includes a master plan with software infrastructures, policies and collection, reinsurance and risk management. In 2005 and 2006 a

number of hardware, software and storage infrastructures projects were planned and partly executed. Operational projects have also been implemented, which included the setup and adjustment of systems following regulatory changes, establishing an organizational portal and SAP system.

14.11 Intangible Assets

The name of the Phoenix is a registered trademark. The Phoenix manages databases that are duly registered according to the Privacy Protection Law of 5741-1981. These databases are vital for running the Phoenix's business affairs and include, inter alia, information on policyholders, agents, suppliers, workers, life, health and elementary claims, collectives, reinsurers and repossessions. The Phoenix develops, through its employees and suppliers, copyrighted programs for in-house use.

14.12 Human Capital

14.12.1 The Organizational Structure

In November 2005, the Phoenix started to implement organizational change intended to increase focus on its customers and accelerate initiation and development of new products. Within the organizational change, a customer division was established, which is responsible for sales and service with the insurance agent distribution channel. At the same time, new distribution channels were established, dealing mainly in coordinating work with banks, and two units that specialize in long term saving and finances have been established. Two units have also been reorganized: general insurance and health insurance. The new organizational structure took effect in January 2006.

The Phoenix has external units in Jerusalem, Haifa, Ramat Gan and Ness Ziona that serve as branches of the head office. The units operate in life insurance and general insurance, and provide full service to the agents who work with them. The veteran employees of the Phoenix have not signed any work agreements, according to the policy employed in the past. As of the date on which the Employee Notice - Work Conditions Law was passed, the new employees have been given a form specifying their employment terms as required by this law. During 2004, the Phoenix started a project to sign a personal work agreement with each employee hired for work, specifying their employment terms and ancillary conditions.

Most of the employees receive a 13th salary and some receive a company car. Increases in pay and compensation for workers are derived from the overall compensation policy at the Phoenix, which is determined by the Board of Directors based on the profit each year.

In 2006 development of human capital focused on two main objectives: training and licensing of workers in activities requiring licensing following the Bachar legislation, and improving the professional level of sales managers, service managers and underwriters.

14.12.2 Phoenix Employee Payroll

The following is an outline of Phoenix employees as at December 31, 2006:

Management	6
Customer Division	591
General Insurance Sector	59
Long-term Savings Sector	47
Health Sector	19
Claims	192
Functional staff	399
Subsidiaries	54
Total	**1,367**

The number of Phoenix employees as at December 31 of the years 2004 and 2005 was 1,176 and 1,345, respectively. The increase in the number of employees resulted from an expansion of its call center and increased scope of personnel in the information systems department as an answer to the master plan and regulation requirements

14.12.3 Senior Management Employees and Officeholders

The employment terms of the senior management staff are similar to those of the other employees, but they benefit from various means of compensation, including additional wages and a bonus that are established annually, mainly according to the results of the company's activity. The senior management staff include a CEO, two assistants to the CEO, four senior VPs serving as department managers, seven VPs and four other office holders who are not VPs.

14.13 Investment Management

The Phoenix manages the following investments:

1. General insurance undertakings
2. Guaranteed return life insurance policies
3. Equity and capital surplus investments
4. Profit-sharing life insurance policies
5. Phoenix Pension members
6. Phoenix provident fund members

The Phoenix Board of Directors established internal procedures for investments and their tracking and regulation. The investment decisions are made through a number of investment committees, which are independent of each other. The investment committees determine the investment policy and criteria for examining and controlling implementation of the investment policy, pursuant to the provisions of the Insurance Business (Control) Regulations (Ways of Investing an Insurer's Capital and Reserves and Management of His Obligations) 5761-2001.

Investments are managed through a number of investment managers, with a separation ("Chinese walls") between management of proprietary trading of the Phoenix and management of sums of policyholders and members. This separation is vested in procedures.

Investments are performed alongside insurance undertakings, while maintaining risk dispersal and duration indices in accordance with the investment regulations. Most of the investments against long tail liabilities (life, compulsory vehicle, liabilities) are for terms of up to five years. Investments are mostly index linked. For details on the sums of investments against insurance undertakings in the various sectors of activity, see the assets and liabilities breakdown table in the financial statements of the Phoenix.

Since 2004 the Phoenix has been giving non-banking financing to large financially strong companies in the economy, and has also increased its investment in long-term yielding real estate. The outstanding loans granted by Phoenix (consolidated) as at December 31 of the years 2004-2006, amounted to NIS 831, 1,405 and 1,446 million, respectively. For further details regarding loans see Note 4 to the published Phoenix financial statements.

14.14 Investments

Phoenix possesses investments in real estate, companies and various assets. Phoenix's principal investments include the following: Holdings of 41.42% of the shares of Mehadrin Ltd., a public company in the agricultural sector; 33.3% holdings in ADC Holdings Ltd. (formerly Shagrir Towing Services Ltd.), 33.3% of whose shares are held by Delek Automotive and it is therefore consolidated in the Delek Group financial statements; half the franchise in Mul Hayam Mall in Eilat; and 70% in the rights and liabilities related to a commercial project that is scheduled to be built at the Ramot neighborhood in Jerusalem. For additional details regarding these investments, see Section 6(g)(1) to the financial statements.

Excellence

As detailed in Section 14.1.3., Phoenix holds approximately 40% of the Excellence shares. Excellence Investments is a public company whose shares are traded on the Tel Aviv Stock Exchange Ltd. The company, through the companies it controls, deals in various capital market activities. Its main activities are investment marketing and management for customers, proprietary trading investment activities, investment banking and underwriting, issuing financial instruments, stock exchange and trading services and provident fund management.

1. **Investment management and marketing**: Excellence provides investment marketing services and manages investment portfolios for its customers. Services are provided for private, corporate and institutional customers. Excellence also manages mutual funds in most existing investment channels. Excellence provides its customers with a range of marketing and investment services in foreign currencies in markets in Israel and abroad in option, spot and forward transactions, non-negotiable interest contracts and advanced financial instruments. Excellence also deals with study fund management (see below), provident and compensation funds and pension fund management.
2. **Proprietary trading investment activities**: Excellence invests its equity in two main investment channels: subsidiary and associated companies and short-term investment portfolios (liquid). In this field, Excellence makes proprietary trading investments in securities and financial instruments, future transactions on share indexes, foreign currency exchange rates and interest rates, and real transactions.
3. **Investment banking and underwriting**: Excellence deals with public and private offerings, capital raising, offerings and transactions off the stock exchange, acquisitions and brokerage The group has working relations with the institutional market – pension funds, provident funds, insurance companies and mutual funds. In specific offerings Excellence participates as an underwriter and in others it takes part in managing offerings and serves as a consortium manager.
4. **Issuing financial instruments:** Excellence issues exchange traded funds and deposit certificates listed on the stock exchange through private companies which are not listed and will not be listed for trade.
5. **Issuing structured instruments**: Excellence issues structured marketable debentures ("Harim Series") on the Tel Aviv Stock Exchange. These debentures are issued via private companies which are not listed and will not be listed for trade.
6. **Brokerage services**: Excellence owns a company that is a member of the exchange, through which it provides investment marketing services and brokerage services in foreign markets for local and foreign customers. Excellence also provides research services for customers in Israel and abroad and trust, management and operation services of various benefit plans for managers and employees of private and public companies whose shares are traded in Israel and abroad. The member of the exchange also offers overseas trade by online systems with direct access to customers and operates a trade room for independent customers that are active in the field and for portfolio managers.
7. **Provident funds**: On 6 March 2007, a transaction was completed in which United Mizrahi Bank Ltd. pension funds were acquired by a subsidiary of Excellence, for a total of NIS 343 million. As part of the transaction the parties also signed an operational agreement, distribution agreement and agreement for providing special services.

14.15 Financing

14.15.1 The Phoenix finances its activities through independents, bank credit and non-bank credit. Hereunder a breakdown of the mean interest rates for 2006 for loans not intended for unique use by the Phoenix:

	Average interest rate for 2006 for loans that are not intended for unique use			
	Long-term loans	**Short-term loans**	**Deferred liability**	**Average rate**
Bank sources – index linked	4.9%	-	-	4.9%
Bank sources - unlinked	9.9%	7.7%	-	7.9%
Non-bank sources – index linked	-	-	4.6%(*)	4.6%
Mean rate	4.9%	7.7%	4.6%	4.7%

* Including, inter alia, Deferred promissory notes that were issued in August 2001 to institutional bodies, some of which have been purchased by banks.

14.15.2 Credit Limits

Within the loan agreements, the Phoenix has not been imposed any credit limits.

14.15.3 Credit Received in 2006

In January 2006, the Phoenix issued Deferred promissory notes (series 3) totaling NIS 150 million for institutional investors. The principal will be repaid in 5 equal annual installments, starting July 25, 2009. The interest is paid annually, starting July 25, 2006.

14.15.4 Credit Rating

On March 5, 2006, Maalot Israeli Security Rating Company Ltd. published a rating of AA to the deferred promissory notes (series C) issued by Phoenix Insurance by way of a private placement in July 2005. On March 14, 2007, Maalot announced an AA rating for non-marketable debentures issued by Phoenix, as detailed below.

14.15.5 Raising Additional Resources

On March 22, 2007, Phoenix raised NIS 600 million by private placement of debentures to institutional investors. The principal of the debentures will be repaid in six equal annual installments in each of the years 2014 to 2019 (inclusive). Interest payments at a rate of 4.5% (subsequent to registration of the debentures for trade by Phoenix), will be made once annually. The debentures are linked to the Consumer Price Index (CPI). The placement received an AA rating from Maalot. Phoenix intends to register the debentures fro trade on the stock exchange. Until such registration date, Phoenix will pay the debenture holders additional interest of 0.7%.

14.15.6 Deferred Promissory Notes that Constitute Secondary Capital

The balance of the statements of liability that constitute secondary capital for 31 December 2004 - 2006 is NIS 130.8, 537.6 and 475.2 million, respectively.

14.16 Taxation

See Notes 33 and 38 to the financial statements.

14.17 Restrictions to and Supervision of the Phoenix's Activity

14.17.1 The Supervision Law and its Provisions

The Phoenix and the Phoenix Insurance are subject to the regulations of the Financial Services (Insurance) Supervision Law of 5741-1981 (hereinafter: the "**Supervision Law**" or "**the Law**") and its provisions (hereinafter: the "**Supervision Provisions**"). The Supervision Law and the Supervision Provisions regulate, inter alia, the following issues:

A. Engaging in insurance requires an insurer license that is given by the Insurance Supervisor, which restricts the insurer to the branches of insurance specified in the license.

B. The Minister of Finance is authorized to determine in the regulations relating to the insurer provisions for minimum issued and paid up share capital and minimum surpluses of assets compared to liabilities; types of properties to be held by an insurer against its liabilities and their rates compared to liabilities; ways of possessing assets against the insurer's liabilities; the cases where an insurer is allowed to invest in its subsidiary, controlling shareholder, another insurer or insurance agent; the duty of the insurer to keep insurance reserves and their method of calculation, functioning as an insurer abroad; the minimum and maximum rate of the risk portion to be borne by insurers; loans that the insurer may give and guarantees that it is allowed to use, and their rates.

C. The Minister of Finance is authorized to determine in the regulations, inter alia, instructions concerning the insurance fee rates and other payments that an insurer may collect from policyholders, including maximum and minimum rates; instructions on terms in an insurance contract and their wording; and instructions on insurance policy structure and form.

D. The Minister of Finance is authorized to determine in the regulations the method of composing annual financial statements, submitting them to the Superintendent and publishing them.

E. An insurer is required to maintain a separate accounting system for life insurance businesses, keep separate assets for covering its liabilities in life insurance and conduct separate reinsurance for these businesses.

F. The insurer has a duty to report to the Superintendent on various issues and the Superintendent has authority to demand information from any insurer concerning its business affairs and extensive authority for ensuring the normative management of the insurer

The following main regulations have been established pursuant to the Supervision Law:

A. The Supervision of Insurance Businesses Regulations (Minimum Equity Required of an Insurer) 5758-1998 (hereinafter: "**Minimum Equity Regulation**s") include provisions for initial capital and equity required of an insurer. The capital requirements are established according to the annual financial statements and the interim statements of the insurer. If the equity on the statement date is smaller than required, the insurer is required to increase it or reduce the scope of its business until the date of publishing the financial statement of the insurer. As long as the required equity has not been gathered, as noted, the insurer may not distribute dividends.

B. Insurance Business (Control) Regulations (Ways of Investing an Insurer's Capital and Reserves and Management of His Obligations) 5761-2001 (hereinafter: "**the Ways of Investing Regulations**") and their amendments took effect in April 2001. The Ways of Investing Regulations include instructions, inter alia, relating to loans that an insurer may give; the types of assets that an insurer is to hold against its liabilities; the cases in which an insurer may invest in its subsidiary, its controller, an interested party, another insurer or any other corporation that engages in insurance brokerage; the duty of the insurer to appoint investment committees, the composition of the committees, their function. The regulations include stability-related restrictions and restrictions concerning asset types.

C. The Insurance Business Control Regulations (Methods for Calculating Allocations for Future Claims in Non-Life Insurance (General Insurance) 5745-1984 include provisions, inter alia, concerning the duty of an insurer to keep insurance reserves and their method of calculation and provisions for pending claims.

D. The Insurance Business Control Regulations (Statement Details) of 5758-1998 determine regulations concerning the content, details and accounting principles for composing the annual financial statements and the interim financial statements of an insurer, combined with some of the Securities Regulations. (Preparation of Annual Financial Statements) 5753-1993 and adjusting them to the insurance branch.

E. The Insurance Business Control Regulations (Ways of Separating Accounts and Assets of a Life Insurance Insurer) 5744-1984 determine guidelines concerning the methods of separating the accounts and assets of life insurance businesses from the aggregate of the insurance businesses of an insurer and a separation of the assets of profit sharing life insurance businesses from other life insurance businesses.

14.17.2 Legislation for Applying the Regulations of the Bachar Committee

As specified in section 15.1.4, in July 2005 laws aimed at applying the recommendations of the Bachar Committee were approved. The highlights of the laws are as follows:

A. **The Competition Law:** the definition of long-term saving assets and determining a market share ceiling (15%, about NIS 49 billion); defining the banks as advisors only (pension and investment), temporary prohibition of sale of insurance in banks, during the sale of insurance - with distribution commission only; definition of the advisor's roles (pension/investment) and marketer (pension/investment) and a clear distinction between the two; mandatory licensing for institutional workers; ban on a union of employees or employers to serve as a pension agent; increasing the duties of loyalty of an agent and advisor; increasing supervision of insurers.

B. **The Consulting Law:** distinction between a marketer and advisor and identical licensing duty for both functions; a transaction for pension insurance may be performed only within an advisory or marketing capacity; the duty of suitability of the product for the needs of the customer; a licensee is required to submit to the customer documents that explain the viability of the pension saving in writing, the advisor's recommendation, proper disclosure concerning conflicts of interest, and so on; documentation of advisory and marketing actions; duties of trust and caution of a licensee; duty of written agreement between an advisor and customer; duty of secrecy between a customer and agent; monetary and/or criminal sanctions for violating duties by the licensee.

C. **The Provident Law:** the right of an employee to choose the fund in which his pension saving will be invested; regulating a principle of mobility between provident and compensation funds for the member; instructions on investing the provident fund sums; duty of collecting distribution commissions from the member for pension advice/marketing; extensive supervision duties for the managing companies; civil and criminal sanctions

14.18 Substantial Agreements

Concerning the agreement for purchasing Excellence, see section 14.2.1. Concerning the Memorandum of Understanding with Bank Hapoalim of March 2007 for purchase of holdings in Isracard Ltd. and Europay (Eurocard) Israel Ltd., see Section 14.22 below.

14.19 Legal Proceedings

See Note 38(h)(b) to the financial statements.

14.20 Objectives and Business Strategy

In 2005 the Phoenix examined and formed a business strategy in view of changes in the branch and the environment, with emphasis on changes arising from the Bachar Legislation. The Phoenix's main goals are: customer orientation, development of new distribution channels, an overall view of long-term saving and significant entry into the sector of finance, excellence in service and examination of expansion into markets abroad.

The main steps implemented to reach these goals are as follows:

A. **Customer orientation and development of distribution channels:** There was an overall change in the organizational structure that is intended to lead the group to act on customer orientation rather than product orientation. As part of the change, business sectors were established (elementary, health, long-term saving, finances); a customer division was established that runs the Phoenix's sales and service activities; activities were reinforced through agents for managing the financial arrangements Agam and Kela of which it acquired control in 2005; new distribution channels were established with the banks, and other factors. A claims system was established to coordinate all of the Phoenix's activities on the subject; functional divisions were established (such as information systems, finances and marketing).

B. **General view of long-term savings:** Establishing a long-term saving sector with the aim of making maximum use of the synergy between the different products and constituting a single address for saving and pension security.

C. **Significant entry into the financial sector:** Concentrating the financial activities under one unit; purchasing joint control in the Excellence investment house as part of developing its activity as a business-financial corporation. The Phoenix plans to integrate Excellence's capacities in investments and finances as part of its routine activity, and in 2006 it launched its first joint product line with the Excellence; purchase of the Mizrahi Bank provident fund of by Excellence as part of the long-term saving concept of the Phoenix; establishment of the Phoenix Platinum, which specializes in giving credit to the business sector, and which will offer credit card factoring and clearing services.

D. **Excellence in service:** In the course of 2006, headquarters work started with the aim of examining ways to improve service, before implementation in 2007.

14.21 Risk Factors

14.21.1 Interest rate Fluctuations

The Phoenix owns a linked, shekel and foreign currency debenture portfolio against its insurance liabilities. This may lead to losses resulting from changes in the interest curves in Israel and abroad, which will lead to a decline in debenture prices.

14.21.2 Exchange Rate Fluctuations

Fluctuations in the exchange rates affect the prices of assets quoted in foreign currency in the Phoenix's investment portfolio as well as on its insurance liabilities, including activities with reinsurers.

14.21.3 Decline in Share Prices

The Phoenix is exposed to a decline in share prices in Israel and abroad, because a significant part of its assets placed against the liabilities, especially yield-based assets, is invested in stock markets in Israel and abroad.

14.21.4 Inflation

The Phoenix holds unlinked financial instruments against its liabilities. The value of these may erode as a result of increased inflation. Consequently, a rise in the consumer price index could result in losses.

14.21.5 Credit Risks

Credit risks lie in non-fulfillment of the undertakings of the other side of the transaction as a result of insolvency, or alternately, devaluation of the debt as a result of a decline in the debtor's credit rating. The Phoenix's assets portfolio contain negotiable and non-negotiable debentures that are exposed to devaluation a result of insolvency of the issuers, or alternately, as a result of a decline in their credit rating. Furthermore, the Phoenix gave the loans as part of bilateral credit, mortgages and loans to agents, which are exposed to credit risks. As part of the insurance liabilities, the Phoenix is exposed to losses as a result of insolvency or decrease in the credit rating of the reinsurers.

14.21.6 ALM Risk

An asset liability management (ALM) risk stems from incompatibility between the insurance liabilities and the assets held against them. The incompatibility could be based on currency, timing or a general incompatibility.

14.21.7 Operational Risk

An operational risk stems from failure of internal systems, people (fraud, human error), and external damage to the company (earthquake). As part of its business activity, the Phoenix is exposed to damages as a result of realization of the operational risks. In this context, the Phoenix constructed a disaster recovery plan (DRP), which includes support of the main business processes which need to be operated after the occurrence of an extreme event. The company also started to implement the regulations of the Supervisor that address construction of a process to prevent fraud and embezzlement in the organization.

14.21.8 Political, Security and Economic Instability

Political, security and economic instability may impair the contract work given to the reinsures, which could affect the level of sales and profits of the Phoenix. In addition, deterioration in the economic situation could affect the level of sales in the various products, particularly the scope of life insurance businesses and long term saving.

14.21.9 Insurance Risks

Insurance risks are related to pricing and estimate of insurance liabilities. The main risks factors that could cause mistakes in pricing and liabilities are: model risk, parameter risk, faulty underwriting, cancellations, changes in life expectancy, catastrophic events, changes in mortality and morbidity rates as a result of medical and technological developments, and more. The Phoenix's activities in the different insurance branches expose it to a range of insurance risks as described above.

14.21.10 Legal Precedents and Class Action Lawsuits

Several lawsuits have been filed against Phoenix, including class action lawsuits, of substantial amounts. Should Phoenix be found liable in these legal proceedings, or in any possible future legal action brought against the Company, or legal precedents in court rulings related to insurance matters, may negatively impact the Phoenix’s business results.

14.21.11 Regulation

The insurance companies in Israel are subject to the provisions of the Financial Services Supervision Law (Insurance), 5741-1981, the regulations and orders therein and the instructions published by the Insurance Supervisor. Changes in these affect the financial reporting and its business activity.

14.21.12 Mobility of Pension Savings

In the course of the last year, the treasury published a number of drafts related to transferring funds in long-term savings. This reform, if and when it comes into effect, will allow consumers unlimited migration different products and bodies. The reform will create a platform for many business opportunities in the field of long-term saving, however it also contains business risks and liquidity risks for the insurance companies.

14.21.13 Information Security

Physical damage to the computers of the Phoenix may cause substantial damage to the company. Consequently, in 2006 the company appointed an information security manager, who works to implement the regulatory instructions on the subject and provide a business solution for the Phoenix. Today the Phoenix's computer network is protected by different and diverse means, such as firewall and anti-virus software and authorized access to the different information systems. The Phoenix has also started information security of the different information systems. The Phoenix has an active backup site for recovery after computer crash.

	Effect of risks factor on the Phoenix business affairs		
	Significant impact	**Medium impact**	**Minor impact**
Macro-level risks	• Fluctuations in share prices • Political and security instability	• Interest rate fluctuations • Exchange rate fluctuations • Inflation • Economic instability (such as unemployment and wages)	
Industry-wide risks	• Catastrophe	• Regulation • Changes in morbidity and mortality rates • Changes in frequency of accidents and car thefts • Rise in health inflation • Legal precedents and class action	• Increased competition in the sector
Risks specific to the Phoenix	• Model risk • Parameter risk • Credit risk (creditors and reinsurers)	• Increased rate of cancellations • Faulty underwriting • Operational risks • Information security	

The impact level of these risk factors on the Phoenix's activities is based on an estimate only and the actual impact level may be different.

14.22 Holdings in Menora

As specified in Section 14.1 above, Delek Investments purchased 15% of the share capital of Menora, and was required by the Antitrust Commissioner to sell part of its holdings. Consequently, in January and February 2007, Delek Investments sold most of its holdings in Menora, and as of this date it holds about 2.2% of its shares. The aggregate profits (before taxes) for sales of the holdings in Menora totaled NIS 142 million.

Menora is a public company traded on the Tel Aviv Stock Exchange. Menora engages in life insurance, comprehensive vehicle insurance, compulsory vehicle insurance, property insurance, liability insurance, health insurance, pension funds and provident funds. In the last quarter of 2004, Menora purchased, inter alia, Mivtachim Pension Funds Ltd.

14.23 Forecast for Developments in the Coming Year

On 9 March 2007, the Phoenix signed a Memorandum of Understanding with Bank Hapoalim Ltd. (hereinafter: "**Bank Hapoalim**"). Pursuant to the MOU, the Phoenix will purchase 25% of the issued share capital of Isracard Ltd. and Europay (Eurocard) Israel Ltd (hereinafter: "**the Companies**"), which are fully owned by Bank Hapoalim, and will be entitled to appoint directors, as agreed in the MOU.

Consideration for the shares will be calculated on the basis of an aggregate value of NIS 2.55 million, adjusted to any dividend distributed before completion of the transaction. In the event of public issue within 15 months, the basis of the Companies' aggregate value will be adjusted upwards for the transaction, to 90% of the Companies' value for the public offering, but will not exceed their aggregate value of NIS 2.7 billion.

The transaction is subject – inter alia – to due diligence examination, determining purchase conditions (including the Phoenix's agreement to arrangements between Isracard Ltd. and Bank Hapoalim), regulatory permits as required, approval of the Bank Hapoalim management and Board of Directors and the Phoenix Board of Directors. The Bank Hapoalim Board of Directors ratified the engagement on March 20, 2007.

15. The US Insurance Market

On August 4, 2006, Delek Finance US, Inc. – a US corporation wholly owned by Delek Capital (hereinafter: "The Subsidiary") – entered into a merger agreement to acquire the entire share capital (100%) of Republic Companies Group Inc. (Hereinafter: "RCGI"). Upon fulfillment of all contingencies, the acquisition transaction was finalized on December 7, 2006.

The proceeds for each RCGI share was $20.40 and the total consideration, excluding transaction costs, amounted to $298 million (NIS 1,249 million). The consideration was paid upon closing the transaction.

Republic Group has been in business under this name in the US insurance market since the early 20th century. RCGI was established in 2002, and in 2003 it acquired and centrally managed various of the Group's insurance operations. In August 2005, RCGI conducted an IPO of its shares to the public. Its shares were listed on NASDAQ until their delisting on December 7, 2006, following the acquisition of RCGI by Delek Capital.

In 2007, subsequent to the closing of the transaction, RCGI was merged into the Subsidiary of Delek Capital and Republic Companies, Inc. (Hereinafter: "Republic").

15.1 General Information on the Sector of Operations

15.1.1 Structure of Sector of Operations

Republic is an insurance holding company, incorporated in the State of Delaware; its major activity is conducted via multiple subsidiaries in the property, auto and liability insurance market for individuals and businesses (small to medium-sized enterprises - SMEs), primarily in the states of Texas, Louisiana, Oklahoma and New Mexico.

Unless otherwise stated – in this chapter, the term "Republic Group" or "The Group" shall describe Republic, its subsidiaries and affiliates.

The Republic Group analyzes its operations by its four distribution channels:

A. **Personal Lines** - Insurance agents or brokers selling Republic insurance policies to individual customers (hereinafter: "**Personal Lines**").

B. **Commercial Lines** - Insurance agents or brokers selling Republic insurance policies to owners of small to medium-sized enterprises (hereinafter: "**Commercial Lines**").

C. **Program Management** - Managing General Agents (or MGAs) offering, in addition to standard Republic Group products, other insurance products intended for specific sectors and niches which are generally inappropriate for the risk profile of standard insurers / policies (hereinafter: "**MGAs**"). Unlike the operation of agents in personal and commercial lines – that is primarily of a marketing nature – MGAs issue policies on their own under the Republic name, or the names of its various insurance subsidiaries and affiliates while exercising discretion over policy terms and prices. They also handle the insurance claims. Republic determines guidelines for the operation of MGAs and covers the outcome of the insurance.

D. **Insurance Services** - Provision of insurance services to insurance companies (hereinafter: "**Insurance Services**") - Cooperation with insurance companies not affiliated with Republic Group by means of granting rights to use Republic Group's licenses and charters in regions where it is licensed in exchange for a fronting fee, subject to signing reinsurance contracts with said companies. Republic Group is liable for insurance payments to policyholders, but it is fully backed by reinsurance with said insurance companies. This segment also includes other corporate and holding company activities.

Property and liability insurance provides protection from pre-defined events, such as damage to property or claims by 3rd parties. A distinction can be made between selling property and liability insurance to personal lines, i.e. insurance for individuals, and selling property and liability insurance to commercial lines, i.e. insurance for businesses. Republic Group is active in both areas. Furthermore, a distinction can be made between the admitted market and the non-admitted market. In the admitted market, insurance policies and rates are generally highly regulated and insurance coverage tends to be standardized. In this market, Republic Group focuses on less competitive segments, which are less covered by major insurance companies due to factors such as business

type, location or level of premium per policy. The Republic Group personal and commercial lines operate primarily in these market segments. The non-admitted market is focused on risks whose probabilities are harder to estimate, which are insured via more flexible policies and rates. The insurance coverage in this market is typically larger. Republic Group operates in this market via MGAs and Insurance Services.

For further details on Republic Group sectors of operation, see section 15.2 below.

Below are financial data for the major sectors of operation of Republic Group (US$ in millions):

For the year ended December 31, 2006:

	Gross Written Premium	Net Insurance Premium Earned	Investment Result	Other	Total	Income Before Taxes	Net Income
Personal Lines	169.3	134.2	5.6	1.6	141.4	16.6	10.3
Commercial Lines	99.1	76.4	4.9	0.2	81.5	5.5	3.4
MGAs	263	69.8	4.1	2.3	76.2	12.7	7.6
Insurance Services	172.2	0	0.6	2.9	3.5	0.1	1.8
Consolidated	603.6	280.4	15.2	7	302.6	34.9	23.1

For the year ended December 31, 2005:

	Gross Written Premium	Net Insurance Premium Earned	Investment Result	Other	Total	Income Before Taxes	Net Income
Personal Lines	140.9	125.7	4.6	2.7	132	19.4	12.3
Commercial Lines	82.8	66.7	3.9	0.2	70.8	2.6	1.7
MGAs	133.5	45.7	2.5	2.3	50.5	7.1	4.5
Insurance Services	140.8	0	0.4	2.1	2.5	0.1	4.2
Consolidated	498	238.1	11.4	6.3	255.8	29.2	22.7

For the year ended December 31, 2004:

	Gross Written Premium	Net Insurance Premium Earned	Investment Result	Other	Total	Income Before Taxes	Net Income
Personal Lines	132.9	124.5	4.4	1.9	130.8	19.9	12.1
Commercial Lines	70.5	51.7	2.8	0.2	54.7	(3.1)	(1.9)
MGAs	146.4	45.1	1.9	2.5	49.5	12.1	7.4
Insurance Services	116	0	0.3	2	2.3	2	4.3
Consolidated	465.8	221.3	9.4	6.6	237.3	30.9	21.9

Assets allocated to different segments as at December 31 of the years 2004-2006 (US$ in millions):

	2006	2005	2004
Personal Lines	221.9	258.3	214.4
Commercial Lines	156.1	167.5	139.2
MGAs	234.7	205.7	184.2
Insurance Services	364.3	220.2	193.8
Consolidated	977	851.7	731.6

15.1.2 Legal Restrictions, Standards, and Special Limitations

A. Regulations that apply to Republic Group by virtue of its holdings in insurance companies and insurance agencies: Republic Group is the parent company of multiple active insurance companies and agencies, and is therefore subject to the state laws where these companies are incorporated, primarily Texas, Oklahoma and Arizona. Generally, legislation in these states requires registration with the State Department of Insurance and reporting of group company activities. Furthermore, material transactions between Group companies, including reinsurance and service contracts, are required to be fair and reasonable; and in the case of material transactions or transactions within certain categories – they also require advanced notice and approval by the local Department of Insurance.

B. Change of ownership: Insurance companies are subject to regulations restricting purchase or transfer of control in such companies. A potential buyer seeking to acquire control of an insurance company or an insurance agency requires prior written approval from the Department of Insurance of the state where the insurance company / agency to be acquired is incorporated. When granting approval, consideration is given to factors such as the financial robustness of the applicant, its plans etc. In view of the above, Republic Group is not free to sell and/or transfer control of the companies it holds without obtaining proper authorization, neither can a change be made to control of Republic itself without obtaining proper authorization.

C. The National Association of Insurance Commissioners (NAIC): An organization composed of insurance commissioners from the various states, aimed at discussing and setting policy with regard to regulation, reporting and accounting by insurance companies. NAIC has no legislative authority, but it is influential in determining the insurance laws of different states. NAIC has published recommendations for laws and regulations representing appropriate minimal standards for insurance regulation. Most states have adopted these recommendations in their state legislation, including among others the NAIC rules for minimal equity, in relation to their investments and activity. Following the Sarbanes-Oxley Act of 2002, NAIC has been actively publishing recommendations for additional standards to be adopted by insurance companies, such as transparency in corporate management, independence of auditing CPAs and in particular, implementation of some of the provisions of Section 404 of the Sarbanes-Oxley Act regarding internal control over financial reporting.

D. Changes to legislation and regulation: Changes to legislation and regulation are proposed from time to time, which may impact the insurance industry. Among others, a proposed Insurance Act at the federal level, in addition to existing state laws, is being discussed as well as proposals to subject parts of state legislation to NAIC rules. It is impossible to anticipate whether these proposals will be accepted, what their content would be and what their impact on Republic Group activities would be.

E. Restrictions on policy terms: In 2002, in response to retraction in certain insurance and reinsurance markets due to the terror attack on the Twin Towers, the Terrorism Risk Insurance Act (TRIA) was enacted. The act created a federal assistance program aimed at assisting the commercial insurance industry in covering claims arising from future terrorism-related losses, and it requires insurance companies to offer insurance coverage for damages and losses arising from certain acts of terrorism. As a result of this act, the company may not exclude or preclude certain damages arising from acts of terrorism in insurance policies. The TRIA was extended through 2007, with certain amendments. Future federal or state legislation related to terrorism insurance or reinsurance may negatively impact Republic Group's income or financial position.

F. Regulation at state level: Insurance commissioners in US states have extensive authority to audit and supervise insurance company activities. The primary objective of such supervision is to protect policyholders. The scope of regulation varies by state, and may include, for example, business licensing, approval of reinsurers, supervision of fair trade, approval of policies and rates, etc. In addition, the regulation mandates submitting financial statements as per accounting principles and requirements of the Departments of Insurance, and review of such statements by the departments. As part of their extensive authority, insurance commissioners may set temporary guidelines regarding local issues or events. For example, in the aftermath of Hurricane Katrina, the state of Louisiana prohibited cancellation of insurance policies for a certain time period, due to non-payment of premiums by policyholders.

G. Periodic reviews by State Departments of Insurance: The state Departments of Insurance may periodically conduct reviews of various issues, such as reviews of an insurance company's financial status, or its activity and transactions with affiliated entities.

H. Statutory Accounting Principles (SAP): SAP are regulatory accounting standards intended to assist insurance commissioners in supervising the solvency of insurance companies. As opposed to GAAP rules, the SAP rules focus on valuation of insurance company assets and liabilities as per the applicable insurance legislation. The SAP rules, adopted in part by insurance commissioners in the states of Texas, Oklahoma and Arizona, determine, inter alia, the retained earnings at group companies and therefore impact the dividend distribution they are allowed to make.

I. Restrictions on dividend distribution: In the states of Texas and Oklahoma, Department of Insurance approval is required for dividend distribution if the dividend, together with all dividends declared or distributed in the preceding 12 months, exceeds the greater of: (1) 10% of regulatory capital, or policyholders' surplus (which is the SAP equivalent of GAAP stockholders' equity) as of December 31 of the preceding year, or (2) 100% of the earnings for the calendar year preceding the year in which the dividend distribution is being determined. In the state of Arizona, Department of Insurance approval is required for dividend distribution if the dividend, together with all dividends declared or paid in the preceding 12 months, exceeds the lesser of: (1) 10% of regulatory capital as of December 31 of the year preceding the dividend distribution, or (2) 100% of net investment income for said calendar year. Furthermore, all subsidiaries and affiliated companies in the group may only distribute dividends out of their retained earnings. Note that contractual restrictions are also in place prohibiting group companies from distributing dividends in case they are in breach of terms of debentures or loan contracts.

J. Guaranty Associations: In Texas, Oklahoma, Arizona and in other states, there is a requirement that property and liability insurers participate in guaranty associations intended to make payments to policyholders on account of liabilities of insurance companies in default.

K. Participation in involuntary risk plans: Similar to guaranty associations, Republic Group is required to participate in involuntary insurance plans for individuals or entities which otherwise would be unable to afford insurance, and to set aside funds for such plans.

15.1.3 Changes to Volume of Operations in Sector and its Profitability

The property and casualty insurance business is cyclical in terms of the fluctuations of both prices and availability of insurance coverage. Markets with surplus insurance capital may experience fierce price competition, provision of overly-extensive insurance coverage, erosion of insurance discipline and declining operating results. Such market conditions would typically lead to a period of reduced coverage, subsequent to insurance companies exiting or reducing their activity in product lines where competition is too fierce and profits are too low. Insurance companies would then assume greater insurance discipline, while increasing premiums and issuing insurance policies with more restrictive terms. The insurance market in general does not necessarily behave in this or any other specific manner, and sometimes a certain segment may ebb while another segment peaks. The Group strives to minimize the cyclical impact described above by expanding its operations into geographical and demographic segments where competition is weak and where there is a lower supply of insurance services and products.

Beginning in 2001, the insurance market in Texas, where most of the Republic Group's operations take place, was hard hit by property damage related to mold. In 2001 and 2002, insurance companies reported relatively weak results and became more cautious in their insurance offerings. These factors led to an increase in insurance premiums, to selectiveness in the risks insured and to rigidity in policy terms. Following these actions, the Texas Department of Insurance ordered insurance companies to reduce insurance rates for homeowners in 2003 by an average of 12.5%. In 2004 and 2005, the property insurance market was significantly impacted by hurricane damage, including Hurricanes Katrina and Rita which impacted Republic Group's areas of operations (see more on this in section 15.19, below).

In 2000-2002, Republic Group's profit margins were eroded due to water and mold damage. Beginning in 2003 Republic Group returned to profitability as a result of several initiatives including a redesign of the personal product line, the re-underwriting of the entire commercial lines book of business and a focus on semi-urban markets, rural areas and small to medium-sized metropolitan markets.

15.1.4 Developments in Markets within the Sector of Operations

The most material development of recent years was the occurrence of Hurricanes Katrina and Rita in 2005. Hurricanes Katrina and Rita significantly impacted Republic's areas of operation. The estimated losses arising from these hurricanes total $50 million and $48 million respectively. Nevertheless, Republic Group's reinsurance program provided most of the coverage for these losses, so the group's net losses amounted to only $5M for these two hurricanes. Additional reinsurance capacity remains in the event of further development of the said hurricane losses.

Despite the severe damages incurred by company policyholders and agents in Hurricane-afflicted areas of Louisiana and Texas, Republic Group continues to operate in these areas while updating and adjusting pricing, diversifying risk and maintaining appropriate reinsurance.

15.1.5 Critical Success Factors in the Sector of Operations and Changes Therein

A. The insurance market is highly competitive and regulated, segmented into multiple insurance segments and different insurance populations. Republic Group regards the following as critical success factors in its sector of operations:

B. **Know-how and experience** – Operating an insurance business requires, among others, extensive familiarity and ties with different entities operating in the area, including MGAs and independent insurance agents, a solid reputation with policyholders and a familiarity with the market conditions. In view of the above, know-how and experience in the sector of operations are a critical success factor, and Republic Group relies on many years of know-how and experience in its areas of operation.

C. **Focus on less competitive insurance segments** – In view of the competition in the insurance market, including with major insurance companies who possess far greater resources than Republic Group, a focus on under-served insurance markets that have been neglected or ignored by larger companies and where Republic's local knowledge allows Republic Group to compete more effectively against its larger competitors.

D. **Reducing operations in competitive segments** – Reducing operations in segments or products where other, stronger insurers are active (e.g., auto insurance), and expanding operations in segments where the company enjoys a competitive advantage (e.g. homeowners).

15.1.6 Major Barriers to Entry and Exit in the Sector of Operations and Changes Therein

The major barriers to entry are the various licensing requirements, including minimum equity, the need to set up marketing operations or to contract with insurance agents, as well as reputation. The major barriers to exit are long term commitments to policyholders, commitments to insurance agents and companies receiving insurance services from the company, and the approval of different states' Departments of Insurance for transfer of control in insurance companies and for withdrawal from certain produce lines or geographic areas (e.g., state Insurance Departments my attempt to limit a company's decision to stop writing wind coverage in coastal areas).

15.1.7 Substitutes for Products in the Sector of Operations and Changes Therein

Substitutes for Republic Group products include primarily similar products from other insurance companies. The major differences between insurance products from different companies generally involve the coverage and premium.

15.1.8 Competitive Structure in Sector of Operations and Changes Therein

Republic Group competes with many companies with its product lines. The Personal Lines market in Texas is dominated by a few large insurance companies (including their subsidiaries and affiliates), including State Farm, Allstate, Farmers and USAA. Republic Group competes, among others, with the following companies: St. Paul Travelers Companies Inc., The Hartford Financial Services Group Inc., and Safeco Corporation .In the Commercial Lines market, Republic Group competes, among others, with the above companies and with Central Mutual Insurance Company. In the MGAs market, Republic Group has two direct competitors: United America Indemnity Group and Clarendon Insurance Group .In the Insurance Services market there are multiple competitors, including: State National Companies, Old American County Mutual Fire Insurance Company, Consumers County Mutual Insurance Company and Home State County Mutual Insurance Company .Republic generally has a market share in Texas of approximately 1%.

The competition is based on pricing, offered coverage, customer service, agent relations (including ease of doing business for agents, service provided to agents and commission rates paid to them), size and financial robustness. Republic Group wishes to differentiate itself from its competitors by providing a wide product range and by focusing on markets where competition is relatively weaker. Republic Group also competes in its sector of operations by fostering good, long-term relations with insurance agents and MGAs, know-how and experience in areas where it operates and its reputation with policyholders. Republic Group also offers flexibility in its operations due to its unique combination of charters and licenses, which include a wide range of insurance operations.

15.2 Products and Services

Republic Group has four major insurance segments:

15.2.1 Personal Lines:

In this segment Republic Group sells insurance policies to individuals via independent insurance agents along with two affiliated managing general agents (MGAs). Insurance policies include homeowners insurance, fire insurance, low-value dwelling insurance, standard and nonstandard auto insurance and personal umbrella insurance. Policyholders are located in the states of Texas, Oklahoma, Louisiana and New Mexico, and Republic Group focuses primarily on geographic and demographic areas where competition is relatively smaller.

A. Property insurance and private dwellings: Insurance against multiple perils, including damage to the home, to household possessions inside it, to garages and other buildings located on the property; dwelling fire insurance against damage due to fire, lightning, windstorm or hail, collapse of buildings and damages arising from water- or electricity-related accidents; the company's low-value dwelling insurance typically provides more limited coverage, up to $150,000.

B. Standard auto insurance: Standard auto insurance policies insure against bodily injury and physical damage to the vehicle. Maximum coverage is limited to $500,000 per occurrence, but the average overall policy coverage is less than $100,000. This insurance is primarily marketed to policyholders who purchase other coverage from the company, such as property and dwelling insurance.

C. Nonstandard auto insurance: Nonstandard auto insurance policies insure against bodily injury and physical damage to vehicles whose owners are drivers whose driving record makes it difficult for them to purchase standard auto insurance policies, and are therefore required to pay higher than normal premiums. Maximum coverage is limited to $500,000 per occurrence, but most nonstandard risks amount to $50,000 or less.

D. Personal umbrella insurance: Umbrella insurance policies provide additional insurance coverage beyond the limits of their auto or homeowners insurance. This insurance is generally limited to $3 million per policy and all risks are substantially ceded to reinsurers.

15.2.2 Commercial Lines:

In this segment, Republic sells insurance policies for small to medium-sized enterprises through independent insurance agencies and an unaffiliated MGA for farm and ranch business. Insurance policies include auto insurance, worker’s compensation insurance, property insurance (real estate), general liability and umbrella insurance and farm and ranch insurance. Republic Group tries to focus on markets where competition between insurance companies is relatively limited, such as garages, family restaurants, light industry and artisan contractors.

A. Property insurance: Insured properties are limited to a maximum property value of $20 million, and insurance is not available for properties that are residential risks, such as apartments and hotels.

B. General liability insurance: Commercial liability insurance provides third-party liability coverage for business losses, including bodily injury, medical payments and fire damage liability. The policy limit is $1 million per occurrence.

C. Commercial package: The commercial package insurance is a combination of commercial property and liability policies.

D. Auto insurance: Commercial auto insurance policies insure against bodily injury and physical damage to vehicle, and may be expanded to include coverage for medical payments, rental car etc. The policy limit is $1 million per occurrence.

E. Workers' compensation insurance: This insurance provides employees coverage in order to meet statutory workers' compensation benefits for workers who are injured on the job.

F. Umbrella insurance: Commercial umbrella insurance provides additional liability insurance for businesses beyond the limits of their general liability coverage. Umbrella limits are up to $5 million and are substantially all ceded to reinsurers.

G. Farm and ranch insurance: These policies are designed to insure the special needs of farm and ranch owners, and provide coverage for dwellings, farm structures, equipment and liability. In addition to Republic Group's normal sector of operations, these policies are marketed in additional states, including Arkansas, Kansas, Missouri, Montana and Nebraska.

15.2.3 MGAs (Program Management)

In this segment, unlike insurance business distributed through independent agents, in the MGAs segment Republic Group markets personal and commercial insurance policies through contractual programs established with unaffiliated MGAs. The MGAs are authorized to offer policies that they write themselves, subject to certain guidelines mandated by the group, and these policies are binding upon the group. Republic Group uses the term "program" to describe an agreement with an MGA by which the group provides the MGA with an insurance product that is customized for a distinct customer segment that generally does not meet the risk profile of standard insurers. Republic Group requires MGAs to sell the policies according to guidelines specified by Republic Group. MGAs provide policyholders with all the services provided by a typical insurance company, including underwriting, billing and claim administration, but they are prohibited by statute from issuing their own policies.

A. Features of contracting with MGAs: MGAs issue the insurance policies on behalf of Republic, and Republic therefore is liable for the insurance risk. Alternatively, Republic may cede a portion to reinsurers. In both cases, the company is directly liable to policyholders. In addition to bearing all or a portion of the insurance outcome of each program, Republic may receive a fronting fee from program reinsurers. The commission to the MGAs is based on the profitability of the programs. Relations with MGAs are based on years of experience and familiarity with products, markets and how the programs are marketed. MGA agreements are typically for a one year term and are automatically renewed unless one of the parties has chosen to terminate them with 90-180 days' advance notice. Republic utilizes various control mechanisms to supervise MGA activity: it receives monthly reports from MGAs and conducts, at minimum, semi-annual audits of each program to assess their compliance with underwriting guidelines provided.

B. Insurance products: Insurance policies sold via MGAs include commercial auto insurance, light commercial liability (for small businesses), prize indemnification (non-payment of any prize sum awarded to a participant in a contest or sports related event), lender's collateral protection and employer's non-subscriber insurance.

15.2.4 Insurance Services and Corporate

In this segment Republic Group provides insurance services to national and regional insurers who wish to utilize the company's charters and licenses to access insurance markets in Texas and other states. According to contracts with the insurers, Republic underwrites risks that are entirely ceded to the carriers in exchange for a fronting fee. That is, the company does not bear the risk involved with insurance policies as long as the insurers meet their obligations towards the company, and in effect you might say that the company has full reinsurance. However the company is directly liable to policyholders. Most of the insurance policies sold under these contracts are auto insurance policies (personal and commercial). The company limits its contracts to insurers rated A- or better by A.M. Best rating company. In the results for this segment, Republic Group includes interest expenses for its debt as well as other unallocated income or expense and equity in the earnings of an unconsolidated 30% owned Mexican insurance company (see section 15.11 below).

15.3 Customers

Personal lines: Policyholders are private individuals.

Commercial lines: Policyholders are small to medium commercial enterprises and businesses, typically in service sectors such as garages, family restaurants, light industry and artisan contractors.

MGAs: Policies are marketed by unaffiliated MGAs. Policyholders include private individuals and businesses.

Insurance Services: Insurance policies are marketed by unaffiliated insurers rated A- or better by A.M. Best rating company, on behalf of Republic Group. Policyholders include private individuals and businesses.

More than 80% of Republic's insurance policies are issued in Texas. Most of the customers reside in rural areas, in relatively small towns with a population of no more than 100,000.

15.4 Marketing and Distribution

Personal lines and commercial lines: Republic's standard insurance products are marketed via an extensive network of independent agents, two unaffiliated MGAs, and one affiliated MGA that insures farms and ranches. Most of the marketing in personal lines and commercial lines is made by independent agents. The agents have no discretion as to the policy terms, and they offer the policies provided them by Republic. Republic prefers to maintain long-term relations with insurance agents, and more than half of the agents have been affiliated with Republic for 10 years or more. Republic Group has a network of over 1,000 independent agents in the personal and commercial lines.

Republic Group's strategy is one of focused marketing to segments where competition in the insurance market is relatively weak - mostly segments that cannot afford the premiums of other insurers and segments with rural or small to medium-sized metropolitan markets, that other insurance companies are not willing to develop and/or do not recognize as revenue potential. Furthermore, the company tries to market its range of products to policyholders who already own one or more of its products.

MGAs and insurance services: The MGA business is conducted by five unaffiliated MGAs and Insurance Services business comes from approximately ten unaffiliated insurers and other producers.

In the period 2004-2007 the group had no single independent agent responsible for over 1.5% of its total premiums. One long-standing MGA relationship accounts for 21.5%, 23.4% and 24.4% of gross written premium and 19.2%, 13.2% and 7.2% of net insurance premiums earned in 2006, 2005 and 2004, respectively. Additionally, one program in the Insurance Services segment accounts for 15.5%, 12.6% and 8.1% of gross written premium in 2006, 2005 and 2004, respectively. However, since this program is 100% ceded, there is no net insurance premium earned.

The product development and marketing strategy at Republic Group is based on dialog and constant consultation with agents and insurance agencies, MGAs and insurers who market the company's products in different segments. This strategy allows the company to learn from the agents about market needs and to issue policies that cover risks not covered by the competition.

15.5 Seasonality

The risks insured by the group typically result in higher losses in the 2nd and 3rd quarters of the year, due to seasonal concentration of insurance occurrences as a result of bad weather in the geography where the group operates. Even though losses due to weather events (hail, windstorms, tornadoes, hurricanes) may occur in any quarter, historically the 2nd quarter has the highest frequency of such weather events. Over the past 5 years, the contribution of weather catastrophes to the net loss ratio[107] in the 2nd quarter was higher by about 8% than their average contribution for the remaining three quarters .Whereas all product lines reflect seasonal losses, the Personal Lines segment is most significantly impacted by this seasonality, and the contribution of weather catastrophes to its net loss ratio in the 2nd quarter is higher by 13% compared to the average contribution in the remaining three quarters.

The company acquires reinsurance to protect itself against the high frequency and severity of insurance occurrences related to the weather.

15.6 Reinsurance

Republic acquires reinsurance in order to reduce its exposure to insurance risk. Republic's reinsurers have an effect on the insurance capacity, insurance terms and rates as well as on

[107] Net loss ratio – is the ratio between losses plus loss adjustment expensed (LAE) and net premiums

profitability. Reinsurance does not exempt Republic from its liability to policyholders according to the insurance policies; it only gives Republic the right to demand that its reinsurers reimburse it for its losses, and therefore the robustness of the reinsurers may impact the business results of insurance companies. As for the importance of reinsurers' impact on Republic operations, see Section 15.19 which describes the reliance on them with regard to damage caused by hurricanes impacting the US in 2005.

Republic Group selects its reinsurers based on their financial robustness, history of operations and payments as well as on their overall reputation. The Group contracts with a large number of reinsurers in order to reduce the risk involved with failure of any reinsurer to meet their obligations. The company only contracts with reinsurers rated A- (Excellent) or better by rating company A.M. Best. If a reinsurer's rating drops below A-, Republic will replace the reinsurer or require external collateral, such as a bank guarantee.

Below are summarized data about reinsurance by different segments ($ in millions):

Segment	Personal Lines			Commercial Lines			MGAs			Insurance Services		
	2006	2005	2004	2006	2005	2004	2006	2005	2004	2006	2005	2004
Gross Written Premium	169.3	140.9	132.9	99.1	82.8	70.5	163.1	133.5	70.5	172.3	140.8	116
Reinsurance Premium	15.3	12.3	6.9	14.4	12	10.8	80.4	76	100.4	172.3	140.8	116
Share (%) covered by reinsurance	9	8.7	5.2	14.5	14.5	15.3	49.9	56.5	68	100	100	100

15.7 Actuaries

Republic Group's liabilities include liabilities for reported losses, liabilities for losses incurred but not reported (IBNR) and liabilities for Loss Adjustment Expenses (LAE) which are intended to cover the final cost of settling claims, including investigation of insurance claims and legal defense against such claims. The extent of liabilities for reported claims is based on estimated damage for such claims. The extent of liabilities for losses incurred but not reported and for loss adjustment expenses is estimated based on historical trends of damage costs, terms of the policies and other factors. The process of estimating liabilities for losses incurred but not reported and loss adjustment expenses is an imprecise science and requires significant judgment and is influenced by many factors subject to significant fluctuation.

The Group uses actuarial models to determine its liabilities. Republic Group employs six actuaries with, on average, over 16 years of actuarial experience in different insurance segments.

15.8 Fixed Assets and Facilities

Republic Group is headquartered in Dallas, Texas where the group leases a 6-story office building (with a total area of 10,500 square meters); all company operations associated with administration, finance, underwriting, claim processing, IT etc. are conducted from this location. The lease runs through February 28, 2017 and it may optionally be extended for another 5 years. The leasing fees are immaterial. In addition, the group leases an office serving employees of its subsidiary, RHP in Houston, Texas.

Republic Group uses several information systems. Among others, the group uses the RepubLink system intended for agents, enabling them to submit policies for approval by the company for Personal Lines products and providing information regarding policies, such as rates and other terms. The system allows the group to collect and obtain data about policyholders, such as claim history and collection. As at the current date, the Republic Group is in final stages of completing information systems for the Commercial Lines products and for ranch and farm insurance policies. Information technology is currently a major expense and will be a major expense in future periods as the Company attempts to utilize technology to provide customer service and remain competitive in its respective segments.

15.9 Intangible Assets

Republic's intangible assets include trademarks as well as licenses and franchises to operate as an insurance company in the various states.

15.10 Human Resources

Organizational Structure

15.10.1 Republic employee payroll – As at the prospectus date, Republic has 321 employees divided in the following areas:

Department	No. of Employees
Accounting/Finance/Treasury/Billing	39
Claims	70
Commercial Lines	69
Corporate Services	17
Corporate Underwriting and Actuarial	12
Executive/Legal/Human Resources	15
Information Technology	47
Marketing	12
Personal Lines	34
MGAs/Insurance Services	6
Total	321

Republic Group has no employer-employee relations with agents marketing the company's insurance products.

15.10.2 Senior management and officers

Republic employs 27 officers, of which 12 are senior executives.

15.10.3 Compensation plans

Republic possesses employment agreements with certain key executives. Otherwise, all employees are at-will employees. Republic provides employee health and life insurance, defined compensation benefit plans (i.e., 401k savings plan), profit sharing and other customary benefit plans to its employees. The Company has two defined benefit pension plans that were frozen effective December 31, 2003.

In December 2006, several senior managers at Republic were granted options that may be converted into Republic shares over a period of five years, in consideration of an exercise price that varies over the period of vesting, as stipulated in the terms of the options. A plan for the allocation of blocked shares was also adopted (representing 1.15% of the Republic share capital). These shares will be unblocked in two tranches over a period of four years, at a quantity that will be set according to variables associated with the company's results. The senior employees were granted the option to sell the shares to Republic subsequent to the various lockup periods, as stipulated in the option terms – as long as Republic remains a privately-held company. As at December 31, 2006, the fair value of the blocked shares and the options amounted to $4 million. In the event that all the option warrants are exercised and the all the blocked shares granted to the Republic executives are liberated, the Delek Group's holding rate in Republic is expected to decrease to 97%.

15.11 Investments

Republic invests conservatively in securities such as government debentures, US state bonds, corporate bonds and mortgage-backed bonds. Republic's investments in fixed income instruments, which form the majority of its investment portfolio, are managed by investment management company, BlackRock Financial Management Inc. (which manages assets totaling in excess of $1 trillion).

BlackRock has the authority and discretion to buy and sell securities on behalf of Republic, subject to guidelines provided by Republic's Investment Committee. Total investments by Republic Group as of December 31 of 2004, 2005 and 2006 totaled approximately $349, $404 and $433 million, respectively.

In addition, Republic holds a 30% share in Mexican insurance company Seguros Atlas S.A. (hereinafter: "**Atlas**"). Atlas is an insurance company doing business in life, health, property and liability insurance. The investment in Atlas was made in 1994; Republic has the right to appoint 4 of 15 directors on Atlas' board, but has no involvement in managing its current business. As at December 31, 2006, the outstanding investment in Atlas amounted to $26.5 million.

15.12 Financing

15.12.1 Republic has the Following Debt Arrangements (in millions):

	Sum ($ millions)	Interest Rate
Senior bank debt	50	7.35%
Debentures	51.5	8.162%
	101.5	7.762%

All of Republic's debt is long-term debt.

15.12.2 Credit Limits

The bank debt includes certain financial covenants including: Minimum consolidated shareholders' equity for Republic of $200 million, according to US GAAP; Maintenance of statutory equity greater than $150 million at Republic Underwriters Insurance Company (RUIC) (Republic's lead insurance subsidiary). The credit agreement includes additional directives limiting the creation of certain debts or liens, limitations on the issue of shares and the merger of certain assets.

15.12.3 Credit Facilities

Following are details of Republic's credit facilities as of December 31, 2006 (in millions):

	Amount ($ millions)	Effective Interest Rate at December 31, 2006	Basis for determining Interest Rate	Maturity
Senior bank debt	50	7.35%	1, 3 or 6 month LIBOR + 2% or US federal funds rate plus .50%	January 2012
Trust I	10.3	9.36%	3 month LIBOR + 4%	September 2033
Trust II	20.6	7.70%	Fixed through 10/08; 3 month LIBOR+ 3.85% thereafter	October 2033
Trust III	20.6	8.025%	3 month LIBOR + 3.85%	November 2036
Total	101.5			

15.12.4 Credit Rating

Rating company A.M. Best granted Republic an "A-(Excellent)" rating in 2003, and in March 2006 has reconfirmed the rating with a stable outlook. This rating is the fourth on a scale of 15 rating categories used by A.M. Best. In addition to the above rating, which refers to the company's financial robustness and overall quality, A.M. Best also rates the quality of long term credit. The rating scale used by A.M. Best for long-term issuer credit rating ranges between "aaa" (Exceptional) and "d" (In default). The long-term credit rating granted to Republic is "bbb-" (Very Good).

15.12.5 Raising Additional Funds

Republic anticipates that it will be able to meet its cash requirements for its ongoing needs for the foreseeable future. Additional funding could be required in the event Republic elects to pursue acquisition opportunities in the future.

15.13 Taxation

For details on taxation, see Notes 33 and 38 to the financial statements of the company.

15.14 Restrictions on and Supervision of Republic Operations

See section 15.1.2, above.

15.15 Material Engagements

Republic Group has agreements with different entities, including agents, insurance agencies, MGAs, other insurers, reinsurers, credit providers and suppliers. Republic has no material engagements that do not form part of its normal course of business.

15.16 Legal Proceedings

For information regarding legal proceedings, see Note 25a to the Company's financial statements.

15.17 Business Objectives and Strategy

15.17.1 Focus on short-tail insurance segments: Republic focuses on short-tail insurance products[108] (such as liability insurance) as opposed to long-tail insurance products (such as product liability), since it estimates that such products and their ensuing liabilities are easier to price, thereby reducing volatility of financial results.

15.17.2 Focus on less competitive markets: Republic provides agents and MGAs with access to products and markets where larger insurance companies do not operate. As part of this strategy, Republic has started issuing insurance policies for low-value dwellings and has entered the farm and ranch insurance business.

15.17.3 Focus on areas where Republic has proven capabilities: Republic prefers to take advantage of many years of experience and know-how in order to focus on profitable products, regions and marketing channels – rather than penetrate unfamiliar markets. Republic also strives to develop relationships with new agents and MGAs in order to expand its business in desirable markets. Republic has over a century of experience in Texas and over 40 years in Louisiana, Oklahoma and New Mexico, and it leverages its competitive advantage thanks to experience and reputation in these regions.

15.17.4 Price insurance products adequately to provide desired profits over the insurance market cycles: Republic attempts to price its business to generate underwriting profits by applying a high level of selectivity to the risks it accepts and it uses a risk-adjusted return approach to capital allocation. Republic allocates its capital and other resources across product lines in response to changing market conditions. Republic intends to expand product offerings in market segments that lack insurance capacity and possibly yield high profits. Conversely, they will strategically reduce product offerings in market segments where competitive conditions prevent the achievement of desired underwriting profits. Accordingly, Republic expects some target market segments to vary from year to year.

15.18 Risk Factors

15.18.1 Exposure to Weather Catastrophes and Damage

As an insurance company, and in view of the geographical region where Republic Group operates, it is exposed to risks due to natural disasters or man-made disasters, such as hurricanes, hail storms, tornadoes and fires. For example, hurricanes Katrina and Rita which occurred in August-September 2005. It is difficult to forecast the occurrence of such events with statistical accuracy, or to estimate the damage that may be incurred. The losses to Republic arising from such disasters depends on different factors, including the exposure of policyholders in the afflicted area, the extent

[108] Short-tail: segments where the time elapsed between the insurance occurrence and the final formation of the damage and payment for it is relatively short; long-tail: segments where the time elapsed between the insurance occurrence and the final formation of the damage and payment for it is long.

of reinsurance and increase in reinsurance rates, unexpected changes to insurance coverage due to regulatory or legal proceedings following a catastrophe, etc.

15.18.2 Incorrect Premium Pricing

Operational results of Republic Group depend, inter alia, on its ability to correctly price premium rates for a wide range of risks. Under-pricing by the Republic Group may impact its profitability, while on the other hand over-pricing may impact its ability to compete and its sales volumes, thereby also impacting profitability.

15.18.3 Incorrect Estimates of Liabilities for Losses and Loss Adjustment Expenses (LAE)

Republic estimates its liabilities in order to cover all losses and loss adjustment expenses arising from its insurance policies. To this end, Republic Group is required to estimate both claims submitted and liabilities for claims not yet submitted. The estimation of liabilities entails, by its very nature, uncertainties. Consequently, the actual losses and loss adjustment expenses for such losses which are payable by Republic may materially differ from its estimates.

15.18.4 Failure of Reinsurers, Changes to Reinsurer Capacity and Rates

Republic Group uses reinsurance in order to protect itself against insurance risks or to share them with reinsurers. Failure of reinsurers, changes to reinsurance capacity and to reinsurer rates may impact the company's ability to pay policyholders or may restrict its ability to underwrite insurance. In Republic's Insurance Services segment, Republic writes insurance on behalf of other insurance companies, in exchange for fronting fees. The risk in this segment is borne by the other insurance companies, however, in the event that they ultimately fail to meet their obligations to Republic Group, Republic Group may be liable for payment of damage without being indemnified.

15.18.5 Dependence on Independent Insurance Agents who Market Republic Group Products

Republic Group's business is dependent on the success of independent insurance agents in marketing its insurance products. These insurance agents also market products of competing insurance companies and at some point may prefer those, to the detriment of Republic Group's sales volume. In addition, customers may choose to purchase insurance via other marketing channels, such as the Internet, and not via insurance agents who market Republic Group products.

15.18.6 Dependence on MGAs

Republic Group uses MGAs who operate under its guidelines, and their role is to issue insurance policy on its behalf and to process claims for these insurance policies. Republic Group is exposed to the risk that MGAs will abuse the authority delegated to them by Republic Group. Furthermore, MGAs may switch to competing companies or reduce their activity on behalf of Republic, for various reasons including changes to rates or change of MGA ownership.

One unaffiliated MGA relationship accounted for $123.7 million in gross written premium in 2006. This MGA was acquired by an unaffiliated third party in Q3, 2005. Following that acquisition, Republic entered into a three-year agreement to continue as the underwriting insurer and increase its underwriting participation from 40% to 50% in 2006. Under the agreement Republic will retain an underwriting participation of 40% in 2007 and a minimum of 30% in 2008.

15.18.7 Lowered Credit Rating

Financial strength ratings are important to the competitive positioning of insurance companies. Republic's insurance subsidiaries and affiliates have been rated "A- (Excellent)" by rating company A.M. Best, and this rating is subject to periodic review by the rating company. A lower rating may impact the company's customer base and the willingness of independent agents and MGAs to contract with it.

15.18.8 Change for Stricter Insurance Policy Terms by Courts of Law or by Regulators

Republic Group insurance policies include various limitations intended to limit Republic Group's potential risk and liability. Determinations by courts of law or by regulators that such limitations are invalid may increase Republic Group's liability and impact its financial results.

15.18.9 The Insurance Market in Texas

Since most of Republic Group's revenues from insurance premiums are derived in Texas, Republic Group is exposed to events which negatively impact the insurance market in this state, such as economic recession, political instability, unemployment, stricter regulation, increased competition, war and terrorist acts, etc.

15.18.10 Competition

The insurance industry is highly competitive. Republic Group competes with larger insurance companies, including international insurance companies, that have more extensive financial, marketing and management resources than Republic Group. Republic Group also competes with entities conducting self insurance, mainly in the commercial insurance market. A further competitive risk to which Republic Group is exposed is marketing of insurance products via the Internet.

15.18.11 Unfavorable Returns on Republic Group Investments

Republic Group's investments are subject to a range of investment risks, such as market financial conditions, market volatility, interest rate fluctuations as well as liquidity, credit and insolvency risks. Specifically, Republic Group is exposed to the following risks with regard to its investments: Losses may be incurred if securities held by Republic Group must be realized ahead of time in order to cover insurance liabilities; decline in the exchange rate of the Mexican Peso vis-à-vis the US dollar, since the results of Atlas, a Mexican company 30% of whose shares held by Republic, are converted from Mexican pesos to US dollars for the purpose of Republic's financial statements.

15.18.12 Regulation

Republic Group is subject to extensive regulation and supervision in states where group companies do business. Regulation covers a range of issues, such as restrictions on company investments, accounting and reporting standards, etc. Changes to regulation or failure by Republic Group or its insurance subsidiaries to comply with licenses and terms may negatively impact Republic Group's business. Other than the existing regulation, changes to legislation are proposed from time to time, which may negatively impact the insurance industry. Inter alia, a proposed insurance act at the federal level, in addition to existing state laws, is currently being discussed, along with proposals to subject parts of state legislation to regulations adopted by NAIC.

15.18.13 Information Systems

Republic Group operations are dependent upon the proper functioning of its information and communications systems, on which the company relies for recruiting new customers, customer service, filing claims and collection. The failure of Republic Group's information systems or failure to upgrade them periodically will impact Republic Group operations.

	Impact of Risk Factors on Republic Group's Affairs		
	Considerable Influence	**Medium Influence**	**Small Influence**
Macro-level risks	• Negative events in the Texas insurance market, including economic recession and political instability	• Poor performance of Republic investments, due to exchange rates, interest rates and inflation, among others	• Unemployment • War and terrorism
Industry-wide risks	• Weather catastrophes and damage • Failure of reinsurers, changes to reinsurance capacity and to reinsurer rates	• Regulation, including changes in regulatory capital requirements, accounting principles or tax laws	• Competition
Risks specific to Republic	• Lower Rating	• Actuarial issues, including incorrect assessment of liability on account of losses and loss-adjustment expenses • Results of the Atlas Insurance investee • Incorrect premium pricing • Dependence on insurance agents • Dependence on MGAs	• IT

The extent of the impact of the above-mentioned risk factors on the Republic Group operations is based exclusively on estimates and the actual impact may differ.

15.19 Events or Issues Outside the Corporation's Normal Course of Affairs

In 2005, the USA experienced three major Hurricanes: Katrina, Rita and Wilma. These three storms are among the 10 greatest storms to ever hit the USA, and they have significantly impacted the US insurance industry. Wilma did not have an impact on Republic Group, but Katrina and Rita have both severely impacted the Group's geographical area of operation. As of the current date, the estimated losses incurred from these hurricanes amount to $50 million and $48 million, respectively. Nevertheless, the company's reinsurance program provided most of the coverage for these losses, so the company's net losses amounted to only US $5 million for these two hurricanes. Additional losses are not expected at this time, although the outcome of ongoing litigation could potentially impact Republic and other insurers in the event of unfavorable judgments.

Following the hurricanes, premium rates for property reinsurance have increased significantly in 2006 and 2007

15.20 Anticipated Development over the Next Year

Republic intends to explore opportunities to expand its activities in its geographical territory – and in other states – and to consider acquisition opportunities that are consistent with its operating strategy.

16. Additional Operations

The Delek Group has various operations that are not included in the above sectors and whose revenues and expenditures are not substantial in relation to the Delek Group's operations. These operations are included in the Group's financial statements as of December 31, 2006 under "Other". They are, as follows:

16.1 **Desalination** – Delek's involvement in desalination is done through Delek Infrastructure, which holds 50% of IDE Technologies Ltd. (hereinafter: "IDE") Israel Chemicals Ltd. (hereinafter: "ICL") holds the remaining 50% of IDE shares. The agreement between the parties and the memorandum of incorporation of IDE set forth, *inter alia*, the rights of both shareholders in the company to appoint directors, the majority required for decisions to pass in the board of directors and in the General Meeting, the right of first refusal and the right to join. In addition, IDE has a management agreement with Delek Infrastructures and ICL under which management and consulting services are provided to IDE in exchange for management fees.

IDE is engaged in production and sales of water desalination plants, industrial concentrators (evaporators) and heat pumps, and in operation and maintenance of desalination facilities. At various locations worldwide, IDE has established seawater desalination plants. In certain locations it acts as operator while at some it constructs the plants on behalf of other operators.

Below are details of the major projects undertaken by IDE:

A. Water desalination plant in Ashkelon: VID Desalination Company Ltd. (hereinafter: "**VID**") was incorporated to construct and operate the water desalination project in Ashkelon. The shareholders of VID are IDE (50%), Veolia Water SA (25%) and Elran Infrastructures Ltd. (25%). VID was awarded the tender issued by the Government of Israel to install and operate a seawater desalination plant in Ashkelon under the BOT (Build, Operate, Transfer) method. Under the BOT agreement signed with the Ministry of Finance, the concession period is 24 years and 11 months starting on Oct-20-02. The plant was installed by OTID Desalination Partnership, of which 50% are held by IDE and the facility is operated and maintained by a company of which 40.5% are held by IDE The cost to build the project was NIS 1.1 billion, and was financed via shareholders' equity and owners' loans (about 23.5%) with the balance financed by foreign capital.

   In August 2005 the desalination plant started operations for a test period, and VID started commercial operation of the facility in 2006. The desalination plant currently produces an annual output of 100 million m^3 of desalinated water. The operation of the desalination plant in Ashkelon began after receiving approvals from the Ministry of Health, the Water Commission, the Desalination Authority and the Ministry of the Environment. It should be noted that with a certain additional investment and without disrupting the current operations of the plant, it is possible to expand the output of the plant to a level of 120 million m^3 per annum.

B. Water desalination plant in Larnaca: A joint partnership including IDE has installed a water desalination plant pursuant to a contract for sale of water to the Cyprus Water Authority. The cost of building the project was NIS 181 million. Construction of the project ended in July 2001, when the partnership started operating the plant, which desalinates 18 million m^3 annually.

C. Water desalination plant in Hadera: In September 2006 H2ID Ltd., held by IDE (50%) and by Housing & Construction Holding Company Ltd. (50%), was awarded a tender by the Government of Israel to plan, finance, construct, operate and maintain under the BOT method a seawater desalination plant in Hadera, with a capacity of 100 million m^3 annually. On Nov-13-06 the concession agreement was signed by the Government of Israel and H2ID, for a term of 25 years (of which 2.5 years of construction and 22.5 years of operation and maintenance). H2ID must close on the financing within 10 months from signing the concession contract with the state and must obtain government approval for starting construction work.

D. Desalination plants in India: At the end of 2005, IDE secured a tender to supply four desalination plants – at a value of $90 million – to one of the largest oil refineries in the world – in Gujarat, India. These are multi-stage refinery type thermal plants, each intended to provide 24,000 m^3 per day of feed water for boilers and process water for the refinery. The plants are to be delivered within 15-24 months, with one of them already delivered as of the date of this report.

16.2 **Power generation plant** - I.P.P. Delek Ashkelon Ltd. (hereinafter: "Delek Ashkelon") is a company fully owned (directly and indirectly) by Delek Investments, which was incorporated and started operations in August 2002 and is engaged in planning, financing, construction, operation and maintenance of a power generation plant in Ashkelon. Delek Ashkelon was awarded a tender to construct a power station on the premises of the desalination plant in Ashkelon, to produce 80 megawatts of electricity. Most of the power plant's output is to be used by the desalination plant, with the rest being sold to private customers and/or to IEC. The construction period, under the contract with VID, was set at 24 months from the end of April 2003, and the period for supply of power to the desalination plant was set to 22.5 years from that date.

In 2003 Delek Ashkelon contracted with Siemens Nederland N.V. (hereinafter: "the construction contractor") for planning and construction of the power plant on its behalf, and further contracted a maintenance service contract with the construction contractor and another entity to provide maintenance services for the power plant for a period of 22.5 years. In 2003 the company also signed a financing agreement and closed on financing amounting to NIS 260 million, about 80% of the expected project cost, and a "Notice to Proceed" was issued to the construction contractor.

Delek Ashkelon and the OTID partnership (see above) have created a transformer station to be used by the desalination and power plants. Construction of the transformer station was completed in early 2005 and it allows power to be routed from the national power grid to the desalination plant for its operations, pending start of operation of the power plant; it also allows power from the power plant to be delivered for other uses.

In August 2005 Delek Ashkelon contracted with the partners in the Yam Tethys transaction for provision of natural gas to the power plant; under this contract, the gas supply would start upon completion of infrastructure for its supply to the power plant, subject to terms set forth in the contract. Run-in and operation of the power plant did not take place on schedule (end of Q2 of 2005) due to delay in delivery of natural gas to the power plant. Operation of the power plant depends on obtaining natural gas, which is contingent on completion of the national delivery system from Ashdod to Ashkelon, on completion of construction of the receiving facilities as well as on obtaining all required approvals for natural gas delivery from the Natural Gas Authority. At this stage, delivery of natural gas to the power plant is not yet possible, despite the completion of the gas delivery system, since a gas transport authorization has yet to be received. At this stage, such authorization is expected to arrive in the second quarter of 2007, although this remains uncertain. Delek Ashkelon has reached an agreement by which IEC paid damages for the delay in construction of natural gas delivery infrastructure to Ashkelon.

Due to delay in delivery of natural gas to the power plant, as set forth above, and in order to finance the preservation expenses and cost of purchasing power from the national power grid for operation of the desalination plant, Delek Ashkelon has requested and obtained preliminary approval from Bank Leumi to increase the credit facility by NIS 40 million, part of which is to be provided under guaranteed from Delek Investments for the operation period until it is repaid. The total shareholders' equity injected by shareholders in Delek Ashkelon will account for 20% of the total credit for this project. See also Note 9h to the financial statements.

Infrastructure operations usually require heavy financial investments in the construction and run-in period which usually lasts 2-3 years. Revenues are generated only subsequent to that period.

16.3 **HOT**

In January and August 2004, Delek Investments and Delek Real Estate acquired some 40% of Matav shares (see section 1.4 above). Matav was one of three cable TV operators in Israel, engaged in provision of multi-channel TV services to subscribers; broadband internet access services for the residential sector; and via Hot Telecom – provision of domestic fixed telephony services, broadband internet access and other services to the business sector.

In December 2006 the merger of the cable companies was completer, in which Matav acquired from the other cable companies all of their TV operations (multi-channel TV) and their domestic fixed telecommunications operations (telephony and internet access). Upon completion of the merger, Matav allocated shares to shareholders and rights owners in the cable companies whose operations and assets had been transferred to Hot. Matav was renamed Hot Cable Media Systems Ltd. (hereinafter: "Hot"). Following the allocation, Delek Investments holds 15.9% of Hot shares. The other major shareholders in Hot are Yediot Media Ltd. ("Yediot") which holds 16.696%; corporations controlled by the Fishman family ("Fishman Group") which hold 14.587% and Bank Leumi Le-Israel Ltd. which holds 15.364%. The Company has appointed 2 directors to the Hot board of directors, on which 8 board members serve.

As part of conclusion of the merger transaction, a right-of-first-refusal agreement has come into effect between the four largest banks in Israel (Bank Hapoalim Ltd., Bank Leumi Le-Israel Ltd., Bank Discount Le-Israel Ltd. and First International Bank of Israel) and the other major shareholders in Hot (Yediot, Fishman Group and Delek Investments). This right-of-first-refusal concerns the dale of shares held by any party to the agreement, soon after completion of the merger transaction, and will be effective for 5 years from date of completion of the merger transaction.

Furthermore, upon completion of the merger transaction a credit agreement became effective, signed between Hot, Hot Telecom limited partnership (which is fully owned by Hot) and a consortium of banks, both for financing of HOT's banking debt as of the date of conclusion of the merger, as well as to provide credit for future investments in the course of HOT's business.

Hot is engaged in three major sectors – provision of multi-channel TV service for subscribers (provided since 1990), provision of broadband internet access to the residential and business sectors over cable infrastructure (provided since April 2002) and provision of domestic fixed telephony service using VoIP technology (provided since Q1 2005). In the multi-channel TV sector, Hot was awarded a nation-wide general license for cable service, and it provides its subscribers with analog and digital TV service.

Over recent years, the merged cable operators have incurred operating losses due to the intensive competition in the cable TV market. In 2005 Hot incurred operating losses due to several major reasons including: continued competition in the cable TV market which caused subscriber churn and increased customer service costs, as well as increased operating costs due to launch of new services (such as VOD) by Hot. In 2006 Hot improved its operating results due to increase in average revenue per user (ARPU), decrease in subscriber churn rate compared to previous years, and launch of a bundled service package including cable TV, internet access and telephony.

Hot revenues for 2004, 2005 and 2006 (pro-forma) amounted to NIS 586, 544 and 579 million, respectively, and its profit (loss) for 2004, 2005 and 2006 (pro-forma) amounted to NIS (83), 69 and (58) million, respectively.

The investment in Hot is reflected in Delek Investment's financial statements based on the book value which is, as of Dec-31-06, about NIS 305 million.

Hot is a public company whose shares are traded on the Tel Aviv Stock Exchange and its reports are made public.

16.4 **Additional holdings and investments**: Delek Group has additional investments and holdings that lie outside the Group's areas of operation. These include, *inter alia*, holdings in high-technology companies, hedge funds and financial investments. For additional details, see Note 9j(h)(3) to the financial statements.

Part Four – General Company Issues

17. Fixed Assets

The corporate headquarters are located in a four-storey building on Giborey Israel Street in Netanya, with a total area of some 3,360 m^2 plus parking spaces. The building is owned by Delek Real Estate (through a subsidiary) and by a third party. The said office space is leased to the Company, Delek Investments, Delek Israel and additional companies owned by the controlling shareholder, with each company participating in h the leasing fees, according to the office space it occupies. The leasing fees are immaterial.

18. Human Resources

18.1 Organizational Structure

The Company is a holding company which controls, directly and indirectly, multiple companies which conduct their operations independently. In addition, the Company invests over recent years via its subsidiaries Delek Investments (100%), Delek Petroleum (100%) and Delek Capital (94%). The financing for these transactions or guarantees for such financing are often provided by the Company or by Delek Investments. Customarily, material transactions made by these subsidiaries require not only approval within the companies but are also submitted for approval by the Company's board of directors. Delek Investments and Delek Petroleum are private companies, 100% held by the Company. Over recent years, Delek Investments has acquired, *inter alia*, holdings in Matav, Menora and Phoenix. Delek Capital is a private company incorporated in 2006 to control the group's financial operations, and 94% of its shares are held by Delek Investments.[1] The following description in sections concerned with Company operations in general refers to the Company, Delek Investments and Delek Capital as a single entity.

18.2 Staff Headcount

A staff of about 20 is employed by the Company, Delek Investments and Delek Capital, of which 4 officers and senior management, with the others being staff and administration employees. These employees also serve as managers and employees of Delek Investments. In 2006, seven new employees joined the group headquarters.

18.3 Officers of the Company and Senior Management Positions at the Company

In addition to the five senior officers mentioned in sub-section 18.2 above, there are eleven CEOs and chairpersons of the boards of directors of the various subsidiary companies in the different sectors in which the Company operates.

Pre-requisites and Employment Conditions – Group officers and senior managers are employed under personal contracts that include various forms of pension coverage. Some officers and senior management are entitled to up to six months pay after leaving the company. Some of the managers and directors in group companies (including the Company's CEO and Chairman of the Board of Directors) have been granted, for their role in said companies, shares or stock options which account for up to 5% of the issued, paid-up share capital of said companies.[2] The terms for exercising of stock options include an extended period for exercise of such stock options as well as

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[1] 5% of Delek Capital shares are held by its CEO, Danny Gutman and 1% of its shares are held by Asaf Bartfeld, CEO of the Company.

[2] For details of a guarantee provided by Delek Investments to Gil Agmon, CEO of Delek Automotive, in order to obtain a loan for acquisition of shares of Delek Automotive, which exceed the aforementioned limit, see section 11.9.5 below and Note 9d(1) to the financial statements.

as additional terms. In some cases, loans were provided to officers in the Group (including the CEO and Chairman of the Board of Directors) for acquisition of securities of Group companies. In addition, bonuses are usually given to managers based on parameters, such as: Management rating, business results of the Group and personal achievements of the manager within the Group. The officers of the Company are also eligible for insurance, waiver and indemnification with regard to their activities in the course of their position as officers.

19. Financing

This section does not refer to credit obtained by subsidiaries engaged in the operating sectors, unless explicitly indicated.

19.1 Following below is a listing of average interest rates on loans from bank and non-bank sources that were in effect in during the reported period and which are not intended for specific use by the Company:

		Average Interest Rate	
		Short Term Loans	**Long-Term Loans**
Bank Sources	NIS credit, non-linked	6.1%	---
	NIS credit, linked	---	5.1%
	Dollar-linked credit	---	6.6%
Non-Bank Sources	NIS credit, non-linked	5.6%	
	NIS credit, linked	---	4.9%
	Dollar-linked credit	---	5.7%

19.2 Credit Obtained Between Date of Financial Statements and Close to the Publication Thereof

Following below is a list of the credit received by the Company and Delek Investments between December 31, 2006 and close to publication of financial statements for 2006[1], in NIS millions:

	Short Term Loans	Long-Term Loans
Bank Sources	50	-
Non-Bank Sources	-	-

19.3 Credit Facilities

The Company and Delek Investments have, as of close to publication of financial statement, credit facilities amounting to NIS 1,961 million. Of these facilities the Group utilized to date NIS 1,531 million. The credit facilities are not secured and can be changed.

19.4 Credit at Variable Interest Rates

Below are details of credit at variable interest rates extended to the company in 2006:

Change Mechanism	Range of Interest Rate in 2006	Interest Rate Close to Publication of Financial Statements
Bank of Israel Interest +	4.95% - 6.5%	4.95%
LIBOR +	5.65% - 7.4%	7.4%

[1] Some of the monies raised will be used, or were used, to repay other loans.

19.5 Credit Rating

All of the Company's debenture issues are rated AA by Maalot, the Israeli Securities Rating Company.

19.6 Financial Parameters

The Company, Delek Investments and Delek Capital have committed, in conjunction with short- and long-term loans from banking corporations, whose balance as of Dec-31-06 amounts to NIS 1,400 million, to the following:

A. The Company's tangible shareholders' equity shall not be lower than 35% of the balance sheet total for Delek Group. Furthermore, the Company's tangible shareholders' equity shall not be less than NIS 2,800 million at any time.

B. The tangible shareholders' equity of Delek Investments, plus owner's loans, would not be lower than NIS 1,500 million at any time; and the tangible shareholders' equity of Delek Investments, plus long-term owner's loans, would not be lower than 35% of the balance sheet total of Delek Investments at any time. Furthermore, Delek Investments committed that its shareholders' equity would not be lower than NIS 800 million at any time.

C. The Company and Delek Investments committed that the ratio of liabilities to tangible shareholders' equity would not exceed 225% for the years 2006-2008 and would not exceed 220% from 2009 onwards.

D. The Company and Delek Investments have committed that the total amount of guarantees would not exceed a cumulative total of NIS 1 billion.

E. The ratio of dividends and management fees obtained from Group companies to total general and administrative expenses plus financing expenses would not be lower than 2 at any time.

20. Taxation

For a description of the tax laws that pertain to the Company, see Note 33 to the financial statements.

21. Guarantees and Liens

21.1 Guarantees

For a description of the guarantees of the Company, see Note 25 to the financial statements.

21.2 Liens

Following below are the details of the Group's liens that do not relate to any of the sectors as described above:

21.2.1 Delek Group Liens:

Fixed first-degree lien to benefit Bank Leumi Le-Israel (hereinafter: "**Bank Leumi**") , on 59,000,000 ordinary shares with NIS 0.1 par value each in Delek Real Estate Ltd. as well as all shares, rights, options and monies received for them and all rights owned by the Company in conjunction with these and with a securities deposit, including all rights in the monetary account attached thereto.

21.2.2 Delek Investments Liens:

Delek Investments has placed liens on various assets to benefit different Israeli banks. Following below is a summary of the principal liens:

50,132,161 shares of Delek Automotive Systems, which constitute 100% of Delek Investment's share of Delek Automotive Systems. Delek Investments holds 55.4% of the share capital of Delek Automotive Systems.

2,444,604 shares of Delek Energy Systems which account for 60% of Delek Investment's holding in Delek Energy Systems. Delek Investments holds 89% of the share capital of Delek Energy Systems.

21.2.3 For details regarding guarantees and liens provided by other companies in the Group in various sectors of operation, see the discussion concerning each different sector.

22. Legal Proceedings

For a description of material legal proceedings in which Group companies are involved see Note 25a to the financial statements.

23. Business Objectives and Strategy

The Company reviews its strategic plans from time to time, updating them according to developments in its sectors of operation and to business opportunities which arise.

Following below are the Group's major objectives and strategy:

23.1 Improved business performance in order to achieve maximum return on equity over time and to monitor business opportunities which may be pursued.

23.2 Focus on material holdings with high growth potential in which the Group can have a material impact.

23.3 Constant monitoring of opportunities to expose value in held companies.

23.4 Review of optional inclusion of domestic or international strategic partners in various companies.

23.5 Subject to locating appropriate business opportunities, expanding Group operations overseas and reducing its dependency on the Israeli market.

23.6 Taking advantage of opportunities in the relevant markets in order to realize investments.

23.7 Expansion and diversification of Company sources of financing.

23.8 Contribution and assistance to the community in Israel.

24. Anticipated Development over the Next Year

Delek Petroleum Ltd. - a fully owned subsidiary of the Company – is in negotiations with management of Chevron Corp. (hereinafter: "**Chevron**") in conjunction with its participation in a tender to acquire Chevron's marketing operations in Benelux countries (Belgium, Netherlands, Luxembourg), comprised of some 750 gasoline stations. The discussions are being held during the exclusive period agreed upon between the parties, which is extended from time to time.

For anticipated development over the next year in the various operating sectors, see discussion concerning each of the Company's operating sectors above.

25. Financial Information Regarding Geographical Regions

Following below is a description of the geographic regions wherein the Group operates, and its major operations in these regions:

Israel – The Company operates in Israel in the following sectors: real estate, automotive, fuel products, energy, biochemical, telecom, insurance and finance.

USA – The Company operates in the USA in the following sectors: fuel products, refinery, energy, biochemical and insurance.

UK – The Group operates in the UK in the real estate sector.

Canada – The Group operates in Canada in the real estate sector.

Western Europe – The Group operates in Western Europe in the real estate and biochemical sectors.

For further information concerning geographical regions, see Note 35(c) to the financial statements.

26. Discussion of Risk Factors

The Company is predominantly a holding company and therefore its major risk factors arise from those specific to each operating sector of the Group. The risk factors for each operating sector are described in the sections describing each operating sector. In addition to the risks presented for each operating sector, following below are additional major Group-wide risks to which the Group is exposed in Israel and abroad:

26.1 Foreign Exchange Rate Fluctuations The Company and its held companies have loans denominated in foreign currency, exposing the Company to the volatility of foreign currency exchange rates (primarily USD). These exchange rates could also influence the financial results of the Company and its held companies, since a substantial part of the Company's purchasing and revenues are denominated in foreign currency.

26.2 Changes in Interest Rates: The Company and its held companies have NIS-denominated variable rate loans, exposing the Company to changes in bank interest rates in Israel. Some of the Group companies have assumed variable rate loans overseas, exposing them to changes in interest rates in those countries. Furthermore, interest rate changes can potentially impact the financial results of the Company and its held companies. Changes to interest rates in Israel and in the USA may negatively impact returns of the negotiable bond portfolio of insurance companies held by the company, which backs their insurance obligations.

26.3 Economic Slowdown and Changes in Markets: The Group has material operations in various countries around the world. Changes in those markets and especially economic slowdown in such markets (including in Israel) can have adverse effects on operations of the Company and its held companies.

26.4 Capital Market Situation: The volatility of negotiable securities held by the Group may expose it to risks resulting from capital market volatility. A decline in Israeli or global capital markets may negatively impact the Company's prospects for raising capital when required and for selling its holdings for capital gains. In addition, a decline in capital markets can have an adverse effect on the ability of the Company and its held companies to raise capital and may cause a decline in the prices of securities issued by held companies after their listing on stock exchanges.

26.5 Security Situation: A worsening security and geo-political situation in Israel can have a negative effect on companies operating in Israel, *inter alia*, due to discouraging foreign investors and corporations from investing in and contracting with Israeli companies. Such deterioration in Israel's security and geo-political situation could also cause economic slowdown in Israel, which may adversely affect Group sales and financial results. Moreover, some of the company's infrastructure facilities – including the desalination plant, the power generation plant and the Yam Tethys facilities - are located in relative proximity to the Israeli border with the Gaza Strip and are therefore exposed to security threats due to terrorist attacks.

26.6 Amendments to Legislation and Standards: Material parts of Group operations are subject to specific laws. Group results are subject to changes in legislation and standards in various areas, including: anti-trust laws, mandatory tender laws, regulation of petroleum sector, gas sector, telecommunications market, supervision of insurance business, price controls for goods and services, custom tariffs, consumer protection etc. In addition, changes to policy of authorities working under such legislation may impact the Group. In similar fashion, some of the Group companies operate overseas and may be impacted by changes to legislation, tariffs, regulatory proceedings and changes of policy in their countries of operation.

Changes in accounting standards can also have an effect on the financial results of the Company and its held companies and on their ability to distribute dividends.

26.7 Bank Supervision: The Company and some of its held companies are influenced by the "Proper Conduct of Banking Business Directives" issued by the Banking Supervisor (of the Bank of Israel – Israel's Central Bank) which includes, *inter alia*, limitations as to the scope of loans that Israeli banks may extend to "single borrowers", to the six largest borrowers and to the "largest borrower group" of the specific banking corporation (as these terms are defined in the aforementioned directives). Consequently, the extent of loans to Group companies and to the controlling shareholder of the Company may impact, under certain circumstances, the ability of Group companies to borrow additional funds from Banks in Israel.

26.8 Licenses and Concessions: Some of the Company's held companies operate under licenses, permits, concessions or various other official government permissions obtained in Israel and abroad from various authorities, including: Ministry of National Infrastructure, Ministry of Communications and Ministry of Transportation. Non-compliance with terms of these licenses, permits or concessions may lead to sanctions, fines or even cancellation of said permits by the relevant authorities. Such cancellation of permits, authorizations, licenses or concessions may materially impact the Company's held companies whose operations depend on these permits. Some of the aforementioned licenses and concessions are granted for a limited term and may be renewed form time to time according to their terms and provisions of applicable laws, and there is no guarantee that these licenses or concessions would be renewed in the future. Such non-renewal of licenses or concessions may negatively impact profitability of the company holding such licenses or concessions, and ultimately also profitability of the Group.

26.9 Environmental Protection: Some of the Company's held companies, primarily in the fuel sector in Israel and the USA as well as in the refinery and biochemical sectors, are exposed to various environmental regulations in Israel and abroad. Changes to legislation in this area or to policy of the supervisory authorities may impact profitability of such held companies and ultimately also the profitability of the Group.

26.10 Changes to Raw Material Prices: Some of the companies held by the Group are exposed to changes in raw material prices, such as the refinery sector which is exposed to changes in petroleum prices (which affect the refining margin), or the biochemical sector which is exposed to changes in global sugar prices. Changes in raw material prices may impact the profit margins of held companies and ultimately those of the Group.

26.11 Legal Proceedings: Some of the companies held by the Group are subject to legal claims, including class action lawsuits, of substantial amounts. Should the companies be found liable in these legal proceedings, or in any possible future legal action brought against the Company or its held companies may negatively impact the Company's financial results. Note that in March 2006 the Class Action Suits Law, 2006 was made public. This law sets a general and uniform manner for submitting and managing class action suits and may result in an increase in the number of requests for the approval of claims as class action suits, thereby increasing the exposure to such lawsuits, although this matter is contingent upon the interpretation that the courts will adopt to this law, *inter alia*.

26.12 Labor Wages and Labor Relations: Material changes to minimum wage or other material changes to labor laws may influence the results of the Company's held companies and ultimately the Company's financial results. Strikes, work slowdowns and the like at held companies can also negatively influence financial results.

26.13 Antitrust: Some of the Group companies may, under certain circumstances, be restricted in their operations by regulations pursuant to the Antitrust Law and by individual rulings by the Anti-Trust Commissioner. In addition, for some operations, the Group and its affiliates are affected by antitrust laws which may influence their dealings which fall under the definition of merger of restrictive arrangements as defined by the law. The Company is therefore, under certain circumstances, dependent upon receiving approvals from the above commissioner that may limit or even prevent the deals. Various conditions in existing or future permits of mergers given by the commissioner regarding the purchase of various holdings in various companies by the main shareholder of the company or companies held thereby could limit the business activities of the Company and its results.

26.14 Limitation on Divestiture of Holdings: There are legal and contractual limits to the ability of the Company and its affiliates to sell its holdings when it wishes to do so. Some of the shares of held companies are subject to liens benefiting banking corporations.

26.15 Dependence on Cash Flows of Affiliates: One of the sources of capital for the Company originates from the profits distributed by the affiliates. Changes in the dividend distribution policy by held companies, changes to profitability (including on account of changes in accounting principles) and cash flows of said companies as well as restrictions on profit distributions can have an influence on the Company's cash flow and its business operations. In addition, the Company's ability to raise foreign financing is based, *inter alia*, on the value of its holdings in Group companies.

Following below is a list of the risk factors and their impact upon the Company:

Risk Factors	**Degree of Impact**		
	Major Impact	**Medium Impact**	**Minor Impact**
Macro-level risks	• Interest Rate volatility	• Foreign Exchange Rate Fluctuations • Capital Market situation • Economic slowdown • Changes to legislation and standards • Bank Supervision • Raw Materials	• Security situation
Industry-wide risks		• Environmental Protection	
Company-specific risks		• Licenses and concessions	• Limitations on sale of holdings • Dependence on cash flows of held companies • Labor wages and labor relations • Antitrust • Legal Proceedings

See also reference to additional risk factors relevant for material companies held by the Group in Sections 7-15 above.

March 28, 2007

DELEK GROUP LTD.

Board of Directors Report on the State of the Company Affairs
For the year ended December 31, 2006

The board of directors of the Delek Group Ltd. (hereinafter: “The Group” or “The Company”) is hereby honored to present the Company’s Board of Directors’ Report for the year ended December 31, 2006.

1. Description of the Company and its Business Environment

The Group is a holding and management company that holds three main subsidiaries in which the business activities of the Group in Israel and abroad are concentrated. These subsidiaries are:

A. Delek Petroleum Ltd. (hereinafter: "Delek Petroleum") – Deals primarily in the sale of fuel and oil products and in the operation of gasoline stations and convenience stores in Israel and the US and an oil refinery in the US. In Israel, the operations are executed via a subsidiary – Delek the Israel Fuel Company, Ltd. (hereinafter: ""Delek Israel”) and in the US, operations are executed via Delek U.S. Holding, Inc. (hereinafter: “Delek USA”) which, during the report period, offered 23% of its share capital to the public on the New York Stock Exchange, according to a company value of approximately $800 million.

B. Delek Investments and Properties Ltd. (hereinafter: "Delek Investments") – Responsible for the Group’s operations in the automotive sector; in oil and gas exploration and production; in infrastructure projects; in the biochemical industry; in telecommunications and in insurance.

C. Delek Real Estate Ltd. (hereinafter: “Delek Real Estate”) – Most of the Group’s operations in the real-estate sector overseas are conducted by the Group’s subsidiary, Delek Belron International Ltd., which holds foreign companies that invest in income-generating real estate overseas (primarily in the UK, Canada, Sweden, Germany, Switzerland and Finland). Operations in the area of construction, development and holding of real estate in Israel are conducted by Delek Real Estate and by the subsidiary Dankner Investments Ltd. During the report period, Delek Real Estate effected private placements of shares to third parties.

As at December 31, 2006, the Company holds 100% of Delek Petroleum and Delek Investments and 67.9% of Delek Real Estate.

2. Principal Operations During the Reported Years

A. 2006 compared with 2005

The Group's net income for the reported year amounted to approximately NIS 1,513 million, as compared with approximately NIS 622 million last year, representing an increase of approximately 143%.

Capital gains flowing to the Company during the report year, mainly the result of a placement of shares in subsidiaries, amounted to approximately NIS 700 million compared with the sum of approximately NIS 130 million in 2005, so that the net income less capital gains amounted to approximately NIS 813 million in 2006, compared with the sum of approximately NIS 492 million in 2005.

The Group's revenues (gross) for the reported year amounted to approximately NIS 26 billion, as compared with approximately NIS 20 billion last year, representing an increase of approximately 30%.

The Group's EBITDA, earnings before financial expenses, taxes, depreciation and amortization amounted to approximately NIS 1,846 million during the report year, as compared with approximately NIS 1,669 million last year, representing an increase of approximately 11%.

Another item which increased significantly is the positive working capital from general business which, on December 31, 2006, amounts to the sum of approximately NIS 605 million compared with positive working capital of approximately NIS 127 million as at December 31, 2005.

The increase in net incomes in 2006 compared with the previous year stems from an improvement in profits in a number of commercial sectors covered by the Group, the most prominent of which are the production of natural gas in the Yam Tethys project, real estate operations, fuel operations in Israel and capital gains (see details in chapter 3 below).

Note that for the first time, a large contribution to the Company's profits was recorded for its operations in the field of insurance which commenced in 2006, and which includes the operations of insurance companies in Israel and overseas. This contribution, in 2006, amounted to the sum of approximately NIS 109 million.

As stated above, the Group's profitability during the reported period was influenced – inter alia – by the operations of the subsidiaries in the Israeli and international capital markets, that created capital gains for the Group, as aforesaid, in the sum of approximately NIS 700 million, as a result of the placement of shares of subsidiaries as follows:

- During the report year, Delek USA issued approximately 23% of its share capital to the public on the New York Stock Exchange (NYSE) according to a value of approximately USD 800 million for the company. The profit flowing to the Group as a result of the placement by Delek USA during the second quarter of 2006 amounted to approximately NIS 443 million.

- During the report year, Delek Real Estate issued shares comprising 11% of the capital of Delek Real Estate (after the placement) to a wholly owned subsidiary of Bank Hapoalim, in consideration for the sum of approximately NIS 252 million. In December 2006, Delek Real Estate issued approximately 5% of its capital (after the placement) to third parties in consideration for the sum of approximately NIS 215 million. The profit flowing to the Group as a result of these placements amounted to approximately NIS 123 million and NIS 62 million respectively. For further details regarding the profit from the placement to a third party in the sum of approximately NIS 40 million, which has not yet been recognized, see Note 9J(6) to the financial statements.

- During the reported period, Delek Automotive allocated approximately 10% of its shares (post-placement) to the CEO of Delek Automotive as part of a private placement, in consideration for approximately NIS 255 million. The profit to the Group as a result of this placement amounted to approximately NIS 59 million.

- In December 2006, The Phoenix Holdings Ltd. (hereinafter: "The Phoenix"), which was at that stage 61.5% held by the Group (see description of acquisitions below) issued shares to institutional investors at a rate of approximately 10% of its capital (post placement), in consideration for the sum of approximately NIS 374 million.

During the report year, Delek Investments exercised the option granted by Menora Holdings Ltd., for the acquisition of an additional 5%, and currently holds some 14.4% of the issued and paid-up share capital of Menora Insurance Company. After the balance-sheet date, in January and February 2007, Delek Investments sold approximately 12.2% of the shares of Menora to a third party in consideration for the sum of approximately NIS 392 million. The profit flowing to Delek Investments as a result of the above sale amounted to approximately NIS 142 million (before tax), and will be included in the first quarter of 2007.

During the report year, Delek Investments exercised the option granted to it to purchase a further 8% of the issued and paid-up share capital of The Phoenix Holdings Ltd. (hereinafter: "The Phoenix") in consideration for approximately NIS 214 million, and it holds approximately 33% of the issued and paid up share capital of the Phoenix. In November 2006, the subsidiary Delek Capital Ltd. (hereinafter: "Delek Capital") completed an additional acquisition of shares of The Phoenix, which constituted approximately 28.5% of the issued and paid up share capital of The Phoenix, in consideration for the sum of approximately USD 214 million (approximately NIS 940 million). Following the closing of the transaction, the Group held approximately 61.5% of the issued and outstanding Phoenix share capital. As set out above, as a result of the private placement of shares of The Phoenix to institutional investors during December 2006, the Group's holdings fell to approximately 55.4% (for additional details see Chapter 6G1 below).

In December 2006, a transaction was concluded in which a US company wholly owned by Delek Capital purchased the entire share capital (100%) of a US insurance company Republic Companies Group, Inc. As a result of the purchase, Republic filed an application to delist its shares and the shares of Republic were delisted from NASDAQ. Under the purchase agreement, the shareholders of Republic were to be entitled to consideration in the sum of $20.40 per share, and the foreign subsidiary paid total consideration in the sum of approximately $290 million for 100% of the share capital of Republic, on the basis of full dilution (for additional details, see chapter 6G2).

During the report year, the Company raised debentures via private placements to the institutional market in Israel, in a cumulative sum of approximately NIS 1,568 million. These debentures are long-term. For additional details, see Chapter 5 below.

During the report year, debentures and options for the Group's shares were converted and exercised in the total sum of approximately NIS 270 million. These conversions increased the Group's shareholders' equity and reduced its debt balance. After the balance sheet date, debentures were converted and options exercised in the total sum of approximately NIS 10 million.

On March 28, 2007, the board of directors of the Company resolved to pay a dividend in the sum of approximately NIS 100 million. This sum is in addition to the sums declared in 2006 – in all, a total of approximately NIS 547 million. The total dividend declared for the profits of 2006 amounted to approximately NIS 586 million.

We note that this year, it has been resolved to pay a dividend in the rate of 40% of the net income in the report year, in light of the fact that the non-recurring capital gains from the public offerings of Delek USA, Delek Real Estate and Delek Automotive Systems are not accompanied by cash flow, which is obtained in companies that make placements.

For further details regarding the operations of the Group companies during the report year, see below.

B. 2005 compared with 2004

The Group's net income for 2005 amounted to approximately NIS 622 million compared with approximately NIS 403 million in 2004, an increase of approximately 54%.

The Group's (gross) revenues in 2005 amounted to approximately NIS 20 billion, compared with approximately NIS 14 billion in 2004, an increase of approximately 42%.

The Group's EBITDA, profit before financial expenses, tax, depreciation and amortization amounted in 2005 to approximately NIS 1,669 million, compared with approximately NIS 1,169 million in 2004, an increase of approximately 43%.

The increase in net income, in revenue and in EBITDA in 2005 stemmed mainly from the results of operations of the La Gloria refinery in USA, which was purchased at the end of April of that year, and from an improvement in business results in the operations of gasoline stations in the USA. The Company also generated profits during 2005 following the issues by Delek Real Estate and Gadot Biochemical, and the realization of real estate assets.

During 2005, Delek USA, through subsidiaries, completed the acquisition of a refinery in the USA with a daily production capacity of 60,000 barrels, that commenced operation at the end of April 2005, along with a crude oil pipeline, at an investment of approximately NIS 320 million (including fuel inventories).

As a result of refinery operations during a the eight month period after the purchase, and as a result of an improvement in the profitability of gasoline stations in 2005, the contribution made by Delek USA to the Group's profits increased to approximately NIS 310 million in 2005, compared with approximately NIS 20 million in 2004.

2005 was characterized by the Company, via its subsidiary Delek Investments, entering the field of finances for the first time, by acquiring holdings in two insurance companies.

In March 2005 a purchase of approximately 10% of the issued capital of Menora Insurance Holdings Ltd. was completed at a cost of approximately NIS 191 million, and an option for the purchase of an additional 5% was received. In December 2005, a purchase of approximately 25% of the shares of Phoenix was concluded at a cost of approximately NIS 720 million, and an option for the purchase of an additional 8%, at a cost of approximately NIS 230 million, was also received.

Likewise, in 2005, real estate operations overseas were expanded into other countries in Western Europe.

During 2005, convertible debentures and options were converted into shares of the Delek Group in the total sum of approximately NIS 498 million, and Delek Real Estate and Gadot issued shares, debentures and options for debentures to the public. The total net proceeds of the issues of securities to the public amounted to approximately NIS 856 million. As a result of the above issues, the Group recorded a profit of approximately NIS 121 million in 2005.

A company created especially for such purpose issued debentures in the US for a total of $275 million as part of the Yam Tethys project and the Company issued debentures to the institutional market in Israel for a total of approximately NIS 929 million. A significant portion of the sums raised in these issues constitute long term credit which was used to redeem short term credit from banks, which has brought about a significant improvement in the Group's working capital.

In 2005, the Group's working capital increased from a deficit of NIS 1,091 million at 31 December 2004 to positive working capital of approximately NIS 343 million – an increase of approximately NIS 1,434 million.

3. Results of Operations During the Reported Period

Contribution of Principal Operations to Net income (NIS millions)

	1-3/06	4-6/06	7-9/06	10-12/06	2006	2005	2004
Delek USA Operations (1)	65	156	80	36	337	310	20
Israeli Fuel Sector Operations	4	4	5	12	25	(15)	(11)
Petroleum and Gas Exploration and Production Operations	11	16	50	31	108	(1)	35
Automotive Operations (2)	30	42	40	39	151	189	163
Real Estate Operations (3)	28	101	18	88	235	100	119
Biochemical Operations (4)	7	7	4	3	21	31	60
Insurance Operations (5)	25	1	27	56	109	4	-
Telecommunications Operations	(19)	(10)	(6)	(8)	(43)	(57)	(26)
Capital Gains and Others (6)	159	393	(8)	26	570	61	43
Net Income	**310**	**710**	**210**	**283**	**1,513**	**622**	**403**

(1) Delek USA's contribution to the Group's profits was effected by a drop in the rate of the Group's holdings as a result of Delek USA's public placement on the NYSE (from 100% to around 77%), and by fluctuations in refining margins between the various report periods.

(2) Following the private placement of Delek Automotive Systems to the CEO in January 2006, the Group's holdings in Delek Automotive Systems fell from 61.5% to 55.3%. In 2005, capital gains of NIS 45 million from the sale of the operations of Shagrir were included.

(3) Following the placement of shares of Delek Real Estate to third parties in January 2006 and in December 2006, the rate of the Group's holdings of Delek Real Estate fell from approximately 80% to approximately 67.9%. In 2005, due to Delek Real Estate's public placement, the rate of the Group's holdings in Delek Real Estate fell from around 90.1% to around 80%.

(4) Following the public placement by Gadot Biochemicals in 2005, the Group's holdings in Gadot Biochemicals fell from around 71% to around 64.1%.

(5) For developments of holdings in the field of insurance, see Chapter 6G below.

(6) This item, for 2006, includes NIS 443 million in capital gains originating from the public offering of Delek USA, plus a sum of NIS 185 million from the private placement of Delek Real Estate and NIS 59 million from the placement of DAS to the CEO and NIS 10 million from the private placement in The Phoenix. In 2005, capital gains flowing from a placement of shares by Delek Real Estate and Gadot in the sum of approximately NIS 130 million were included. This item also included unallocated financial expenses and results of other operations for infrastructure and investments.

The following are principal data regarding the Group's consolidated statements of income, in NIS millions:

	1-3/06	4-6/06	7-9/06	10-12/06	2006	2005	2004
Revenues	6,004	6,857	7,155	6,313	26,329	20,347	14,275
Less – excise and royalties	536	529	554	592	2,211	2,014	2,026
	5,468	**6,328**	**6,601**	**5,721**	**24,118**	**18,333**	**12,249**
Cost of Revenues	4,830	5,448	5,862	5,077	21,217	15,802	10,234
Gross Profit	**638**	**880**	**739**	**644**	**2,901**	**2,531**	**2,015**
Selling, Marketing and Gas Station Operating Expenses	224	237	234	235	930	861	814
General & Administrative Expenses	100	118	113	110	441	337	296
Operating Income	**314**	**525**	**392**	**299**	**1,530**	**1,333**	**905**
Financial Expenses, net	137	177	123	117	554	594	342
	177	**348**	**269**	**182**	**976**	**739**	**563**
Gains from realization of investments in investee companies, net	182	443	8	69	702	139	100
Other Income (Expenses), Net	4	5	11	(17)	3	113	(28)
Income before taxes on income	**363**	**796**	**288**	**234**	**1,681**	**991**	**635**
Taxes on income	71	162	102	69	404	339	189
Income after taxes on income	**292**	**634**	**186**	**165**	**1,277**	**652**	**446**
Net Share in Profits of Affiliates and Partnerships	78	204	108	201	591	146	136
Minority Interest in Subsidiary Earnings, Net	(60)	(128)	(84)	(83)	(355)	(176)	(159)
Profit from ongoing operations	310	710	210	283	1,513	622	423
Net cumulative effect of changes in Accounting Rules, from start of period	-	-	-	-	-	-	(20)
Net Income	**310**	**710**	**210**	**283**	**1,513**	**622**	**403**

A. 2006 compared with 2005

Revenues

The Company's consolidated revenues for 2006 amounted to approximately NIS 26 billion compared with approximately NIS 20 billion in 2005. The increase in revenues stems mainly from refinery operations in the USA, which commenced in May 2005, and therefore, these revenues have only been included since 2005, from fuel operations in the USA due to expansion of operations and acquisition of rights to operate pumping stations and convenience stores in, from an increase in fuel prices in Israel and the USA, and from an increase in the number of vehicles sold by Delek Automotive Systems.

Gross Profit

The consolidated gross profit for 2006 amounted to approximately NIS 2,901 million, compared with approximately NIS 2,531 million in 2005. The increase in gross profit stems mainly from refinery and fuel operations in the USA, from an increase in the amount of vehicles sold by Delek Automotive Systems as set out above, and from an increase in operations in the field of gas production. Note that the difference in the gross profit between the quarters is effected mainly by fluctuations in refining margins in the USA, for details on refining margins, see the report containing the description of the corporation's business, chapter 7.

Selling, Marketing and Gas Station Operating Expenses

The increase in selling, marketing and station operation expenses in 2006 as compared with 2005, originates primarily from the increase in the cost of operating convenience stores and gas stations, as a result of the acquisition of gas stations and convenience stores in the USA, coupled with the oil refinery operations.

General & Administrative Expenses

The increase in general and administrative expenses in 2006 compared with 2005 stems mainly from expansion of the operations of gasoline stations in the USA and from the recording of expenses for employee options and shares during the report period in accordance with Accounting Standard No. 24, which were set off as a result of termination of the amortization of goodwill following the entry into force of Accounting Standard No. 20 (Amended), see also Note 2(m) to the financial statements.

Financial Expenses, net

The Group's net financial expenses in 2006 amounted to approximately NIS 554 million, as compared with approximately NIS 594 million in 2005, representing a net decrease of approximately NIS 40 million.
Financial expenses in 2006 were affected mainly by a revaluation of the shekel against the dollar (a reduction of approximately 8.2% in 2006 compared with an increase of approximately 6.8% in 2005) and due to a reduction in the consumer price index for 2006 by a rate of 0.1% compared with an increase in the CPI of approximately 2.4% in 2005.

Gains from Placements and Public Offerings

In 2006, the Company generated profits from placements in subsidiaries in the sum of approximately NIS 700 million, flowing mainly from a profit for a first-time placement of shares of Delek USA to the public on the New York Stock Exchange, in the sum of NIS 443 million, from a profit due to a private placement of shares of Delek Real Estate to third parties in the sum of approximately NIS 189 million, from a profit for the placement of shares of Delek Automotive Systems to the CEO in the sum of approximately NIS 59 million, and from a profit for a placement of shares to institutional investors in The Phoenix, in the sum of approximately NIS 10 million.

During the corresponding period in the previous year, the Company earned profits from placements of shares by Delek Real Estate and Gadot, in the sum of approximately NIS 130 million.

Other revenues

The Group's other revenues in 2006 amounted to approximately NIS 3 million compared with approximately NIS 113 million in 2005. The reduction stems mainly from realization of assets and companies in England by Delek Real Estate in 2005.

Net Share in Profits of Affiliates and Partnerships

The Group's share in the profits of affiliates and partnerships during the reported period amounted to the sum of approximately NIS 591 million, as compared with approximately NIS 146 million in the corresponding period last year.

In 2006, this item mainly included the share in the profits of associated companies held by Delek Real Estate, in the net sum of approximately NIS 469 million, share in the earnings of the insurance companies (The Phoenix and Republic) in the amount of NIS 99 million, share in the profits of Avner in the total sum of NIS 42 million, and net of the losses of HOT (formerly Matav), in the sum of approximately NIS 43 million.
The increase in 2006 stems mainly from a valuation of the profit-bearing real estate assets in affiliates of Delek Real Estate, and recording of part of the Phoenix's profits in 2006.

Minority Interest in Subsidiary Earnings, Net

The minority interest in consolidated subsidiary earnings, net, increased from approximately NIS 176 million in 2005 to approximately NIS 355 million in 2006. The increase derived mainly from the increase in the proportion of the minority interest in the profits of Delek Real Estate, Delek Automotive Systems and Delek USA, as a result of share placements, as set out above.

B. 2005 compared with 2004

Revenues

The Company's consolidated revenues for 2005 amounted to approximately NIS 20 billion compared with the sum of approximately NIS 15 billion in 2004. The increase in revenues stemmed mainly from refinery operations in the USA, from fuel operations in the USA due to the acquisition of 100 gasoline stations and convenience stores in the USA in April 2004, and due to an increase in fuel prices in Israel and in the USA.

Gross Profit

Gross profit in 2005 amounted to approximately NIS 2,531 million compared with the sum of approximately NIS 2,015 million in 2004. The increase in gross profit stemmed mainly from the refinery and fuel operations in the USA, as set out above.

Selling, Marketing and Gas Station Operating Expenses

The increase in sales, marketing and gasoline station operating expenses in 2005, compared with 2004, stemmed mainly from the purchase of 100 gasoline stations in the US and from an increase in automotive advertising expenses.

General & Administrative Expenses

The increase in general and administrative expenses in 2005 compared with 2004 stems mainly from the operations of the refinery in the US and from the full consolidation of Dankner Investments in 2005 compared to a partial consolidation in 2004.

Financial Expenses, net

The Group's net financial expenses amounted, in 2005, to approximately NIS 594 million compared with NIS 342 million in 2004, a net increase of approximately NIS 252 million. The increase in financial expenses stemmed mainly from the following reasons:

- An increase in the Group's credit, stemming mainly from the acquisition and the first time consolidation of Dankner Investments, and the acquisition of Matav during 2004, from the acquisition of Menorah and The Phoenix in 2005 and from an increase in credit in fuel operations in Israel. Likewise, financial expenses were affected by an increase in interest rates which took place during the accounting year, and by the commencement of operations that were in the process of being set up in the previous year, and therefore, the financial expenses in respect of these were capitalized for the cost of the asset (the production plant at Yam Tethys in the first quarter of last year, and the IPP Electricity Generating plant).

- An increase in the rate of increase of the CPI known in 2005 compared with 2004 (2.7% in 2005 compared with 0.9% in 2004), which brought about an increase in financial expenses for loans and linked debentures in the sum of approximately NIS 65 million.

- The fact that in 2004, this item had included profits in the sum of approximately NIS 42 million, which stemmed from an increase in the value of Delek Investments' and the Delek Group's negotiable security portfolio, which reduced financial expenses compared with profits of approximately NIS 5 million only in 2005.

- The recording of exchange rate differentials for loans taken in US dollars for the purpose of financing the operations of Yam Tethys in the sum of approximately NIS 33 million.

- An increase in financial expenses in Delek USA in the sum of approximately NIS 88 million as a result of a reduction in the value of future transactions for prescribing distillation margins which do not constitute hedging, and which were recorded in the Israeli financial statements as financial expenses in the sum of approximately NIS 42 million, ascribed to expenses for the balance of costs of raising loans taken in the past and repaid during the second quarter of 2005 in the sum of approximately NIS 14 million, an increase in the sum of the loans for the purchase of 100 gasoline stations and convenience centers during the course of 2005, and acquisition of a refinery during the accounting year, and an increase in interest rates on the loans in the USA.

- The increase in the financial expenses is net, after set-off of a reduction in the financial expenses of Delek Automobile in the sum of approximately NIS 36 million in 2005, compared with 2004, which stemmed mainly from profits from future transactions and from a valuation of supplier balances which gave rise to financing revenues during the accounting year.

Gains from Placements and Public Offerings

Profits from the realization of investments, in the sum of approximately NIS 139 million, stem from profits from the issue of shares in Delek Real Estate in the sum of approximately NIS 111 million, of shares in Gadot in the sum of approximately NIS 10 million, of Orpak in the sum of approximately NIS 4 million, and from the exercise of shares in the Company's long term securities portfolio.

Net Share in Profits of Affiliates and Partnerships

The Group's share of the profits of affiliates and partnerships in 2005 amounted to the sum of approximately NIS 146 million compared with approximately NIS 136 million in 2004.
In 2005, this item included the portion of profits of affiliates held by Delek Real Estate, in the net sum of approximately NIS 123 million (of which NIS 85 million was for estimated fair value of productive real estate assets of foreign companies which prepare their financial statements in accordance with international accounting rules), profits from realization of the assets of Shagrir, which is an affiliate of Delek Automotive, in the sum of approximately NIS 46 million, a portion of the profits of Avner and Amisragas in the total sum of approximately NIS 36 million, and less the losses of Matav, in the sum of NIS 57 million.
The increase in 2005 compared with 2004 stems from an increase of NIS 14 million in this item from Delek Real Estate, mainly due to Delek Real Estate's portion of profits from investments from overseas affiliates, less an increase in losses stemming from Carmel Coastline Company, from profits from realization of the assets of Shagrir as set out above and less the increase in the Company's portion of the losses of Matav, due to the fact that Matav's expenses were included partially in 2004, and as a result of the increase in Matav's total losses.

Minority Interest in Subsidiary Earnings, Net

The minority's interest in net earnings of subsidiaries rose from approximately NIS 159 million in 2004 to approximately NIS 176 million in 2005. The increase stems mainly from an increase in the rate of the minority's interest in the profits of Delek Real Estate and Gadot, as a result of placements by those companies.

4. Financial Position

In 2006, the Group for the first time consolidated the financial data for The Phoenix and Republic Companies Group Inc. (hereinafter: "Republic") since acquisition of Republic and the increased control of The Phoenix took place at the end of 2006. The rest of the assets of the insurance businesses as at December 31, 2006 amounted to approximately NIS 34 billion and the balance of the general assets amounted to approximately NIS 18 billion. In the consolidated balance sheet, the data for The Phoenix and Republic are presented separately as part of the assets and liabilities of the insurance businesses.

The following are the main changes in the balance sheet items for assets and liabilities from general businesses in 2006 compared with 2005:

Cash and Short-Term Investments

The cash and short-term investment balances increased in 2006 from NIS 1,696 million to approximately NIS 1,516 million, representing an increase of approximately NIS 180 million.
From an increase in the sum of approximately NIS 334 million which stemmed mainly from fuel and refinery operations in the USA, from an increase of NIS 70 million in the automobile sector as a result of the acquisition of negotiable securities and a reduction in the sum of approximately NIS 219 million from the real estate sector.

Investments in investee and other companies

Total investments in investee and other companies amounted to the sum of approximately NIS 2,815 million, compared with the sum of approximately NIS 2,586 million, an increase of approximately NIS 229 million net.

This increase stems from the acquisition of approximately 13.68% of the shares of Industrial Buildings Ltd. in consideration for the sum of approximately NIS 269 million, an increase in the investments of associated companies in the real-estate sector possessing profit-generating real estate assets, inter alia, in the UK, Germany, Switzerland, Finland, Canada and Israel in the sum of NIS 262 million and net of the repayment of loans from affiliates in the sum of NIS 98 million and the realization of investments in associated companies in the real-estate sector in the sum of NIS 48 million and an increase in loans received from associated companies in the sum of approximately NIS 122 million.

In 2005, the balance of approximately NIS 658 million for investments in The Phoenix was included and this is not included in 2006 due to The Phoenix's having become a consolidated company.

The Group's share in the earnings of associated companies amounted to NIS 591 million and also contributed to the growth in this item.

Long term loans, deposits and debts

The balance of long-term loans, deposits and debts increased by the sum of approximately NIS 258 million. The principal increase stemmed from the loan amounting to approximately NIS 204 million from Delek Real Estate to Vitanya, which can be converted into shares of Vitanya Ltd. For further details, see chapter 6E below – real estate operations.

Investments in oil and gas exploration and production

The balance of investments in oil and gas exploration and production increase by the sum of approximately NIS 175 million. The increase stemmed mainly from an expansion of the operations of Delek Energy Systems overseas (particularly in Vietnam and the USA). For further details see chapter 6C below.

Plant property and equipment

Fixed assets increased by approximately NIS 559 million, net. The growth originates mainly from the acquisition of fuel stations and convenience stores in the USA for a sum of approximately NIS 230 million, along with NIS 248 million on account of purchase of marketing assets and fuel refining in the USA.

Short-Term Credit from Banks and Others

A net decrease of approximately NIS 343 million was recorded. The decrease was due mainly to a net decrease in credit from banking corporations and financial institutions to members in the Group, and a raising of new credit with longer repayment dates.

Undertakings to Suppliers and Service Providers

There was a decrease of approximately NIS 355 million stemming mainly from a decrease in the sum of approximately NIS 342 million in Delek Automotive's supplier balance.

Accounts Payable

There was an increase of approximately NIS 281 million flowing mainly from an increase in the institutions item in the sum of approximately NIS 50 million mainly from Delek USA, from an increase of approximately NIS 50 million stemming mainly from an increase in transactions in derivatives in Delek Real Estate and in Delek Automotive Systems, an increase in interest payable on debentures in the sum of approximately NIS 96 million mainly in Delek Real Estate, and an increase in joint gas and oil transactions in the sum of approximately NIS 42 million.

Long-term loans

There was an increase of approximately NIS 757 million flowing mainly from the taking of long-term loans from financial institutions.

Debentures Convertible Into Company Shares

There was a decrease of approximately NIS 197 million stemming mainly from conversion of debentures into shares during the report period, in the sum of approximately NIS 257 million.

Other Debentures

There was a net increase of approximately NIS 1,734 million stemming mainly from an issue of debentures, a private placement by the Group in the sum of NIS 1,568 million. Likewise, during the report period, Delek Real Estate effected a private placement of debentures in the sum of approximately NIS 400 million.

Other Liabilities

There was an increase of approximately NIS 230 million stemming mainly from a balance of liabilities in the sum of approximately NIS 102 million for a placement of blocked shares to the CEO of Delek Automotive (for details see Note 9J(3) to the financial statements), an increase in the sum of approximately NIS 50 million stemming from DES USA's share of the fair value of liabilities for hedging transactions for oil and gas prices effected by a partnership purchased during the report period, and an increase in the sum of approximately NIS 40 million for deferred profits made by the Group in a placement of Delek Real Estate shares (see Note 9J(a) to the financial statements).

Shareholders' Equity

Shareholder's equity as at December 31, 2006 amounted to approximately NIS 3,447 million compared with approximately NIS 2,276 as at December 31, 2005.
The increase in shareholder's equity stems mainly from profits in the report period in the sum of approximately NIS 1,513 million, from conversion of debentures in shares of the Company in the sum of approximately NIS 257 million, and from exercise of option warrants for shares of the Company in the sum of approximately NIS 13 million, less dividends declared in the sum of approximately NIS 547 million, and less capital from provisions made for currency conversions in the sum of approximately NIS 76 million.

Contingent Liabilities

The Company's accountants draw attention, in their Opinion, to lawsuits against the Company and its subsidiaries. For details see Note 25 and Note 38H(b) to the financial statements.

5. Sources of Finance

A. In the report year, the Company raised approximately NIS 1,568 million via the issue of two series of debentures in the Israeli institutional market. For details see Note 22 B to the financial statements. It should be noted that Maalot – The Israel Securities Rating Company Ltd. – a Standard & Poor's strategic partner, has granted all the Company's debentures an (AA) rating, including the Series L debentures which were issued in November 2006.

B. Conversion of debentures and exercise of option warrants for shares in the Company – in the report year, convertible debentures and option warrants were converted in the sum of approximately NIS 270 million for shares in the Company. For details see Note 27 B and C to the financial statements.

C. In December 2006, Delek Finance US, Inc. completed a capital raising from a banking corporation in the sum of approximately $220 million for the purpose of financing the acquisition of a US insurance company – see also chapter G(2).

D. Surplus financial liabilities of the Company (in non-consolidated statements) as at December 31, 2006 totaled approximately NIS 58 million (including a total of approximately NIS 2,702 million in loans, net, to companies in the Group).

The surplus financial liabilities of Delek Investments (in the non-consolidated financial statements of Delek Investments) as at December 31, 2006, totaled approximately NIS 1,299 million (including a total of approximately NIS 625 million in net loans from Group companies).

The surplus financial liabilities (in the non-consolidated statements) of Delek Hungary (which is the direct parent company of Delek USA), as at December 31, 2006, amounted to approximately NIS 174 million.

The outstanding financial debt of Delek Petroleum (in non-consolidated statements) amounts to negligible sums.

The surplus financial liabilities (in non-consolidated statements) of Delek Capital and of Delek Finance US, Inc. (which is the direct parent company of Republic), as at December 31, 2006, amounted to approximately NIS 2,053 million.

Surplus financial liabilities include liabilities to banks and other creditors (including companies in the Group), less cash, cash equivalents, marketable securities and balances at banking institutions.

E. As to the first-time issue of shares of Delek Automotive Systems, Delek Real Estate, and The Phoenix, see Chapters 6D, 6E and 6G below.

F. As to the first-time placement by Delek USA shares, see Chapter 6A, below.

G. As to the raising of capital by debentures, by Delek Real Estate, see Chapter 6e, below.

6. Analysis by Sectors of Operation

A. Delek USA

The following are the results for Delek USA, as included in the Group's consolidated financial statements:

	2006			**2005**			2004
	Total	**Refinery and marketing operations**	**Convenience Stores and Gasoline Stations**	**Total**	**Refinery Operations** (1)	**Convenience Stores and Gasoline Stations**	**Convenience Stores and Gasoline Stations**
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues	14,252	8,072	6,181	9,190	4,239	4,951	3,846
Gross Profit	1,403	683	719	1,174	527	647	570
Sales expenses, gasoline station operation expenses and other ascribed expenses	527	-	527	449	-	449	411
Ascribed administrative expenses	101	51	50	81	26	54	89
Profit before mutual expenses	774	632	142	645	501	144	70
Unallocated G&A expenses	75			46			-
Operating Income (1)(2)	699			599			70
Other revenues	-			10			4
Financial expenses (2)	81			130			42
Income Before Taxes	618			478			31
Net Income	**418**			**310**			**20**

(1) Operations commenced at the end of April 2005, as set out below.

	1-3/06			4-6/06			7-9/06			10-12/06		
	Refinery Operations	**Convenience Stores and Gasoline Stations**	**Total**	**Refinery Operations**	**Convenience Stores and Gasoline Stations**	**Total**	**Refinery Operations**	**Convenience Stores and Gasoline Stations**	**Total**	**Refinery and marketing operations**	**Convenience Stores and Gasoline Stations**	**Total**
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues	1,691	1,390	3,081	2,047	1,647	3,964	2,278	1,765	4,043	2,056	1,379	3,435
Gross Profit	123	156	279	314	187	501	144	222	366	102	154	256
Sales expenses, gasoline station operation expenses and other ascribed expenses	-	124	124	-	134	134	-	141	141	-	128	128
Ascribed administrative expenses	10	11	21	16	12	28	10	12	22	15	15	30
Profit before mutual expenses	113	21	134	298	41	339	134	69	203	87	11	98
Unallocated G&A expenses			12			17			21			25
Operating Income			122			322			182			73
Other revenues			-			-			-			-
Financial expenses (1)			23			18			19			21
Income Before Taxes			99			304			163			52
Net Income (excluding minority interest)			65			201			111			41

(2) Losses from future transactions for the setting of distillation margins which do not constitute hedging in the sum of approximately NIS 42 million were accredited to the Israeli financial statements as financial expenses in 2005.

Delek USA operates a refinery with a maximum production capacity of 60,000 barrels, and a pipeline for the transportation of crude oil, which are located in the State of Texas, USA, as well as gasoline stations and convenience centers in eight neighboring states in the southeastern USA. Delek USA markets its products to 392 gasoline convenience stores and its operations are especially concentrated in the State of Tennessee (198 stations), Alabama (92 stations) and Virginia (36 stations), under the brand name MAPCO Express. Likewise, Delek USA sells fuel products as an exclusive supplier to approximately 61 stations operated by third parties, and to other stations, without a supply contract.

Delek USA operates in markets where the large oil companies and the large department store chains – which also compete in the sale of fuel and lubricant products – are active and therefore, Delek's share of the total American market is negligible. In Nashville and Memphis (in the State of Tennessee), and in northern Alabama, Delek USA enjoys one of the largest market shares in its area of operations.

On May 9, 2006, Delek USA completed a public offering and registration for trade of its shares on the New York Stock Exchange. 11,500,000 shares were sold in the offering at a price of $16 per share. The net proceeds amounted to $172 million (net of underwriting fees and before offering expenses). Following the offering, the Group's holdings in Delek USA have decreased to approximately 77.4%.

During the fourth quarter of 2006, Delek USA acquired rights to the operation of 43 gas stations and convenience stores (ownership rights to 30 stations and leasehold rights to 13 stations) in Southeastern Tennessee and northern Georgia in the USA, from Fast Petroleum (hereinafter: "Fast"). Delek USA intends to convert the convenience stores to the Mapco Mart brand in the next several months.

On July 31, 2006, Delek USA acquired various refinery and fuel marketing assets from the Pride-LP Group and related companies, based in Abilene, Texas. The assets acquired include two fuel product sales terminals, located at Abilene and San Angelo, Texas, seven fuel product transmission pipelines of approximately 114 miles in length which connected Delek USA's terminals and the Dyess US Air Force Base, and fuel product storage tanks with a total capacity of more than one million barrels.

After the balance sheet date, in February 2007, the subsidiary Mapco Express, Inc., which is wholly owned by Delek USA, entered into a contract for the purchase of 107 gasoline stations with convenience stores, from Calfee, based on Delton, Georgia, for consideration of the sum of approximately $65 million (not including inventory). The gasoline and convenience stores are located in the area of eastern Tennessee and Georgia, and operate under the brand name "Favorite Markets". The purchase shall be financed through a combination of Delek USA's cash balances and an increase of the subsidiary's credit limit. Completion of the transaction is subject to preconditions.

The following is an analysis of the results of Delek USA's operations during the report period.

Revenues

The sales of Delek USA amounted to NIS 14,252 million during the reported period , as compared with NIS 9,190 million during the corresponding period last year. The increase is primarily attributed to the following factors:

- The sales of Delek Refinery, including Delek Marketing and Supply in the sum of approximately NIS 8,072 million, compared with NIS 4,239 million during the corresponding period last year, operations which commenced on April 29, 2005 (Delek Marketing and Supply markets fuel products via two terminals that it owns and a number of terminals that are owned by a third party, since July 31, 2006. These sales, during the report period, amounted to approximately NIS 930 million).
- Acquisition of 25 fuel stations and convenience centers in December last year and 43 gas stations and convenience centers in July and August 2006.
- An increase in the same-store volume of sales of convenience stores and gas stations.

Sales of Delek USA in 2005 totaled NIS 9,190 million compared with approximately NIS 3,846 million in 2004. The increase stemmed from the following main factors:

- Sales of Delek Refining, in the sum of NIS 4,239 million, operations which commenced on April 29, 2005.
- Purchase of 100 gasoline stations and convenience stores in April last year.
- A sharp increase in fuel prices.
- An increase in the sales volume of Same Store products.

Gross Profit

The gross profit in the reported period amounted to NIS 1,403 million, as compared with NIS 1,174 million in the corresponding period last year. The increase flows mainly from refinery and marketing operations which produced a gross profit of approximately NIS 683 million compared with approximately NIS 527 million during the corresponding period last year, from an increase in operations of convenience stores and gasoline stations and due to the acquisition of 25 convenience stores and gasoline stations in December last year, and 43 convenience stores and gasoline stations in July and August 2006. The gross profit for 2006 includes profits stemming from an increase in the value of refinery fuel inventory (closing inventory calculated using the average method as opposed to the balance using the LIFO method), in the sum of approximately NIS 4 million (net income after tax of approximately NIS 3 million).

Gross profit in 2005 amounted to NIS 1,174 million, compared with NIS 570 million in 2004. The increase stems mainly from refinery operations, which gave a gross profit (after amortization and production costs) of approximately NIS 527 million, and from an increase of operations and profitability of the convenience stores and service stations, and due to acquisition of the operations of 100 convenience centers and gasoline stations in April 2004. The gross profit for 2005 includes profits flowing from increased value of refinery fuel inventory (closing inventory calculated according to the average method, as compared with the balance under the LIFO method), in the sum of NIS 37 million in 2005 (net income after tax of approximately NIS 24 million).

Sales expenses, gasoline station operation expenses and other ascribed expenses (hereinafter: "operating expenses")

Operational expenses amounted to NIS 628 million during the reported period , as compared with NIS 530 million during the corresponding period last year. This increase is primarily attributed to an increase in the fuel station and convenience store operating costs, as a result of acquiring the operations of 25 convenience stores and fuel stations in December 2005 and the acquisition of 43 convenience and fueling centers in July and August 2006, coupled with an increase in credit card commissions and higher fuel prices.

Operating expenses in 2005 came to NIS 530 million, compared with NIS 500 million in 2004. The increase stemmed mainly from an increase in the costs of operating convenience stores and gasoline stations, as a result of purchase of 100 convenience centers and gasoline stations in April 2004, from an increase in credit card commissions and from an increase in fuel prices.

Non-ascribed general and administrative expenses

Non-ascribed general and administrative expenses amounted to approximately NIS 75 million during the reported period, as compared with approximately NIS 46 million during the corresponding period last year. This increase is primarily attributed to General & Administrative Expenses associated with the acquisition of the oil refinery in April 2005, the acquisition of the Marketing and Supply operations in July 2006 and additional expenses that were incurred by the Company in parallel to its IPO in May 2006.

Non-ascribed general and administrative expenses amounted in 2005 to approximately NIS 46 million. In 2004 all expenses were ascribed to gasoline station operations. The increase stems mainly from general and management costs relating to the refinery purchased by the Company on April 29, 2005.

Operating Income

Operating income for the report year amounted to NIS 699 million compared with the sum of approximately NIS 599 million in the previous year. This increase is primarily attributed to the profitability of the refining segment, that originates from an increase in the volume of operations of the refinery, coupled with growth in the contribution of the convenience stores and fuel stations. (missing an explanation of the refining margin and the fact that despite the fact that the refinery was operational for the entire year, there is no significant increase in operating income).

In 2005, the profit from operations amounted to NIS 599 million compared with approximately NIS 70 million in 2004. The increase stemmed mainly from the profitability of the refining sector, from an increase in profitability of existing stations and as a result of the purchase of 100 convenience stores in April 2004.

Financial Expenses

The financial expenses amounted to approximately NIS 81 million during the reported period, compared with approximately NIS 130 million during the corresponding period last year. The corresponding period last year included a non-cash, non-recurring expenditure of NIS 14 million related to the refinancing of the Company, coupled with loss from future transactions in 2005, for the setting of refinery margins that do not constitute financial hedging, in the sum of approximately NIS 42 million, that were allocated to the Israeli financial statements as financial expenses.

Financial expenses for 2005 amounted to approximately NIS 130 million, compared with approximately NIS 42 million in 2004. The increase in financial expenses stems from an increase in loans from the Company (mainly due to the purchase of 100 convenience centers in April 2004, and due to purchase of the refinery), an increase in interest rates on loans, due to a one-time non-cash expense of approximately NIS 14 million with respect to refinancing of Delek USA's loans, and from a loss from future transactions for fixing refining margins, which are not recognized as hedging for accounting purposes, in the sum of approximately NIS 42 million, note that these contracts terminated during the fourth quarter of 2005.

Net Income

The net income in the reported period amounted to NIS 418 million, as compared with NIS 310 million in the corresponding period last year. The increase is attributed to the rise in sales, coupled with the operating margins of Delek USA.

Net income in 2005 amounted to NIS 310 million compared with a profit of NIS 20 million in 2004. The increase stems from an increase in sales and in Delek USA operating margins. Note that there was a significant increase in current distillation margins around the world, and in the USA in particular, in the third and fourth quarters of 2005. This level of margins had a significant effect on the profitability and the cash flows of refinery operations.

It should be noted that there are a number of differences between the financial results of Delek USA under generally-accepted published accounting principles in the USA and the inclusion thereof in the financial statements under generally-accepted accounting principles in Israel. The main differences stem from a different accounting policy (the method of determining inventory costs based on LIFO in US financial statements, as compared with the averaging method used in Israel, the amortization of goodwill in Israel up to December 31st 2005, as compared with its not being amortized in the financial statements of Delek USA), along with various classifications (results of future transactions for determining refinery margins which do not constitute hedging are included under operating income in the US reports, as opposed to being included under financial expenses in the Group's financial statements).

Additional Information

For details regarding the grant of options to the CEO of Delek USA, to directors of Delek USA and to the chairman of the board of directors and the CEO of the Delek Group, see Note 9J(b)(1).

B Israeli Fuel Sector Operations

Presented below are the results of Delek – The Israeli Fuel Corporation, Ltd.:

	1-3/06	4-6/06	7-9/06	10-12/06	2006	2005	2004
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Gross income	1,595	1,719	1,715	1,606	6,635	6,040	5,281
Gross Profit	113	142	111	131	497	469	496
Operating Income	16	36	11	29	92	45	53
EBITDA	32	50	27	44	153	112	124
Financial Expenses	14	23	15	7	59	74	55
Net income (loss) before share in Delek USA results	4	4	5	12	25	(15)	(11)
Delek Israel's share of Delek USA's results (*)	-	21	3	0	24	-	-
Net Income (loss)	4	25	8	12	49	(15)	(11)

(*) In 2006, Delek Israel included its share in the Delek USA results for the first time (approx. 3%).

The Group's operations in the Israeli fuel sector are performed by Delek – the Israel Fuel Company Ltd. (hereinafter: ""Delek Israel"), which is a private company.
Delek Israel operates in the field of petroleum fuels in Israel, including marketing and distribution of petroleum fuels and oils, and initiation of the set-up and operation of gasoline stations and convenience stores. Delek Israel sells its products to 225 public gasoline stations in Israel.

The following is an analysis of the results of Delek Israel's operations during the report period:

Revenues

Sales of fuels in Israel (including excise taxes) amounted to approximately NIS 6,635 million during the period of the report compared with approximately NIS 6,040 million in 2005 (an increase of 10%). The main increase in sales stems from an increase in fuel prices by an average rate of approximately 14% and an increase in the excise imposed on diesel, which were set off partly by a decrease in quantities of fuel sold.

Sales of fuels in Israel (including excise taxes) amounted to approximately NIS 6,040 million in 2005 compared with approximately NIS 5,281 million in 2004 (an increase of approximately 14%). In 2004, sales included sales to a large institutional customer in the amount of NIS 358 million, compared with NIS 15 million in 2005. Subtracting the sales to the large institutional customer, the increase in sales was approximately 22%, and quantitative sales in 2005 increased compared to 2004 by 2.1% (less sales to the large institutional customer). Fuel prices in 2005 rose by 18% on average, compared with 2004.

Gross Profit

The gross profit for the year of the report amounted NIS 497 million compared with NIS 469 million in the previous year.
The increase in gross profit stems mainly from an improvement in profits from fuel sales.
Gross profit in 2005 amounted to NIS 469 million compared with NIS 496 million in 2004. The decrease stemmed mainly from a reduction in inventory profits in 2005 compared with 2004, and on the other hand, an increase was recorded in profits from sales of shipping fuels.

Operating Income

Operating income during the report period amounted to approximately NIS 92 million compared with approximately NIS 45 million in 2005. The increase in operating income stems from an increase in gross profit and a decrease in sales general and administrative expenses.
Operating income in 2005 amounted to approximately NIS 45 million compared with NIS 53 million in 2004. The decrease stemmed from a decrease in gross profit in 2005, which was set off in part by a decrease in sales expenses, the operation of gasoline stations and general and administrative expenses.

Financial Expenses

Financial expenses in the report year amounted to approximately NIS 59 million compared with approximately NIS 74 million in 2005, a decrease of approximately NIS 15 million. The decrease in financial expenses stems from a decrease in the known CPI and a decrease in the dollar exchange rate in 2006, whilst the CPI and dollar exchange rate rose in 2005.

Financial expenses in 2005 amounted to approximately NIS 74 million compared with approximately NIS 55 million in 2004, an increase of approximately NIS 19 million. The increase in financial expenses stemmed from an increase in the known CPI and a decrease in the dollar exchange rate in 2005 compared with a revaluation of the dollar exchange rate in 2004. An increase in Delek Israel's credit also contributed to the increase in financial expenses.

Other revenues

Other revenues in 2006 amounted to approximately NIS 10 million, which was similar to 2005. In the report year, this item includes compensation in the sum of approximately NIS 7 million which Delek Israel received due to its being the second place in the bid for ORA (Oil Refineries Ashdod). In 2005, this item contained one time revenues flowing mainly from compensation from the Palestinian Authority for nationalization of the assets of Delek Israel which were situated within the territory of the Authority, in the sum of approximately NIS 3 million, and a capital gain from dilution of the holdings of Orpak, in the sum of NIS 4 million.

Other revenues in 2005 amounted to approximately NIS 9 million, compared with an expense of approximately NIS 8 million in 2004. In 2004, this item included a provision made for devaluation in the sum of approximately NIS 4 million, and losses from realization of assets.

Taxes on income

Tax expenses during the report year amounted to approximately NIS 21 million compared with NIS 11 million in 2005. The increase stems mainly from a change in deferred taxes.

Tax expenses in 2005 amounted to NIS 11 million, similar to 2004.
Following approval of the Regulations gradually reducing the company tax rate to a rate of 25% in 2010, Delek Israel incurred tax expenses in 2005 in the sum of approximately NIS 11 million, compared with an expense of approximately NIS 5 million in 2004, due to a reduction in the tax rate at the end of the previous year to 30%. These tax expenses were caused as a result of an updated of deferred taxes to the future tax rates known at the end of each period.

Delek Israel's share of the profits of associates

Delek Israel's share of the profits of associates amounted to approximately NIS 32 million compared with NIS 20 million in 2005. As of the second quarter of the report year, the Company began ascribing equity profits for the holdings of Delek Israel in Delek US, upon execution of a joint voting agreement with Delek Petroleum in Delek Hungary. Delek Israel's share of Delek US amounted during the report year to NIS 24 million. However, a decrease in the Company's profits from Amisragas was recorded from NIS 18 million in 2005 to NIS 6 million in 2006. The decrease stemmed from a provision recorded by Amisragas for tax expenses following the dismissal of its appeal against a tax assessment in the Supreme Court.

Delek Israel's share in the earnings of associated companies in 2005 amounted to NIS 20 million compared with NIS 13 million in 2004. The increase is due mainly to an increase in the earnings of an affiliate – Amisragas.

Net Income

Delek Israel's net income in 2006 amounted to approximately NIS 49 million compared with a loss of NIS 15 million in 2005. The increase stems from an improvement in fuel profitability and from the first time ascription of the profits of Delek US, as of the second quarter of the report year.

In 2005, the net loss amounted to NIS 15 million compared with a loss of approximately NIS 10 million in 2004. The increase in the loss stemmed mainly from a decrease in gross profits, and from an increase in financial expenses.

Net Financial Credit

Delek Israel's total financial credit, net (total financial liabilities net of cash and cash equivalents, emergency inventories, loans to related parties and long-term deposits, loans and receivables) as at December 31, 2006, amounted to NIS 1,057 million, as compared with approximately NIS 1,212 million at the end of 2005.

Additional Information

For information on the option plan for the CEO of Delek Israel, see Note 9J(c) to the financial statements.

C. Petroleum and Gas Exploration and Production Operations

The following are the results of oil and gas exploration and production operations, as included in the Group's results:

	1-3/06	**4-6/06**	**7-9/06**	10-12/06	**2006**	2005	**2004**
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Income less royalties	58	51	84	75	268	184	141
Operating Income	34	29	52	39	154	95	83
EBITDA	49	41	73	60	223	142	110
Financial Expenses	21	11	6	5	43	90	39
The Group's share in results of Avner	7	9	17	10	43	15	22
Net Income (loss)	11	16	50(**)	31	108	(1)	35
Gas sales in BCM (*)	0.5	0.5	0.7	0.6	2.3	1.7	1.2

(*) The data refer to gas sales by the entire Yam Tethys group, rounded to the nearest tenth of one BCM.

(**) This item includes a profit in the sum of NIS 6 million, flowing from a decreased rate of holding as set out below.

1) **Results of Operations**

A. Most of the Group's oil and gas exploration and production operations are related to direct and indirect holdings in the Yam Tethys project.
The method of presentation of Yam Tethys' operations, as expressed in the consolidated financial statements of the Group, is considerably effected by the structure of the holdings in the Yam Tethys project:

- All of the results of Delek Drilling, which holds 25.5% of the Yam Tethys venture, are consolidated in the Group's financial statements, with the minority interest being included in the item regarding net minority interests in profits of consolidated companies and partnerships.
- The results of the 4.4% of the Yam Tethys venture that are held directly by Delek Investments are fully consolidated in the Group's financial statements.
- All of the results of Avner, which holds 23% of the Yam Tethys venture, are set out in one line – net Group's share in profits of partnerships and affiliated companies.

B. The subsidiary Delek Automotive Systems Ltd. (hereinafter: "DAS") operates overseas via two principal companies that coordinate its commercial operations in Vietnam, in the USA and in Guinea Bissau, as follows:

- Delek Energy (Vietnam) LLC (hereinafter: "Delek Vietnam") – which focuses on oil and gas exploration in Vietnam. The company has 25% participation rights in a project in Vietnam.
- Delek International Energy Ltd. – which directly holds rights in Guinea Bissau, and which, via Delek Energy System US Inc., (hereinafter: "DES USA") holds rights in projects in the USA.

  The results of operations in the USA have been included since the fourth quarter of 2006.

C. In the third quarter of 2006, Delek Investments' holdings in DES fell from 89.4% to 88.9% as a result of exercise of option warrants. The profit generated to Delek Investments in 2006 amounted to the sum of approximately NIS 6 million.

D. The Group (via its holdings in the Delek Drilling Partnership, and Avner and Delek Investments as aforesaid) sells natural gas to the Electricity Company, which is supplied to the Eshkol Power Station at Ashdod, and since July 2006, to the Reading Power Station in Tel Aviv, and has been selling natural gas to the Oil Refinery at Ashdod since November 2005. Consequently, the Group continued to record growth in net income during the reported year, coupled with positive cash flows from the gas selling operations.

The following is an analysis of the results of operations during the report period

Revenues

In 2006, the Group earned revenue from the sale of gas, less royalties and less sums paid for the transaction to determine the price of gas as a fixed dollar value in accordance with a hedging transaction, in the sum of approximately NIS 268 million, compared with revenue from the sale of gas less royalties of approximately NIS 184 million in 2005.

The increase in revenues this year compared to last year stems from commencement of the supply of natural gas to the Reading power station as of the beginning of the third quarter of the year. In addition, the increase in revenues stems mainly from the third quarter of the year, as a result of the supply of gas during IEC peak times at spot prices that are significantly higher than the prices in the 2002 contract, in accordance with an amendment of the IEC contract signed in August 2006 which relates to gas sales as of July 1, 2006, and from the supply of gas to the refinery at Ashdod, which commenced in November 2005.
In addition, the revenues from sales of oil and gas in the USA, in the sum of approximately NIS 10.1 million, were included for the first time in the report year.

In respect of 2006, sums of approximately NIS 15.5 million were paid for the hedging transaction to determine the price of gas in an agreement with the Electricity Company at Delek Drilling and Delek Investments. Of this, approximately NIS 13.5 million were accredited to reduction of revenues from sale of gas, and approximately NIS 2 million for financial expenses, in accordance with the ratio between the foreseen amount of gas in respect of which the hedging transaction was effected, and the amount of gas actually sold in 2006.

In 2005, the Group earned revenue from the sale of gas, less royalties and less sums paid for the transaction to determine the price of gas as a fixed dollar value in accordance with a hedging transaction, in the sum of approximately NIS 184 million, compared with revenue from the sale of gas less royalties of approximately NIS 141 million in 2004 (recognition of revenues began in March 2004). In respect of 2005, sums of approximately NIS 14 million were paid for the hedging transaction to determine the price of gas in an agreement with the Electricity Company at Delek Drilling and Delek Investments. Of this, approximately NIS 11 million was accredited to a reduction in revenues from sales of gas, and approximately NIS 3 million to financial expenses, as set out above.

Operating income and EBITDA

The operating income for the report year totaled approximately NIS 154 million compared to operating income of approximately NIS 95 million in 2005.

The increase in profit in the report year stems from an increase in the revenues item, mainly due to sales of gas to the Electricity Company as set out above. Note that sales of gas to the oil refinery in Ashdod were also included in the report year, these sales beginning in November 2005 as aforesaid. At the same time, there was a more moderate increase in operating and general expenses.

In 2005, operating income and EBITDA, following deduction of the costs of the Gad 1 shaft, in the sum of approximately NIS 7 million, carried by Delek Drilling, which was abandoned in 2005, compared with approximately NIS 2 million for petroleum assets at the Yavne Meter, which was sold to Ratio Petroleum Exploration in 2004.

Financial Expenses

Financial expenses for 2006 amounted to approximately NIS 43 million compared with approximately NIS 90 million in 2005, i.e. a decrease of approximately NIS 47 million.

The decrease stems mainly from a reduction in the financial expenses of Delek Drilling, which amounted to approximately NIS 7 million in the report year, as opposed to approximately NIS 41 million in the previous year, i.e., a reduction of approximately NIS 34 million.
The significant gap between the report year and the previous year stems mainly from the fact that during the report year, the shekel appreciated at a rate of approximately 8.21% compared with a devaluation of approximately 6.85% in the previous year. As a result of

surplus liabilities for deposits and dollar cash at Delek Drilling, the appreciation of the shekel during the report year brought about revenues from exchange rate differentials in the sum of approximately NIS 14 million, as opposed to exchange rate differentials in the previous year, of approximately NIS 17 million.

In addition, there was a decrease in financial expenses during the report year as a result of a decrease in the CPI by about 0.1% in the report year, compared with an increase in the CPI by about 2.4% in the previous year, which caused the Company revenues in the report year due to linkage differentials in the sum of approximately NIS 0.5 million compared with linkage differential expenses in the sum of approximately NIS 12 million in the previous year. Note that in 2006, expenses for the gas price hedging transaction, in the sum of approximately NIS 2 million were accredited to the financial expenses item.

Financial expenses in 2005 amounted to approximately NIS 90 million, compared with the sum of approximately NIS 39 million in 2004. Note that in 2004, interest expenses, exchange rate differentials, guarantee commissions and linkage differentials were capitalized up to the first recognition of revenues (March 2004), whilst in 2005, these expenses were recorded in full for profit and loss. The increase in financial expenses in 2005 stems from a number of factors, and mainly from the recording of exchange rate differentials for surplus net dollar liabilities, due to a devaluation of the Shekel compared with the Dollar in 2005 by a rate of approximately 6.85% compared with an increase in the Shekel rate in 2004, in the rate of approximately 1.62%. As set out below, due to the fact that most of the gas operations are effected in US Dollars, including revenues, assets and liabilities, the dollar liabilities are economically hedged, and this is not expressed in accounting records.
Likewise, financial expenses were affected by an increase in the CPI by approximately 2.4% in 2005, compared with an increase in the CPI by approximately 1.2% in 2004. Note that in 2005, expenses for the hedging transaction against gas prices, in the sum of approximately NIS 3 million, were included in financial expenses, as set out above.

Additional Information

The average daily consumption of natural gas by the Israel Electricity Company ("IEC") varies, among other things, in accordance with seasonal changes in power demand and according to maintenance work performed by the IEC. The above consumption of gas by the IEC in 2006 was higher than in the previous year, mainly due to the connection of the Reading Power Station and due to the maintenance works done in the previous year at the Eshkol Power Station at Ashdod. Sale of natural gas to the IEC during the fourth quarter of the year were lower than the third quarter, mainly as a result of seasonality, of the maintenance works done by IEC and as a result of the additional Mary 7B development drilling work which took place from the production platform commencing in the fourth quarter, which caused brief disruptions in the supply of gas from the platform. Note that there are still significant delays in the timetables for connecting other power stations of the IEC and the Hadera Paper Mills to the national natural gas transmission system.

2) Global Oil and Gas Exploration

A. Delek Vietnam, a wholly-owned subsidiary of Delek Energy Systems is a 25% partner in a project in Vietnam, which includes the petroleum assets in blocks 12W and 12E. The other partners in the project include: Premier Vietnam - 37.5%, which acts as operator of the project, and Santos - 37.5%.

In the accounting year, the parent company of the project operator (Premier Oil PLC) gave notice that it was performing a number of drillings at the DUA field where oil and gas had been found. Likewise, a number of drillings were performed in order to evaluate the potential of the gas and oil reservoirs. The above company also gave notice that production tests had been done on two reservoirs there being a flow of oil from the target reservoir at a fixed rate of 5,543 barrels of oil per day, plus 6.76 million cubic feet of gas a day, and the project operate will assess the results and prepare a assessment report for the reservoirs (see below).
In addition, during the account year, drilling was effected on the Blackbird prospect, which is approximately 21 km south west of the drilling at the Dua field. This exploration uncovered four oil-bearing strata, which were examined using logs, with oil samples being taken for ongoing evaluation. The parent company of the project operator also gave notice that production testing had been conducted on two strata in which oil was flowing at a cumulative production rate, in both of them, of approximately 6,000 barrels of oil per day. In January 2007, a diagonal exploration was completed, the aim of which was to obtain additional information from the reservoir, and to enable preparation of reports, estimating the size of the gas reserves and evaluating the reservoirs (see below).

On March 18, 2007, Delek Energy Systems gave notice that it had received data from the project operator, Premier, relating to the project and to the results of the exploratory drilling conducted in the Dua and Blackbird fields.
According to Premier's initial evaluations regarding the quantities that can be produced from the Dua and Blackbird oil fields, based on current information, it is most likely that approximately 80 million barrels of oil could be produced from the field, subject to the following. At this stage, this is merely an assessment of the quantities that could be produced, in respect of which there is no certainty, and the assessments might change the more geological and engineering information becomes available and/or as a result of unexpected factors relating to oil and gas exploration. Note that as is common in the area in which the Company operates, there are many risk factors including the investment required for development of the oil fields, which might affect the project and its economic feasibility.

Since production of oil from the fields is currently planned to commence in 2010, Premier has commenced doing preparatory work to develop the two oil fields, and to prepare for a comprehensive 3D seismic survey which is due to commence in April 2007, and which is intended, *inter alia*, to assist in reducing the uncertainty relating to the quantities of petroleum in the Blackbird field. The seismic survey will be conducted over an area covering more than the Blackbird field, with the aim of defining new prospects for the next stage of exploratory drilling, which are planned for 2008 or earlier, subject to the availability of a rig.

In the total budget for 2007 is approved, the consolidated company, Delek Vietnam, is expected to bear its share (25%) of such budget, in the sum of $24 million.

Note that the national petroleum company of Vietnam (Petro-Vietnam) has a right to purchase 15% of the rights in the project, in return for refund of expenses, and that the Vietnamese government and Petro-Vietnam are entitled to participate in the yields, royalties and taxes on the yields from this project.

DES' portion (25%) of the capitalized costs applicable to it and generated in the accounting year on this project amounted to the sum of approximately NIS 80 million. This sum includes the sum of approximately NIS 3.8 million in costs of purchase from others of rights to receive supreme royalties which they had in the above project.

DES' operations in Vietnam in the report year caused the Company expenses in the sum of approximately NIS 2 million compared with expenses in the sum of approximately NIS 1 million in the previous year.

B. Delek Energy Systems set up a wholly owned subsidiary, Delek International Energy Ltd. (hereinafter: "Delek International"), which wholly owns Delek Energy Systems U.S. Inc., which was recently incorporated in the USA (hereinafter: "DES USA", which coordinates exploration and production of oil and gas in the USA.

(1) At the end of September 2006, DES USA purchased rights in a registered US limited partnership called AriesOne Limited Partnership (hereinafter: "AriesOne") which deals in exploration and product of oil and gas.
The rights that DES USA purchased are the rights of the limited partner, constituting approximately 83.49% of the rights in AriesOne. The balance of the rights in the partnership, being 16.51%, are held by the general partner. The Company and the general partner signed a partnership agreement which, inter alia, included the management and decision-making methods to be employed in the partnership. Similarly, the Company has a right to replace the general partner in the period following December 30, 2010, pursuant to the conditions set out in the agreement.
AriesOne holds petroleum assets that are located in the southern USA (Texas, Louisiana, Colorado, Kansas, Oklahoma and New Mexico), which also include exploration and production fields, in which there are approximately 240 oil and natural gas producing wells.
Payments for the acquisition of rights amounted to the sum of approximately NIS 34.3 million. DES USA also undertook to invest a sum of approximately $2 million in conducting three development explorations in proven reserves of AriesOne. The partnership has also made undertakings for hedging transactions against oil and gas prices, which were made prior to the acquisition. The fair value of the undertakings, as at the date of the acquisition, amounted to approximately NIS 80 million. The total sum of the investment of the Company's share of the assets of the partnership (including for the portion of the partnership's undertakings flowing from the above hedging transactions) amounted (after amortization) to the sum of approximately NIS 114 million.

(2) An agreement was signed in October 2006 in Houston, Texas, between DES USA and Jay Petroleum LLC, a company owned by Isramco Inc. (hereinafter: "Jay"), of the first part, and between McCommons Oil Company (hereinafter: "The Seller"), an American company active in the energy sector. According to the agreement, DES USA and Jay have each acquired 50% of the right to explore and produce natural gas and/or oil in the layer known as Barnett Shale (at a depth of 2,100 meters or more), at a total area of over 2700 acres in Texas. In consideration for such rights, DES USA and Jay each paid the vendor the sum of approximately $1.2 million. Upon signing the said agreement, DES USA and Jay signed a Joint Operations Agreement (JOA), pursuant to which, Jay Management Company LLC, owned and controlled by Isramco Inc., was appointed Operator of the exploration project. The JOA also outlined a preliminary work plan within whose framework a three-dimensional seismic survey would be conducted, along with two natural gas drills and that pursuant to the results, the partners will consider conducting additional drills.

The results of operations in the USA, which have been included as of the fourth quarter of 2006, brought the Company a net income in the sum of approximately NIS 4 million.

C. In February 2007, an agreement was executed between Delek International and Premier Old West Africa B.V. (hereinafter: Premier) under which Delek International purchased 11.43% of the rights in two marine franchises in Guinea Bissau, West Africa, from Premier. In consideration for the rights, Delek International undertook to bear 22.86% of the drilling expenses up to a total cost of approximately $13.3 million, and at the rate of its share of the rights above such sum. In the event of a commercial discovery, the national petroleum company of Guinea Bissau is entitled to purchase 30% of the rights in the project.

On March 25, 2007, DES reported:

(1) Espinafre 1 shaft had become blocked and was abandoned for technical reasons before reaching the target reservoir.
The cost of Espinafre 1 is expected to amount to approximately $35 million, of which Delek International is expected to bear approximately $7.3 million.

(2) Upon completion of the operations at Espinafre 1, the drilling rig is expected, in the near future, to commence drilling at Eirozes 1, which is due to examine a potential oil reservoir which is larger than the target reservoir at Espinafre 1, and which is at similar depths.
The drilling is planned to last around 30 days and at an expected budget (100%) of $30 million.

D. In addition, Delek Energy Systems is also currently working to locate and investigate additional investment opportunities in oil and gas exploration worldwide.

D. Automotive Operations

The following is data from the consolidated financial statements of Delek Automotive Systems Ltd. (hereinafter: "Delek Automotive"):

	1-3/06	**4-6/06**	**7-9/06**	10-12/06	**2006**	**2005**	**2004**
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues	1,009	1,134	1,011	906	4,060	3,868	3,923
Gross Profit	122	126	118	130	496	441	466
Operating Income	107	113	102	116	438	378	402
EBITDA	109	115	104			387	414
Financial Revenues (Expenses)	(10)	(15)	3	(16)	(38)	14	(22)
Profit after taxes	66	70	72	66	274	264	256
Company's share in the earnings of affiliates and partnerships	-	-	-	(1)	(1)	44	6
Net Income	66	70	72	65	273	309	261

The contribution of the automotive sector to the Group's net incomes in 2006 amounted to the sum of approximately NIS 151 million compared with the sum of approximately NIS 189 million in 2005, and the sum of approximately NIS 163 million in 2004.

Delek Automotive is a public company whose financial statements are made public. As at the balance sheet date, the Group holds approximately 55.4% of Delek Automotive.

The following is an analysis of the results of Delek Automotive's operations during the report period.

Revenues

Sales during the report year amounted to the sum of approximately NIS 4,060 million compared with the sum of approximately NIS 3,868 million last year, an increase of approximately 5%, stemming mainly from an increase in the quantities of vehicles sold. During the report year, 36,103 vehicles were sold, compared with 34,072 last year.

Sales in 2005 amounted to approximately NIS 3,868 million, as compared with approximately NIS 3,924 million in 2004, a decrease of approximately 1.5%. This decrease stemmed mainly from the amount of vehicles sold – 34,072 this year, compared with 35,792 vehicles in 2004.

For further details regarding the split of sales of vehicles into quantities, see chapter 11 to the report of description of the Group's business.

Selling, Marketing, General and Administrative Expenses

In 2006, there was a fall in sales, marketing, general and administrative expenses, of approximately NIS 10 million, which stemmed mainly from a fall in advertising expenses in comparison with 2005. Likewise, during the report year, there was also an increase in general and administrative expenses of approximately NIS 5 million compared with the corresponding period last year, stemming mainly from an increase in wage expenses, which stemmed from registration of the economic benefit embodied in the grant of options to employees and shares to the CEO of Delek Automotive.

During 2005, there was an increase in sales and marketing expenses of approximately NIS 6 million, which stemmed mainly from an increase in Delek Automotive's advertising expenses, which were partially set off as a result of a decrease in agents' commissions, and there was a reduction in general and management expenses of approximately NIS 6 million, compared with the previous year, which stemmed mostly from a termination of reduction of payments made by a subsidiary of Delek Automotive to another company, due to termination of its appointment as importer of Ford products into Israel.

Financial Revenues

In 2006, Delek Automotive incurred financial expenses in the sum of approximately NIS 38 million, which stemmed mainly from payments of interest to the banks in the sum of approximately NIS 37 million, and from recording of the fair value of hedging transactions (not recognized for accounting purposes) in the sum of approximately NIS 43 million. These expenses were set off by interest revenues from customers in the sum of approximately NIS 19 million and by exchange rate differentials for a debt to an automobile supplier in the sum of approximately NIS 23 million.

In 2005, Delek Automotive had net financing revenues of approximately NIS 14 million, which stemmed mainly from exchange rate differentials, caused by a weakening of import currency exchange rates and foreign currency liabilities (approximately NIS 24 million), and by the closure of hedging transactions and a recording of fair value of open futures transactions as at December 31, 2005 (approximately NIS 20 million). These revenues were set off by the financial expenses of Delek Automotive, for bank credit which amounted to approximately NIS 30 million.

Delek Automotive's share of the profits of associates

Delek Automotive holds 33% of the ownership and control of ADC Holdings Ltd., formerly Shagrir Towing Services Ltd. (hereinafter: "Shagrir") which also operated in the automotive sector. During the first quarter of 2005, a transaction was concluded in which Shagrir sold all of its goodwill in the field of vehicle towing services, vehicle repairs and substitute vehicles, including intellectual property rights, the name "Shagrir", its trade mark, registered database of existing clients, intangible rights and auxiliary assets thereto and Shagrir's contracts (hereinafter: "the operations") and also all of the assets and liabilities in connection with the operations, as defined in the agreement.
As a result of this transaction, in 2005, Delek Automotive included a profit of approximately NIS 46 million (the Group's share being approximately NIS 28 million).

Additional Information

For the issue of shares to the CEO of Delek Automotive and grant of options to employees of Delek Motors Ltd. (a subsidiary of Delek Automotive) see Note 9J(d)((1) and (2) to the financial statements.

E. Real Estate Operations

The following is data from the consolidated financial statements of Delek Real Estate:

	1-3/06	4-6/06	7-9/06	10-12/06	2006	2005	2004
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues	112	93	98	136	439	484	503
Gross Profit	47	37	41	43	168	198	267
Operating Income	25	11	17	27	81	154	242
Financial Expenses	47	77	58	52	234	242	199
Other Income (Expenses), Net	(1)	4	3	13	19	99	1
Share of profits of affiliates	79	246	70	141	536	130	109
Net Income	40	141	26	123	330	121	124
Total Assets	4,992	5,259	5,573	6,629	6,629	4,708	4,940

Principal Operations in 2006:

1) For greater detail regarding the private placements of shares of Delek Real Estate to third parties during the report period, see Note 9J(a) to the financial statements - real estate operations. As a result of the private placements, the Group's holdings in Delek Real Estate fell to approximately 68%. The profit flowing to the Group as a result of the allotments amounted to approximately NIS 185 million.

2) In August 2006, Delek Real Estate conducted a private placement of additional non-convertible debentures (Series D) with a par value of NIS 371,057,014. The total consideration received from this placement amounted to approximately NIS 400 million. The conditions of the debentures issued are identical to those of the existing debentures, and they have been listed for trading on the Tel Aviv Stock Exchange.
Within the framework of the private placement, the debentures received an A+ rating from Maalot - the Israel Securities Rating Company. The said rating is contingent upon the ability to maintain financial covenants (as stipulated when receiving the rating for the said series of debentures at the issuing date).

3) During 2006 and until approval of the financial statements of Delek Real Estate, a consolidated subsidiary of Delek Real estate acquired – through associated companies (in which the holdings amount to 40%-45%) – income-generating assets that are leased for extended periods, in Germany, Finland, Switzerland and Canada. The scope of asset purchases effected by the consolidated companies amounted to approximately NIS 2.7 billion. Asset purchases were financed, mainly, using non-recourse loans from banking corporations and via shareholders' loans (Delek Real Estate's portion being approximately NIS 1.1 billion).

   Similarly, during the fourth quarter of 2006, a consolidated company of Delek Real Estate purchased profit-bearing assets that are leased out for long periods in Finland and Germany, via consolidated companies (that are held at rates of 80%-90%). The scope of asset purchases effected by the consolidated companies amounted to approximately NIS 0.85 billion. Asset purchases were financed, mainly, using non-recourse loans from banking corporations and via shareholders' loans (Delek Real Estate's portion being approximately NIS 0.74 billion).

The following table presents a summary of Delek Real Estate's investments since the beginning of 2006:

Date of acquisition	Country	% of Holdings	Principal Tenant
January 2006	Finland	45%	Telia Sonera Headquarters
January 2006	UK	2.4%	Additional shares in parking lot transaction
January 2006	Germany	40%	Deutsche Telekom
January 2006	Germany	40%	Metro shopping center
February 2006	Germany	40%	Adidas shopping center
May 2006	Germany	40%	Allianz
June 2006	Switzerland	40%	COOP
June 2006	Canada	45%	Wal-Mart
October 2006	Germany	40%	Metro
October 2006	Finland	90%	Neste Oil
October 2006	Switzerland	45%	Government body – Swiss government
October 2006	Switzerland	45%	Government body – Swiss government
December 2006.	Germany	80%	German government – Deutsche Welle Anstalt

Delek Real Estate is considering the possibility of expanding the overseas investments in income-generating real estate (offices, commerce, gas stations, parking lots and hotels) by acquiring income-generating real estate while placing an emphasis on high-quality locations, the existence of long-term leasing contracts or management contracts (in hotels), and high quality tenants and/or managers. We note that regarding the acquisition of rights in hotels, acquisitions may be made as part of Delek Real Estate's policy regarding the acquisition of passive investments. Delek Real Estate is examining the possibility of expanding its operations – in line with the said strategy – into France, Italy and the United States.

Furthermore, in line with the Delek Real estate strategy to occasionally realize assets, a consolidated subsidiary and an associated company of Delek Real Estate have sold their holdings in two projects – one in Sweden and one in Germany.

A foreign company held by a consolidated company, Delek Global Real Estate (hereinafter: "Delek Global") gave notice on March 16, 2007 of its intention to effect a placement of its shares to institutional entities and to list its shares for trading on the AIM stock exchange in London. The foreign company intends to issue approximately 22% of its share capital. The quantity of shares to be issued might change in accordance with resolutions that may be passed regarding the price range and state of the market. Delek Real Estate intends to act to conclude the placement, but at this stage, there is no certainty that the placement of Delek Global's shares will be effected, *inter alia* due to factors which are not within the Company's control, such as the state of the English capital market and changes in the real estate market – for additional details, see Note 9J(a) to the financial statements.

Asset Valuation:

Some of the associated companies of a consolidated subsidiary of Delek Real Estate formulate their financial statements according to international GAAP, including the implementation of International Standard 40, stipulating that income-generating real estate be presented according to fair value. Delek Real Estate routinely performs valuations of its assets using regular assessors and leading firms, concerning assets belonging to the foreign companies that operate according to international standards.

These valuations are normally conducted once annually. In cases where the management of a consolidated subsidiary of Delek Real Estate feels that a special event has taken place (i.e.: Refinancing and/or advanced negotiations for the sale of assets and/or a significant change in

market conditions), the consolidated subsidiary conducts additional valuations (in addition to the regular annual valuation). Moreover, in the case of the acquisition of new assets, the valuation will be performed in the course of the year following the acquisition, unless an extraordinary event has taken place (such as the events outlined above), requiring the consolidated subsidiary of Delek Real Estate to reexamine the value of its assets.

In the course of the period, following indications of a substantial price increase in Germany, Switzerland, UK and Scandinavia that originated inter alia from transactions for the sale of assets initiated by a consolidated subsidiary of Delek Real Estate and/or its partners, and following preparations by a consolidated subsidiary of Delek Real Estate for an IPO on a London Stock Exchange, the management of a consolidated subsidiary of Delek Real Estate conducted appraisals of all its assets. As a result of this examination, an associate of Delek Real Estate included its portion of the increased value of the profit-creating real estate in the year ending December 31, 2006, in the sum of NIS 425 million, as part of the item covering the Company's share in the earnings of associate companies (after the effect of tax payable by foreign associated companies in the sum of approximately NIS 69 million).

The substantial price costs in these countries are mainly the result of high demands for high-quality real estate assets, as held by Delek Real Estate, i.e., assets in high-demand locations with tenants with financial strength who sign long-term lease agreements. The said demand is generated primarily by funds, institutional players and large real-estate companies.

Parallel to international operations, Delek Real Estate has also significantly expanded its operations in the local real estate market, as follows:

1) In October 2006, an agreement was signed between Delek Real Estate and Vitanya Ltd. (hereinafter: "Vitanya") and its shareholders, under which Delek Real Estate is to provide a loan in the sum of $47 million (approximately NIS 205 million) convertible into 50% of the shares of Vitanya over 10 years from the date of the placement.

   Vitanya deals primarily in the development and maintenance of income-generating real estate in Tel Aviv and Herzlia, with assets covering 34 thousand square meters, unrealized construction rights covering 48 thousand square meters and additional construction rights potential of 19 thousand square meters.

   According to the agreement, the parties undertook that any new income-generating real estate project or transaction will first be offered to Vitanya. In this respect, "development of income-generating real estate" was defined by the parties as any project wherein 75% or more of the construction rights have yet to be realized, or any project involving an amendment of the designation of agricultural land – in the area between Hadera and Gedera only – whose scope exceeds $5 million, other than the development of gas stations, or when the income-generating real estate accompanies another main project.

   The said transaction forms part of the Delek Real Estate strategy to expand its income-generating real estate assets in Israel, since the Company believes that Vitanya possesses the potential to develop and operate income-generating real estate assets.

2) Delek Real Estate operates via Delek Real Estate – Productive Assets Ltd., hereinafter – "DPA") in bringing all of the profit generating assets which the various companies have, into the above company. This is done in accordance with Delek Real Estate's strategy of bringing all profit generating assets into one company with the aim of promoting the set up of an REIT fund or alternatively, of listing it on the Tel Aviv Stock Exchange. Delek Real Estate intends to continue acquiring profit generating assets in Israel under the above Company. Likewise, Delek Real Estate intends to examine the acquisition of shares of companies that hold profit generating real estate with the aim of acquiring control and examining future merger and/or integration of such a company as may be purchased, as aforesaid, into the above company.

3) In May 2004, Delek Real Estate purchased control of Dankner Investments, which became the Group's residential building branch in areas of demand, and through this company, Delek Real Estate currently controls thousands of residential units in various real estate projects and land reserves. Delek Real Estate is conducting advanced negotiations with Azorim, with the intention of merging or selling Dankner Investments Ltd. to/with Azorim. The intention is

to create an added advantage by centralizing the real estate operations in the development, construction and marketing of residential real estate in Israel, within a large and specialized company. The profit generating assets in Israel, construction operations in Central Europe and the Ben Gurion Airport second luggage terminal construction project will not be merged and will be transferred into the title of Delek Real Estate. Based on negotiations, the value of Dankner Investments together with projects in Jerusalem (Bayit Va-Gan) and Nes Ziona (transferred from Delek Real Estate to Azorim) is $95 million. Delek Real Estate shall receive shares in Azorim and a sum in cash in consideration for its holdings in Dankner and the projects to be transferred from it as aforesaid.

Results of Operations

The contribution of the real estate sector to the net incomes of the Group in 2006 amounts to the sum of approximately NIS 235 million compared with the sum of approximately NIS 100 million in 2005, in addition to capital gains in the sum of approximately NIS 185 million generated to the Group as a result of private placements of shares to third parties. The contribution of the real estate sector to the Group's net income in 2005 amounted to approximately NIS 100 million compared with approximately NIS 119 million in 2004, as set out below.

The following is an analysis of the results of operations of Delek Real Estate during the report period:

Revenues

2006 compared with 2005

1) Revenues from leasing fees in the report year amounted to approximately NIS 313 million, as compared with approximately NIS 315 million last year.

2) Revenues from sale of apartments in 2006 amounted to the sum of approximately NIS 126 million compared with the sum of approximately NIS 164 million in 2005, a reduction of approximately NIS 38 million, which stems mainly from projects that have not yet matured to be recognized as revenue (under Standard 2).

2005 compared with 2004

1) Revenues from leasing fees in 2005 amounted to approximately NIS 315 million, as compared with approximately NIS 358 million in 2004.
The reduction in revenues in the sum of approximately NIS 43 million stems from a reduction in income from rental in England in the sum of approximately NIS 58 million, due to termination of consolidation of the financial statements of companies and assets sold during the third quarter of 2005, and other leased assets received in 2004 on account of termination of a lease term over three stories, and payment of a termination of contract fee in the sum of NIS 31 million.

2) Revenues from the sale of apartments in 2005 amounted to approximately NIS 164 million compared with approximately NIS 110 million in 2004, an increase of approximately NIS 54 million stemming mainly from the consolidation of the results of Dankner Investments as of July 1, 2004, and due to progress in the execution and opening of additional stages in the Valley Project in the Israeli town of Nes Tziona.

3) Revenues from the sale of commercial space, offices and land in 2005 amounted to approximately NIS 5 million compared with approximately NIS 34 million in 2004, a decrease of approximately NIS 29 million stemming mainly from the sale of a property in Hod Hasharon, Israel, which yielded a total of approximately NIS 29 million in 2004.

Gross Profit

2006 compared with 2005

1) The gross profit from rentals in the report period amounted to a sum of approximately NIS 156 million compared with approximately NIS 181 million in the previous year, an increase of approximately NIS 25 million.
The decrease in gross profit stems mainly from the sale of companies and assets in England during the third quarter of 2005, less the affect of the increase in gross profit from productive assets in Israel, NIS 21 million stemming from new purchases and the first time consolidation in November 2006 of the Finnish portfolio, which contributed NIS 5 million.

The gross profit from the sale of apartment inventory in the report year amounted to approximately NIS 12 million compared with approximately NIS 18 million in the previous year. The decrease stems from a decrease in the number projects which matured to be recognized as revenue.

2005 compared with 2004

2) The gross profit from rentals in 2005 amounted to a sum of approximately NIS 181 million compared with approximately NIS 233 million in 2004, an increase of approximately NIS 52 million.
The decrease in gross profit stemmed mainly from a decrease in gross profit in the sum of approximately NIS 36 million in England due to the discontinuance of the consolidation of the financial statements of companies and assets sold during the third quarter of 2005, and due to the other lessee income in the sum of approximately NIS 31 million paid in the previous year as stated in paragraph A1 above, and on the other hand, from an increase of approximately NIS 10 million in gross profit in Canada.

3) The gross profit from the sale of apartment inventory in 2005 amounted to approximately NIS 18 million compared with approximately NIS 12 million in 2004.
The increase stemmed mainly from the gross profit from the sale of apartments by the Dankner Investments subsidiary which was consolidated for the first time on July 1, 2004, and from progress in the construction and opening of additional stages in the Valley Project in the Israeli town of Nes Tziona.

General & Administrative Expenses

General and administrative expenses during the report year amounted to the sum of approximately NIS 87 million compared with the sum of approximately NIS 43 million for the corresponding period in 2005, a decrease of NIS 44 million.

The increase in general and administrative expenses stems mainly from expenses for payment based on shares in the sum of approximately NIS 50 million for three option plans, set off by the effect of termination of amortization of goodwill, as of 2006, which amounted to the sum of NIS 12 million.

General and administrative expenses in 2005 amounted to the sum of approximately NIS 43 million compared with the sum of approximately NIS 26 million in 2004. The increase in such expenses stems mainly from general and management expenses at Dankner Investments, which was consolidated for the first time on July 1, 2004, and from the amortization and goodwill flowing from the acquisition of Dankner Investments in the sum of NIS 12 million in 2005, compared with NIS 4 million in 2004.

Financial Expenses

Financial expenses for the report year amounted to approximately NIS 234 million compared with approximately NIS 242 million in the previous year.

The decrease in financial expenses in the sum of approximately NIS 8 million stems from repayment of loans in the third quarter of 2005 as a result of the sale of assets in England, of the effect of the zero rate of CPI increase in 2006 compared with a positive CPI increase of 2.6% in 2005, set off by the affect of the increase in debentures (an additional fundraising in August 2006), refinancing of two assets in England and financing costs for companies consolidated for the first time in the sum of NIS 10 million.

Financial expenses in 2005 amounted to the sum of approximately NIS 241 million compared with NIS 199 million in 2004. The increase in financial expenses in the sum of approximately NIS 42 million stems from financial expenses at Dankner Investments, which was consolidated for the first time on July 1, 2004, and from the financial expenses for new loans and raising of debentures taken and on the other hand, a fall in financial expenses at the subsidiary Delek Belron International Ltd. following the sale of assets and holdings in consolidated foreign companies in England.

Other revenues

In 2006

Other revenues in 2006 stemmed mainly from dividends received in the sum of approximately NIS 14 million from Industrial Buildings and approximately NIS 7.6 million from investments in Hilton Hotels.

In 2005

1) In March 2005, a consolidated subsidiary of Delek Real Estate sold all of its rights (75%) in a property in England which was a logistics center of Ericsson, the balance of the rental period being seven years, in consideration for a total of approximately GBP 22 million (approximately NIS 181 million).

   The subsidiary's profit (before taxes) from the sale was approximately GBP 1.7 million (approximately NIS 14 million).

2) On July 15, 2005, foreign subsidiaries finalized a transaction for the sale of their holdings in other foreign subsidiaries. The Group derived a profit of approximately NIS 64 million from the sale, which was presented in the other revenues item.

Delek Real Estate's share of the profits of associates

Delek Real Estate's share of the profits of associated companies in 2006 amounted to the sum of NIS 536 million compared with the sum of NIS 130 million in 2005. The increase in Delek Real Estate's share of the profits of the associated companies in 2006 in the sum of NIS 406 million compared with the previous year stems mainly from an increase in the value of the assets of associated companies net, which amounted to the sum of NIS 425 million (including valuation for assets sold), compared with a valuation of NIS 73 million in 2005, an increase of NIS 352 million, and from an increase in the profits of associated companies and profits from investments in associated companies.

Delek Real Estate's share in the earnings of associated companies in 2005 amounted to the sum of NIS 123 million compared with the sum of NIS 109 million in 2004. The increase in Delek Real Estate's share of the earnings of associated companies in 2005 by NIS 14 million compared with 2004 stems mainly from an increase in profits from an investment in associated companies overseas, in the sum of NIS 21 million.

Additional Information

1) In January 2006, a scheme for the allotment of options to employees and directors of Delek Real Estate was approved in accordance with the provisions of section 102 of the Income Tax Ordinance. For details see Note 9J(a) to the financial statements.

2) During 2006, the Board of Directors of Delek Real Estate and the General Meeting of the Delek Real Estate shareholders approved an engagement of a Delek Real Estate consolidated subsidiary with a company wholly-owned by the son-in-law of the Group's controlling shareholder, for the granting of a special (phantom) bonus. For additional details, see Note 9J(a) to the financial statements.

3) In 2006, the management of Delek Real Estate approved the grant of a special (phantom) bonus to two of its employees (who are not interested parties). For further details see Note 3(a)3 to the financial statements.

4) After the balance sheet date, in February 2007, Delek Real Estate effected a private placement to institutional investors of NIS 770,843,644 non-convertible debentures (series E). Under the conditions of the debentures (series E), the principal shall bear fixed annual interest from the date of issue of the debentures until the date of listing of them for trading on the stock exchange at the rate of 5.4% and after the date of listing of the debentures for trading on the stock exchange, interest in the rate of 4.8%. The interest shall be paid every six months. The principal is to be paid back in seven equal installments commencing on February 27, 2013 and until February 27, 2019. The principal and the interest shall be linked to the consumer price index.

F. Gadot Biochemical Industries

The following is data from the financial statements of Gadot Biochemical Industries Ltd. (hereinafter: "Gadot"):

	1-3/06	4-6/06	7-9/06	10-12/06	2006	2005	2004
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues	100	99	89	78	366	375	343
Gross Profit	32	34	25	21	112	117	111
Operating Income	18	19	12	8	57	69	67
EBITDA	22	22	16	13	73	83	80
Financial Expenses	2	3	3	1	9	7	8
Net Income	11	12	6	3	32	47	(86)

The contribution of the biochemicals sector to the Group's net income in the report year amounted to approximately NIS 21 million, as compared with approximately NIS 31 million in the corresponding period last year.

Gadot is a company whose shares are publicly traded and in which the Group holds 64.11%.

Description of Gadot's operations and business environment

Gadot is a manufacturer of food additives and chemicals for the food, health additives, detergents and toiletries industries.

Gadot manufactures crystalline fructose, citric acid, citric acid salts, phosphate acid salts, and special citric acid-based salts. Most of the Gadot sales are made in European and North American markets, and its customers include the world's leading international companies in the food and detergent industries.

Gadot is acting to realize a business strategy intended to maintain a high rate of growth by way of strategic acquisitions outside of Israel, and to this end, it has contracted with investment banks which assist it in locating appropriate investment targets.

The following is an analysis of the results of Gadot Biochemicals' operations during the report period:

Revenues

Revenues fell during the report year by approximately NIS 9 million amounting to approximately NIS 366 million compared with approximately NIS 375 million in 2005. The reduction stemmed from a slow-down in sales during the fourth quarter, and from the effect of the change in the exchange rate of the dollar as against the shekel.

Gadot's revenues increased in 2005 by approximately NIS 32 million amounting to approximately NIS 375 million compared with approximately NIS 343 million in 2004. About one third of the increase stemmed from an increase in fructose sales and the rest from an increase in the company's market share of the citric acid salts market where the company is an important player.

Gross Profit

The gross profit decreased in 2006 by approximately NIS 5 million amounting to a sum of approximately NIS 112 million, compared with NIS 117 million last year. The decrease in gross profit stemmed, inter alia, from an increase in the cost of raw materials and energy.

The gross profit increased in 2005 by approximately NIS 6 million to a sum of approximately NIS 117 million, compared with NIS 111 million in 2004 as a result of growth in operations. Gross profit feel by about one percent compared to 2004. The decrease in the profit stemmed, inter alia, from a considerable increase in energy costs and raw material costs.

Selling, Marketing, General and Administrative Expenses

Increased costs for sea and land transportation caused an increase in marketing costs in the report year, by approximately NIS 4 million to a sum of approximately NIS 43 million last year.

The increase in sales volume and in the prices of maritime and ground shipping led to an increase in marketing expenses in 2005 by approximately NIS 4 million to a sum of NIS 38 million compared to approximately NIS 34 million in 2004.

Operating Income

Operating income in the report year amounted to approximately NIS 57 million compared with NIS 69 million in the previous year. The decrease in operating income stems from a world-wide increase in the prices of raw materials, a continued increase in energy inputs and, as a result, in sea transportation inputs, and an increase in general and administrative expenses. The increase stems from an increase in expenses for business development, costs of introduction of an information system (ERP) and first-time implementation of Accounting Standard 24, for options granted to Gadot employees as part of a public placement.

Operating income in 2005 amounted to the sum of approximately NIS 69 million, compared with NIS 67 million in 2004. As stated above, operating income did not group by the same rates at which revenues grew due to a world-wide increase in the prices of raw materials. a continued increase of energy inputs, and as a result, of maritime transportation inputs.

Financial Expenses

Financial expenses for the report year amounted to approximately NIS 9 million compared with approximately NIS 7 million last year. The increase in financial expenses stemmed mainly from interest on debentures (a full year in 2006 as opposed to half a year in 2005), and from recording the fair value of future transactions as part of hedging operations against Gadot's sales in euro.

Financial expenses amounted, in 2005, to approximately NIS 7 million, compared with NIS 8 million in 2004. The decrease in financing costs stems from a conversion of dollar loans to CPI-linked debentures after the placement, and from a recording of the fair value of future transactions. as part of operations to hedge against Gadot's sales in Euro.

Taxes on Revenue

In 2006, tax expenses in the sum of approximately NIS 15 million were recorded, which included the sum of NIS 1.9 million for adjustment of a tax asset.
In 2005, Gadot generated a first time provision for tax expenses in the sum of NIS 15 million. The recording of taxation expenses was required due to recognition of a tax asset in the sum of approximately NIS 20 million in the final quarter of 2004. Recording of the tax asset was required due to the high level of probability of exploitation of losses for tax purposes from previous years, due to Gadot's profitability.

Net Income

Net income during the report year amounted to the sum of approximately NIS 32 million compared with NIS 47 million last year, a decrease of approximately NIS 15 million.

The net income in 2005 amounted to the sum of approximately NIS 47 million compared with approximately NIS 86 million in 2004, a reduction of approximately NIS 39 million. The reduction in profitability between these years stems mainly from a one time recording of revenues of approximately NIS 26 million in 2004 (compensation of approximately NIS 6 million and first-time recording of a tax asset in the sum of NIS 20 million), and from recording of taxation expenses during 2005.

Additional Information

For additional details on biochemical operations see Note 9(j)(f) to the financial statements.

G. Insurance and Financial Services

1) **Phoenix Holdings Ltd. (hereinafter: "The Phoenix")**

A. In December 2005, Delek Investments purchased approximately 25% of the issued and paid-up share capital of The Phoenix in consideration for approximately NIS 720 million. In June 2006, Delek Investments exercised the option granted to it to purchase approximately 8% more of the issued and paid-up share capital of The Phoenix in consideration for the sum of approximately NIS 213 million. Following the above purchase, Delek Investments holds approximately 33% of the issued and paid-up share capital of The Phoenix. In November 2006, the subsidiary Delek Capital Ltd. (hereinafter: "Delek Capital"), completed purchase of 28.5% of the issued and paid-up share capital of The Phoenix from Mayer Automobile and Truck Company Ltd. and Mayer Holdings (The Phoenix) Ltd. (hereinafter: the "**Vendors**"). The proceeds amounted to approximately $214 million (approx. NIS 940 million). Following the closing of the transaction, the Group indirectly holds approximately 61.5% of the issued and outstanding Phoenix share capital. As a result of the allocation of shares effected by The Phoenix in December 2006, the rate of the Group's holdings fell to approximately 55.5% of the issued and paid-up share capital of The Phoenix, see C below [sic].

The surplus investment cost over balance sheet value generated in these last three purchases amounted to approximately NIS 962 million (see also Note 9J(g) to the financial statements). The Group is attaching work done by an external appraiser for the purpose of ascribing this cost surplus, to these financial statements.

B. The certification from the Antitrust Commissioner regarding acquisition of control of The Phoenix provided that by May 13, 2008, Delek Investments would sell part of its holdings in Menora Holdings Ltd. (hereinafter: "Menora"), so that it would not hold more than 5% of the issued and paid-up capital thereof. Under the permit for the transaction obtained from the Supervisor of Insurance Businesses (hereinafter: the "Permit"), Delek Investments undertook to supplement shareholders equity of The Phoenix Insurance Company Ltd. and of other institutional entities held by The Phoenix to the sum set out in the Supervision of Insurance Businesses Regulations and the Supervision of Financial Services Law. Regarding Phoenix Insurance, Ltd. the sum of the said liability will be the lowest of 50% of the equity required by the regulations or the sum of NIS 557 million. This undertaking shall only be exercised when the capital of the institutional entities is negative. The Permit which was given to the holders of control of the Company is in force so long as it controls the Company and includes restrictions on the placement of means of control in all of the

corporations held via means of control of The Phoenix. In addition, the Delek Group undertook not to sell control of The Phoenix for 3 years. The Permit states that no more than 50% of the annual profits of The Phoenix are to be sold for 3 years from the date of the Permit, so long as the shareholders' equity of The Phoenix Insurance is less than 120% of the shareholders' equity required under the Supervision of Insurance Law.

C. In December 2006, The Phoenix issued 20,500,000 ordinary shares of NIS 1 par value each and 6,000,000 option warrants to institutionals for a total consideration of approximately NIS 374 million. As a result of this placement, the Group's holdings fell to approximately 55.5% of the issued and paid-up share capital of The Phoenix (via Delek Investments approximately 29.8% and via Delek Capital, approximately 25.7%). The earnings generated for the Delek Group as a result of this placement amounted to NIS 10 million and were included in the statement of income as "Gains from realization of investments in investee companies".

D. We note that in accordance with the directives of the Securities Authority, the Group included proforma data in the financial statements (see Note 39 to the financial statements).

Results of Operations

The following are principal data from the consolidated financial statements of The Phoenix:

	1-3/06	4-6/06	7-9/06	1-9/06	1-12/06
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Profit from life insurance	104	21	63	186	374
Profit from general insurance	52	8	87	43	190
Revenue from investments and others, net	21	33	8	5	67
Expenses of interest on long-term liabilities	(11)	(20)	(12)	4	(39)
Revenue (expenses) net from other companies and from insurance agencies	3	12	8	(4)	19
General and management expenses not accredited to insurance business financials	(5)	(17)	(6)	(9)	(37)
Expenses of deduction of original difference	(2)	(1)	(2)	(2)	(7)
Income Before Taxes on Income	162	36	146	223	567
Taxes on income	(66)	(5)	(58)	(77)	(206)
Company's share of net expenses of affiliates and minority share of net expenses of affiliates	12	2	2	5	21
Net Income	108	33	90	231	382

The profit from life insurance during the report period amounted to approximately NIS 374 million. The premiums in 2006 amounted to approximately NIS 2,535 million.

Revenues from investments in the life insurance sector during the reported period include gross profit of approximately NIS 35.5 million from the sale of Phoenix's full rights to the real estate known as the Givatayim Mall, as detailed below.

The profit from general insurance during the report period amounted to approximately NIS 190 million. Revenues from premiums in 2006 amounted to approximately NIS 2,148 million.

Changes in Investments During the Reported Period

A. On April 9, 2006 and in accordance with the agreements reached between Phoenix Investments Ltd. and the Excellence controlling shareholders and with Mizrahi Bank, the contingent terms have been met and the necessary authorizations obtained as required by law, for duly signing the agreements for the overall acquisition of 41% of the Excellence shares in consideration of NIS 322.5 million

B. On May 17, 2006, Phoenix Insurance Properties and Construction (Commercial Centers) Ltd. entered into an agreement for the sale of Phoenix's full rights in the real estate known as the *Givatayim Mall*. The proceeds of the sale amounted to approximately NIS 147 million. As a result of the sale, Phoenix Insurance recorded a (gross) capital gain in the second quarter in the sum of approximately NIS 35.5 million (net – approximately NIS 26 million).

C. On June 4, 2006, Phoenix Insurance and Phoenix Investments and Finances Ltd. (hereinafter: "Phoenix Investments") entered into an agreement with Habas Public Credit Company (1994) Ltd. for sale of all of their rights in land and in the project known as the Rothschild 1 Project. The proceeds of the sale amounted to approximately NIS 92.7 million. As a result of the sale, Phoenix Investments recorded a (gross and net) profit of approximately NIS 6.8 million. Phoenix Insurance recorded a profit of approximately NIS 20.5 million gross, and approximately NIS 17.4 million net. The Phoenix Group as a whole recorded quarterly earnings of NIS 27.3 million (gross) and approximately NIS 24.2 million (net).

We note that the Group's financial statements do not include the Group's share in the earnings from the sale of Givatayim Mall (as set out in clause (b) above) and the Rothschild Project due to the attribution of surplus cost to these assets.

D. In November 2006, The Phoenix Insurance and Tau Real Estate Yields (hereinafter: "Tau") entered into an agreement for the purchase of 50% of the rights and undertakings in the Mul Hayam Shopping Center in Eilat. The purchase was effected via a partnership held in equal shares by The Phoenix and Tau (hereinafter: the "Partnership"). The transaction was concluded in January 2007, and in consideration for purchase of the aforesaid rights, the partnership paid a total of approximately NIS 260.4 million. The Phoenix Group's share of this sum amounted to NIS 130.2 million.
As part of the agreement, the partnership relations between the partners and the seller have been determined. In this capacity, the partnership was guaranteed priority in the Mall's revenues, equal to 7.5% per annum over 8 years, secured from the Seller's share in the revenues of the Mall.

E. As part of The Phoenix's strategy of offering its customers a variety of products, on March 9, 2007, The Phoenix entered into a contract with Bank Hapoalim Ltd., via a memorandum of understanding, to the effect that 25% of the share capital of Isracard Ltd. and Europay (Eurocard) Israel Ltd. (hereinafter: the "Companies"), both of which are wholly controlled by Bank Hapoalim, would be purchased, and it would be entitled to appoint directors on its behalf, as agreed under the memorandum of understanding.

The consideration for the shares shall be calculated on the basis of an attached value of NIS 2.55 billion, with adjustments for the payment of dividends, if and to the extent paid as at the date of conclusion of the transaction. In the event that the Companies make a public placement within 15 months, the basis for the Companies' value shall be adjusted upwards for the purpose of the transaction to 90% of the Companies' value for the purpose of the public placement, but not above the attached value of the Companies of NIS 2.7 billion.

Performance of the transaction is subject to due diligence, to conditions (including the consent of The Phoenix as to arrangements between Isracard Ltd. and Bank Hapoalim), regulatory approvals, to the extent necessary, to the approvals of management and the board of directors of Bank Hapoalim, and to the approval of the board of directors of The Phoenix.
Likewise, during August 2006, The Phoenix set up The Phoenix Platinum Ltd., which specializes in providing credit to the commercial sector, and which shall offer factoring and credit card clearing services.

2) **Republic Companies Group, Inc. (hereinafter: "Republic")**

On August 4, 2006, a wholly-owned American subsidiary of Delek Capital Ltd., entered into a merger agreement for the acquisition of all share capital (100%) of Republic Companies Group Inc. (hereinafter: "Republic"). Following the performance of the preconditions, the acquisition transaction was concluded on December 7, 2006.

The consideration for each share of Republic amounted to the sum of $20.40 and the total consideration, before the transactions costs, amounted to the total sum of approximately $289 million (NIS 1,275 million). The consideration was paid on the date of closing of the transaction.

In 2007, after closing the transaction, Republic was merged into a subsidiary of Delek Capital. After the aforesaid merger, Delek Capital has full ownership of Delek Finance US, Inc. (hereinafter: "Delek Finance") which holds the share capital of Republic. In order to finance the purchase, Delek Finance took loans from a banking corporation in the USA, in the sum of approximately $220 million.

As a result of completion of the transaction, the financial statements of Republic are consolidated with those of Delek Finance as of December 31, 2006.

Republic is a holding company which holds insurance companies which deal primarily in individual and commercial property insurance, as well as general insurance products for individuals and SMEs, primarily in Texas, Louisiana, Oklahoma and New Mexico.

Surplus investment cost over balance sheet value at Republic amounted to $110 million (approximately NIS 466 million). See also Note 9J(g) to the financial statements). The Group is attaching a report prepared by the management of Republic regarding the ascription of cost surplus generated by the purchase, and recording it on Republic's books as set out in the report, to this report.

For additional details regarding the results of Republic's operations in the last three years, see chapter 15 of the description of the corporation's business.

3) Menora Holdings Ltd.

A. On March 13, 2005, a transaction was completed in which Delek Investments purchased 9.99% of the issued share capital of Menora Holdings Ltd. (hereinafter: "Menora") by way of a private placement of Menora in consideration of NIS 191 million. Furthermore, Delek Investments received an option (that may be exercised over a period of 18 months) to purchase from Menora an additional 5% of the issued and outstanding shares of Menora. On April 9th 2006, Delek Investments exercised the option in consideration of NIS 107.4 million (approx. $23.3 million). The investment is presented in the books of Delek Investments as a permanent investment, according to the cost method. Delek Investments hold a total of 14.4% of the share capital of Menora (see also Section 1 of this chapter).

B. In 2005, a dividend from Menora in the sum of approximately NIS 4 million, was registered on the profit and loss statements.

C. After the balance sheet date, in January and February 2007, Delek Investments, as part of a requirement by the Antitrust Commissioner (see section 1 above), exercised approximately 12.2% of Menora's shares to a third party at a price of NIS 52 per share, and for a total consideration of approximately NIS 392 million. As a result of such sale, Delek Investments' holdings of Menora fell to approximately 2.2%. The profit flowing to Delek Investments as a result of the above sale amounted to approximately NIS 142 million (before tax) and will be included in the first quarter of 2007.

4) Additional Information

In February 2007, Delek Capital signed an agreement with Barak Capital Ltd. (hereinafter: "Barak Capital") and Mr. Eyal Bakshi regarding the grant of an option for a period of six months, for no consideration, under which Delek Capital shall be entitled to purchase shares in Barak Capital in consideration for payment of the sum of approximately NIS 24 million and the provision of shareholders' loans, on conditions as agreed in the option agreement, such that if and when such sale is concluded, Delek Capital shall hold up to 49.9% of the issued and paid-up capital of Barak Capital. Barak Capital deals in financial operations which include, mainly, trading in securities. In addition, an option was granted to Mr. Aharon Cohen and/or a company under his control, to join the aforesaid transaction, upon such terms as shall be agreed upon between the Parties.

H. HOT – Cable Communications Systems Ltd. (formerly Matav)

The following is data from the consolidated financial statements of HOT – Cable Communications Systems Ltd. (hereinafter: "HOT"):

	1-3/06	4-6/06	7-9/06	10-12/06	2006	2005(*)	2004(*)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues	140	150	143	143	579	544	586
Gross Profit	11	14	28	31	84	48	99
Operating Income (loss)	(9)	(4)	8	6	1	(34)	4
Financial Expenses	12	13	12	11	48	52	51
Other Income (Expenses)	-	2	(3)	(8)	(9)	154	(43)
Net Income (loss)	(24)	(17)	(4)	(13)	(58)	69	(83)

(*) Reclassified.

In 2004, the Group purchased 40% of the holdings of Matav – Cable Communications Systems Ltd. (hereinafter: "Matav") by acquisition of 20% of the shares of Matav from Dankner Investments and by purchasing Dankner Investments Ltd. which held another 20% of the shares of Matav at that time.

Matav is one of three cable television companies in Israel that operate jointly under the "Hot" brand name and supply cable television services to approximately 932,000 households in Israel, as well as broadband Internet services to approximately 485,000 households. Matav's portion of the multi-channel cable television industry is approximately 26%. The three cable companies hold Hot Telecom as a partnership (Matav's share is approx. 26.6%), which commenced supply of telephony services to the general public in 2005.

On December 31, 2006, the cable companies' merger transaction (hereinafter: the "Merger"), under which Matav purchased all of the operations of the other parties to the transaction in the relevant fields from them, was concluded.
As a result of conclusion of the Merger, the resolutions approved by the general meeting of Matav, changing Matav's name to Hot Cable Communications Systems Ltd. (hereinafter: "Hot") came into force, the articles of association of Matav were amended so as to reflect the name change and the new structure of the board of directors, and directors who were approved by the general meeting of Matav were appointed as aforesaid in accordance with the new structure of the board of directors, contemporaneous with termination of the office of all of the current members of the board of directors of Matav (apart from the external directors).

On that date, Matav issued 45,649,467 shares to the holders of shares and rights in the cable companies, whose operations and assets had been transferred to Matav. Following that placement, the Delek Group holds approximately 16% of the merged company. For additional details see Note 9J(e).

As part of conclusion of the Merger, a right of first refusal agreement between the four large banks and the principal shareholders of the merged company came into effect, under which the right of refusal shall be with respect to the sale of shares that each of the parties to the right of first refusal agreement shall hold, immediately after conclusion of the Merger, and which shall be in force for five years following the date of conclusion of the Merger. In parallel with conclusion of the Merger, a credit agreement signed between Hot and a consortium of banks came into force both for the purpose of financing the merged company's bank debt as at the date of conclusion of the Merger, and in order to provide credit for effecting future investments. For additional details, see Note 3 to the financial statements of Hot which are available to the public.

The investment in Matav is reported in the Group's financial statements by the equity method of accounting. The loss which the Group recorded due to its holdings in Matav during the report period amounted to the sum of approximately NIS 43 million compared with a loss of approximately NIS 57 million accredited to the profit and loss statements for 2005. The balance of the investment in Matav as at December 31, 2006 amounts to approximately NIS 305 million.

The following is an analysis of Matav's results during the report period:

Revenues

HOT's revenues in the report year amounted to approximately NIS 579 million compared with NIS 544 million in the previous year, an increase of 6%. The increase in revenues stems mainly from an increase in the revenues of the multi-channel television broadcasting sector from NIS 484 million in 2005 to NIS 524 million in 2006. The increase in revenues in this sector is explained by an increase in average revenue per cable television subscriber, and an increase in revenues from content by demand for World Cup broadcasts and VOD services. A number of subscribers in the muti-channel cable television sector of the Company at the end of 2006 amounted to approximately 249,000 compared with approximately 251,000 at the end of 2005.

Gross Profit

HOT's gross profit in 2006 amounted to approximately NIS 84 million compared with approximately NIS 48 million last year, an increase of approximately 75%. The increase in gross profit is explained mainly by a decrease in the ratio of content cost to total revenues.

Selling, Marketing, General and Administrative Expenses

HOT's sales and marketing expenses during 2006 amounted to approximately NIS 45 million compared with approximately NIS 54 million last year, a decrease of approximately NIS 9 million. The decrease stems mainly from a reduction in the costs of publication, compared with those recorded in 2005.

HOT's general and administrative expenses in 2006 amounted to approximately NIS 37 million compared with NIS 28 million in 2005. The increase by the sum of NIS 9 million stems mainly from expenses which HOT bore that were related to the merger of the cable companies (an increase in salary expenses as a result of the retirement of senior officers, registration of a benefit for option rights and one-time expenses for professional consultants).

Sale of Shares in Partner

In April 2005, Matav sold to Partner about 80% of the Partner shares that it had held, in consideration for approximately NIS 250 million. The profit to HOT as a result of the said sale (including for an arrangement obtained from the taxation authorities regarding tax obligations with respect to the sale of Partner shares) amounted to approximately NIS 170 million. The profit to the Group as a result of said sale, taking into consideration balance of surplus costs ascribed to Matav in Partner, amounted to approximately NIS 7 million. Following the aforesaid sale, Matav holds approximately 1.2% of the shares in Partner.

I. Additional Activities

1) Infrastructures

A. Seawater Desalination

The Group's operations in the field of seawater desalination are conducted via IDE Technologies Ltd. (hereinafter – Desalination Engineering), in which Delek Infrastructure Ltd. (hereinafter: "Delek Infrastructure") holds 50%. (Delek Infrastructure is 100% owned by Delek Investments).

Desalination Engineering deals in the manufacture and sale of desalination plants, industrial concentrators (evaporators) and heat pumps, and in the operation and maintenance of desalination plants. At various locations worldwide, IDE has established seawater desalination plants. In certain locations it acts as operator while at some it constructs the facilities on behalf of other operators. Inter alia, Desalination Engineering has set up a partnership which operates a seawater desalination plant in Cyprus that has had an output of 18 million m^3 per annum since July 2001.

In 2005, a seawater desalination plant, operating using the BOT method with the Government, began operating in Ashkelon. 50% of the plant are held by Desalination Engineering, via VID Desalination Company Ltd. (hereinafter: VID). The desalination plant supplies 100 million cubic meters of water a year at full capacity, following receipt of approvals from the Ministry of Health, the Desalination Authority and the Ministry of the Environment.

During the report year, Desalination Engineering began to supply an order received in 2005 to provide four desalination plants each designed to supply 24,000 cubic meters of feed water and process water to a refinery in India, which is one of the largest refineries in the world. The sum of the transaction is approximately USD 90 million. Supply of the plants is expected to be completed within up to twenty-four months of the date of order.

H2ID Ltd. (an investee company in which Desalination Engineering holds 50% of the rights, while Shikun Ubinui Holdings holds the remaining 50%) secured a tender published by the Government of Israel on September 18, 2006, for the design, financing, construction, operation and maintenance – under the BOT method – of a seawater desalination plant in the Hadera region, with a capacity of 100 million m^3 per annum. According to the agreement that forms the base of this tender (to be signed by the State), the party securing the tender shall undertake to build the plant, operate it and maintain it for a franchise period of 25 years (2.5 years of construction plus 22.5 years of operation and maintenance). Upon the termination of the franchise period, the plant will be transferred to the State free of charge.

B. Electricity Generation Plant

On August 5, 2002, The Group established a wholly owned subsidiary (indirectly) under the name of IPP Delek Ashkelon Ltd. (hereinafter: "Delek Ashkelon"). Delek Ashkelon is engaged in building a facility for the generation of electricity (hereinafter: the "Power Station") that shall deliver electricity to the desalination plant in Ashkelon (in the context of the BOT agreements of VID and the State) and to others.

The Power Station will produce 80 megawatts of electricity and is part of the BOT contract for the Ashkelon desalination plant. Most of the capacity of the generating station is to be used by the desalination plant, with the rest being sold to private customers and/or the IEC. After the operation period of the desalination plant, the power station will become State property.

In 2003, a financing and financial closing agreement in the sum of approximately NIS 260 million was signed to set up the Power Station, which represented approximately 80% of the total anticipated cost of the project. A Notice to Proceed has been issued to the construction contractor, Siemens Nederland N.V.

Completion of set-up of the Power Station requires a process of running it on natural gas. The Power Station was not run and operated on time (by the end of the second quarter of 2005). Due to a delay in providing natural gas to the Power Station and in order to finance the costs of preservation and purchase of electricity from the national electricity grid in order to operate the desalination plant, Delek Ashkelon requested and obtained the consent, in principle, from Bank Leumi, to increase its credit limit by a total sum of approximately NIS 40 million, part of which would be given under guarantee by Delek Investments, for an operating period, until repayment. The total shareholders' equity to be injected by the shareholders of Delek Ashkelon shall constitute approximately 20% of the credit for the project. See also Note 9H.1 to the financial statements.

Operation of the power station on time depends on completion of the set up of the national transmission system from Ashdod to Ashkelon, and completion of set up of the PRMS – acts which are to be done by Natural Gas Lines Israel Ltd. (hereinafter: "NGL") as well as the receipt of all of the permits required for the pumping of natural gas by the Natural Gas Authority. At this stage, Gas Lines has not yet obtained all of the consents required and it is expected that it will receive them in the future. See also Note 9H.1 to the financial statements.

Delek Ashkelon has reached an arrangement with IEC pursuant to which IEC paid a sum of $8 million in compensation for the failure to deliver natural gas to Ashkelon under the conditions prescribed. The arrangement was concluded at the beginning of 2006.

Following the aforesaid, in 2006 Delek Ashkelon recorded a sum of NIS 32 million as revenues in the statement of income, equal to the level of operating loss accumulated by Delek Ashkelon since the date of the undertaking to supply electricity to VID (September 16, 2005). The remaining compensation, in the sum of NIS 6 million, has been postponed and is presented under "deferred income". This balance will be recorded as revenues in the statement of income, in line with the operating loss that shall be incurred by Delek Ashkelon in the future as a result of the delay in the supply of gas.

Notwithstanding the fact of receipt of the entire aforesaid sum of compensation, at this stage, it is not possible to determine the amount of the additional cost that Delek Ashkelon shall be required to pay on account of the delayed arrival of the natural gas, since it is not yet possible to determine with any certainty the date on which the supply of natural gas to the Power Station via the national transportation system will be made possible.

In October 2006, Delek Ashkelon entered into an agreement for the supply of electricity to Mekorot Water Company Ltd. (hereinafter: "Mekorot") in quantities of up to 10 MW. The agreement is for the term in which Mekorot operates its facilities for the purposes of the desalination plant, and so long as the Power Station is running commercially in accordance with the BOT agreement, but for no more than 22.5 years. In August 2006, Delek Ashkelon signed a memorandum of understanding with Delkia Israel Ltd. (hereinafter: "Delkia") for the operation of the power station on behalf of Delek Ashkelon, as a Turn-key project, as well as for the operation of the transformation station.

Infrastructure operations usually require heavy financial investments in construction and running-in processes that usually last 2-3 years. Revenues are generated only subsequent to that period.

2) **Fuel**

Following a tender conducted by the Chevron Corporation (hereinafter: "Chevron") for the sale of Chevron's marketing operations in the Benelux countries (Belgium, Netherlands, Luxembourg), which includes 750 gasoline stations, negotiations are being held between Delek Petroleum and Chevron during the exclusivity period agreed upon between the parties, which is extended from time to time.

7. Details Concerning Exposure to and Management of Market Risks

A. 1) The Company's operations are concentrated mainly on holding and managing the shares in its subsidiaries. These investments are long-term, and therefore no hedging transactions are required in respect of them.

Risk management of the subsidiaries and other affiliates is done directly by the companies themselves. Some of the companies are public and traded on the stock exchange and therefore there is due disclosure of this in their financial reports.

2) Mr. Ido Adar, MBA, is responsible for managing currency risks for the Company and for some of the subsidiaries. For the past three years, Mr. Adar has acted as treasurer of the Company, and prior to that, he acted as director of the treasury and insurance department of Delek Israel.

B. Description of Market Risks

1) As stated above, the Company is mainly a holding and management company and its principal exposure is due to the market risks of its subsidiaries and affiliates (hereinafter: "Subsidiaries").

The main risks for these companies are as follows:

- Foreign Currency Exchange Rate Fluctuations
  The Company and its investee companies have loans denominated in foreign currency, exposing the Company to the volatility of the FX markets. Likewise, exchange rates can have an effect on the Company's business results and a substantial portion of its revenues are in foreign currencies.

- Interest Rate Fluctuations
  The Company and the affiliates have Shekel loans at variable rates of interest, and therefore, they are exposed to fluctuations in Israeli bank interest rates. Some of the Group companies have assumed variable rate loans overseas, exposing them to foreign rate movements.

- Exposure to CPI Increases
  A considerable portion of the Company's and the affiliates' long-term loans are in Shekels, and are linked to the Israeli consumer price index. In the assessment of management of the Company, in a considerable portion of cases, the Group's exposure to Israeli CPI increases is a limited economic exposure, since in its assessment, the value of the Group's fixed assets rises over time, at least at the same rate of increase as the CPI.

  Note that some of the companies in the Group hedge against CPI increases above a particular annual level.

- Economic Slow-Down and Fluctuations in Markets in which the Group Operates
  The Group has substantial operations in various countries around the world. Changes in those markets and economies and especially economic slowdowns (including in Israel) can have adverse effects on the operations of the Company and its investee companies.

- Value of Capital
  Changes in prices of listed securities held by the Group expose it to risks stemming, *inter alia*, from fluctuations in the capital market. A capital market low in Israel or around the world might adversely effect the Group's ability to find sources of financing where necessary, as well as the Group's ability to make capital gains from exercise of its investments. Likewise, a low in capital markets might make the raising of capital difficult for the Company and its affiliates, and might bring about a possible decline in the prices of the securities of the affiliates after issue on securities exchanges.

- Price Risks
  The Group's real estate operations are substantially exposed to changes in the fair value of productive real estate for affiliates which draft their financial statements in accordance with international accounting rules, including the presentation of productive real estate at its fair value and ascription of differentials in fair value to the profit and loss statements.

2) The Group is exposed to changes in the prices of raw materials, other prices and other economic indices, which might substantially affect the assets and liabilities of the Group, including the Group's liability to suppliers, debts of customers to members of the Group, the value of the inventory in their possession and other assets and liabilities.

3) In the first quarter of 2004, the preparations of the gas reservoir and the gas production and transportation system under the Yam Tethys venture were in fact implemented, and therefore, as of that date the financing costs for the USD loans used to finance the asset were ascribed to the profit and loss statement (up until that time, the financing costs were ascribed to the asset). Because of the fact that the financial statements of the corporations that hold the Yam Tethys venture (hereinafter: the "Corporations") are set out in NIS, the financing costs, including linkage differentials flowing from fluctuations in Dollar exchange rates, have been ascribed to the profit and loss statements as of the first quarter.

   As a result of this, due to the substantial sum of loans set out in US Dollars, the Corporations have substantial accounting exposure to fluctuations in the Dollar exchange rate.

   Since most of the relevant operations of the Corporations are effected in USD – revenues from natural gas sales are received in USD, the vast majority of fixed assets used in the Yam Tethys venture are denominated in USD and a considerable portion of financing of operations is in USD, the Corporations have limited economic exposure to fluctuations in the USD exchange rate. Most of this exposure is accounting exposure, which is not economic and therefore, usually, the corporations do not hedge against it.

C. Corporation's Market Risk Management Policy

- Overseas subsidiaries tend to finance their investments in each country in the investment currency of such country. The revenues of subsidiaries from productive assets, which are supposed to finance repayments of the principal and payments of interest, are denominated in local currency, as are all of their other assets, and therefore, the subsidiaries do not have economic exposure to fluctuations in foreign currency exchange rates.
- In order to neutralize interest risks relating to loans taken by subsidiaries for the purchase of their assets, the Companies have set out a policy under which most of the loans that they raise outside of Israel are long-term loans, at fixed interest rates.

- The Company and its subsidiaries tend, from time to time, to make use of currency options and other derivatives. These transactions are entered into with large financial corporations in Israel and overseas, and are done for the purpose of hedging and for other purposes.
- Rental agreements relating to the Group's commercial real estate assets are mostly long-term and therefore the Group does not have substantial exposure to changes in market prices for rental.

D. Supervision and Implementation of Market Risk Management Policy

- The subsidiaries manage their market risks under the supervision of their respective boards of directors or via special board committees. The Company also employs the advice of external experts in these markets.
- The internal auditing mechanisms of the Company and its subsidiaries also monitor market risk management issues.
- The companies in the Group are required to provide full reports on the type and level of their exposure, and the hedging methods that they employ or that they do not employ in respect thereof.

E. (1) **Linkage basis report for general businesses**

As at 31 December 2006 (NIS Millions) Reported Amounts											
	NIS		Foreign Currency							Non-Monetary	Total
	Non-linked	Linked	US dollar	CAD	Sterling	Yen	Euro	Swiss Franc	Other Currency		
Assets											
Cash and cash equivalents	123		564	28	78		84		4		881
Short-Term Investments	192	48	574	1							815
Accounts Receivable	1,847	6	459	10	1		24	2	3		2,352
Other accounts receivable	141	12	157	121	22		11	12	2	79	557
Inventories			5			32	16			1,314	1,367
Buildings and Land for Sale										110	110
Investments in investee and other companies	301	47		14	232		236	112	28	1,845	2,815
Land for ease										3,230	3,230
Land for construction										477	477
Long term loans, deposits and debts	99	142	479	26	93		6	54		4	903
Investments in oil & gas exploration and production										969	969
Fixed Assets, net										3,077	3,077
Other Assets and Deferred Charges, net										741	741
Total general business assets	**2,703**	**255**	**2,238**	**200**	**426**	**32**	**377**	**180**	**37**	**11,846**	**18,294**
Short Term Credit from Banking Corporations and Others	1,774	650	529	55	36	37	92	12			3,185
Trade payables and service providers	217	5	988			32	56				1,298
Accounts Payable	478	79	239	38	30		32			12	908
Dividend payable	86										86
Debentures convertible for shares in the Company		8									8
Debentures convertible for shares in consolidated companies		301									301
Other Debentures		3,808	413								4,221
Short Term loans from Banking Corporations and Others	395	656	1,596	953	470		778	32			4,880
Employee severance undertakings	14									2	16
Deferred Taxes										399	399
Other Liabilities			208			32	37			60	337
Total general business liabilities	**2,964**	**5,507**	**3,973**	**1,046**	**536**	**101**	**995**	**44**	**0**	**473**	**15,639**
Net balance	**(261)**	**(5,252)**	(1,735)	**(846)**	**(110)**	**(69)**	**(618)**	**136**	**37**	**11,373**	**2,655**

(2) Linkage basis report for insurance businesses

As at 31 December 2006 (NIS Millions) Reported Amounts						
	NIS		Foreign Currency Linked	Participating in profits	Non-Monetary	Total
	Non-linked	Linked				
Cash and cash equivalents	733		172	210		1,115
Investments	1,105	8,153	2,431	13,739	590	26,018
Plant property and equipment					580	580
Receivables	1,033	394	2,205	202	46	3,880
Deferred and other purchase expenses		120	36	39	2,352	2,547
Total insurance business assets	2,871	8,667	4,844	14,190	3,568	34,140
Insurance reserves and contingent liabilities	4,550	7,606	2,385	13,988	134	28,663
Long-Term Liabilities		189	1,395			1,584
Other Liabilities	91	11	380	46	341	869
Total insurance business liabilities	4,641	7,806	4,160	14,034	475	31,116
Net balance	(1,770)	861	684	156	3,093	3,024

Linkage Base Report

As at 31 December 2005 (NIS Millions) Reported Amounts												
	NIS		FX								Non-Monetary	Total
	Non-linked	Linked	US dollar	CAD	Sterling	Yen	Euro	Swiss Franc	Cyp Pnd	Other Currency		
Assets												
Cash and cash equivalents	105		455	21	229		21		2	2		835
Short-Term Investments	280	38	356	6			1					681
Accounts Receivable	1,852	9	437	11	1		40	2	4			2,356
Other accounts receivable	190	83	93	58	20		26	12	1		63	546
Inventories						91	6				1,366	1,463
Buildings and Land for Sale											41	41
Investments in investee and other companies	19	64	11		119		93	38		31	2,211	2,586
Land for ease											2,316	2,316
Land for construction											462	462
Long term loans, deposits and debts	100	118	322	21	6	9		65	1		3	645
Investments in oil & gas exploration and production											794	794
Fixed Assets, net											2,518	2,518
Other Assets and Deferred Charges, net											747	747
Total Assets	**2,546**	**312**	**1,674**	**117**	**375**	**100**	**187**	**117**	**8**	**33**	**10,521**	**15,990**
Short Term Credit from Banking Corporations and Others And others (not including current maturities)	1,535	1,069	641	260	7	1	2	12		1		3,528
Suppliers and service providers	339		843			416	30	1	4			1,633
Accounts Payable	364	48	151	23	43		1		1		3	634
Debentures convertible for shares in the Company	1	204										205
Debentures convertible for shares in consolidated companies		315										315
Other Debentures		1,907	580									2,487
Short Term loans from Banking Corporations and Others	268	1,095	1,326	898	492			44				4,123
Employee severance undertakings	8		3								2	13
Deferred Taxes	1										213	214
Other Liabilities			92								15	107
Minority interests											455	455
Total Liabilities	**2,516**	**4,638**	**3,636**	**1,181**	**542**	**417**	**33**	**57**	**5**	**1**	**688**	**13,714**
Net balance	**30**	**(4,326)**	(1,962)	**(1,064)**	**(167)**	**(317)**	**154**	**60**	**3**	**32**	**9,833**	**2,276**

F. Derivative Positions

The following are data on derivative positions of the Company and its affiliates:

1) Derivative positions of the Company and Delek Investments

A. The Company and Delek Investments have no open positions as at December 31, 2006 (except for Delek Investments' share of the transaction for setting the gas price, included as part of section 7 below).

B. The highest value of the Company's and Delek Investments' open positions during 2006 was as follows (NIS millions):

	USD / NIS	
	Nominal Value	
	short	long
Calls	173	
Puts		170
Futures	888	857

2) Derivative positions of Delek Automotive

A. Open positions as at December 31, 2006 (in NIS millions):

All sums relate to the period of up to one year (except where expressly stated)

	USD / NIS				Euro / Yen		Euro / NIS				Yen / NIS	
	Nominal Value		Fair Value		Nominal Value	Fair Value	Nominal Value		Fair Value		Nominal Value	Fair Value
	long	Short	long	short	long	long	long	short	long	short	long	long
Calls For hedging not recognized for accounting	462	180	2	(0.3)			56	56	1	(1)	35	-
Puts For hedging **not recognized for accounting**	741	190	(11)	8	26	(1)	139		(1)			
Non-hedge					26	(1)						
Forward for hedging **not recognized for accounting**	253	42	(12)	-							18	-
Non-hedge					26	(1)						

	Yen / USD				Euro / USD				USD / NIS – more than one year			
	Nominal Value		Fair Value		Nominal Value		Fair Value		Nominal Value	Nominal Value	Fair Value	Fair Value
	long	Short	long	short	long	short	long	short	long	short	long	short
Calls For hedging not recognized for accounting	97	20	-	-	167	167	2	(2)		84		(1)
Non-hedge												
Puts												
For hedging **not recognized for accounting**	74		-			28		-	84	84	(1)	5
Forward for hedging **not recognized for accounting**									84		(6)	
Non-hedge						56		1				

There are also interest transactions that are put and call options in the sum of $75 million, the fair value of which amounted to approximately NIS (1.3) million.

A. Maximum derivative holdings in the report year (NIS millions)

	Euro / Yen	USD / NIS		Yen / USD		Euro / USD		Yen / NIS		Euro / NIS	
	Nominal Value	Nominal Value		Nominal Value		Nominal Value		Nominal Value		Nominal Value	
	long	short	long	short	long	short	long	short	long	short	long
Calls	55	477	600	21	140	110	137		95	87	54
Puts	-	399	831		92	20		18			132
Futures	27.5		423			55			18		

3) Derivate positions of Gadot

A. Open positions as at December 31, 2006 (in NIS millions):

	Euro / USD				USD / NIS			
	Nominal Value		Fair Value		Nominal Value		Fair Value	
	long	Short	long	short	long	short	long	short
Calls Hedge – not recognized	98	32	0.3	-		11		-
Puts Hedge – not recognized	143	19	(2)	0.6				

The foreign currency hedges are intended to protect the economic value of the products exported by Gadot, by fixing an exchange rate, should the transaction be a futures contract or underwriting of the economic value of the sales for exports if the transaction is an option. Costs for hedges not recognized for accounting purposes are accredited to the financing item.

B. Maximum holdings of derivatives on July 19, 2006 (NIS millions):

	Euro / USD		USD / NIS	
	Nominal Value		Nominal Value	
	short	long	short	long
Put option for hedging – not recognized	199			

In December 2001, Gadot purchased an option for Libor interest for three months for a period from January 2004 until October 2007 for long-term loans taken for the purpose of financing the fructose project, which are linked to the dollar and which bear interest at a rate of Libor + 0.9. The cost of the option, in the sum of approximately NIS 473,000, is depreciated, in equal installments, over the life of the option, starting in 2002.

4) Derivative positions of Delek Real Estate

A. Open positions as at December 31, 2006 (in NIS millions):

	EUR/CAD				CAD / ILS				GBP / CAD			
	Nominal Value		Fair Value		Nominal Value		Fair Value		Nominal Value		Fair Value	
	long	Short	long	short	long	short	long	short	long	short	long	short
Calls Non-hedge not recognized for accounting		22		0.4	52		1		99	66	5	(3)
Puts Non-hedge **not recognized for accounting**		22		-	68		2			66		(0.4)
Futures					68		3					

	USD / CAD				USD / ILS				EUR / GBP			
	Nominal Value		Fair Value		Nominal Value		Fair Value		Nominal Value		Fair Value	
	long	Short	long	short	long	short	long	short	long	short	long	short
Calls Non-hedge – not recognized										28		(0.1)
Puts Non-hedge not recognized	53		1		180	181	8	(11)		28		(0.2)
Futures												

	CHF / CAD			
	Nominal Value		Fair Value	
	long	Short	long	short
Calls Non-hedge not recognized for accounting		18		(0.1)

There are also interest rate transactions such as IRS, Swaption, Floor and CAP. The fair value for all of these transactions is approximately NIS 23 million.

C. Maximum derivative holdings in the report year (NIS millions)

	EUR / GBP	CHF / GBP	CAD / USD	CAD / GBP	CAD / ILS	CAD / EUR	CAD / CPI	ILS / CPI
	Nominal Value	Nominal Value	Nominal Value	Nominal Value	Nominal Value	Nominal Value	Nominal Value	Nominal Value
	short	short	short	short	long	short	short	short
Calls Non-hedge	121		139					
Puts Non-hedge		19		87	121	54		
Forward Transactions Non-hedge	22	25	24	4	65	30		

	ILS / USD	GBP / USD	EUR / USD	GBP / JPY	EUR / Pol.	Euro / Hung.	GBP / ILS	CAD / CHF
	Nominal Value	Nominal Value	Nominal Value	Nominal Value	Nominal Value	Nominal Value	Nominal Value	Nominal Value
	short	short	short	short	long	short	short	short
Calls Non-hedge						45		37
Puts Non-hedge	134	32	28		45			
Forward Transactions For profits	63	17	23	1		19	1	

	Hung. / USD	SKR / USD	CHF / USD
	Nominal Value	Nominal Value	Nominal Value
	short	short	short
Calls Non-hedge	6		79
Forward Transactions For profits	6	23	2

5) Derivative positions of Delek Israel

A. Open positions as at December 31, 2006 (in NIS millions):

	USD / NIS				CPI / NIS			
	Nominal Value		Fair Value		Nominal Value		Fair Value	
	long	Short	long	short	long	short	long	short
Forward Transactions For hedging not recognized for accounting	30		(0.6)		150		(3.5)	

B. Maximum derivative holdings in report year (NIS millions)

	USD / NIS		CPI / NIS	
	Nominal Value		Nominal Value	
	long	Short	long	Short
Forward transactions	60		150	

6) Delek USA

As at the balance sheet date, there are CAP and Floor interest rate transactions. The maximum holding (at nominal value) during 2006 amounted to the sum of approximately $134 million. The nominal value of the open positions as at the end of the year (long) amounted to approximately $129 million and the fair value amounted to approximately $3.4 million (approximately NIS 14.3 million).

7) Derivative positions for the gas and oil sector (Delek Energy) in NIS millions:

A. Open positions as at December 31, 2006 (in NIS millions):

	Nominal Value		Fair Value	
	Long	Short	Long	Short
Contract to ensure gas price (including portion of Delek Investments)		1,099		(53)
Forward dollar-shekel transaction for hedging – recognized.	43		(1)	
Contract to ensure natural gas price – Henry Hub		7		(4)
Contract to ensure crude petroleum price – Nymex WTI		42		(68)

B. Maximum derivative holdings in report year (NIS millions)

	Nominal Value	
	Long	Short
Forward dollar-shekel transaction for hedging – recognized.	68	
Contract to ensure gas price (including portion of Delek Investments)		1,499
Contract to ensure natural gas price – Henry Hub		7
Contract to ensure crude petroleum price – Nymex WTI		45

In May, 2004, a hedging agreement was singed between the partnerships and Delek Investments and a foreign investment bank which deals in futures transactions in the natural gas market. The deal was completed in the beginning of June 2004, fixing the price of natural gas at $2.47 per MMBTU for the years 2005-2010. In October 2004,the deal was extended to the first quarter of 2013.

The sum of the price fixing transaction was approximately $303.5 million at Delek Drillings and approximately $287 million at Avner, and approximately $59 million at Delek Investments. As at December 31, 2006, the sum of the transaction amounts to approximately $217 million at Delek Drilling and approximately $211 million at Avner.

The price of natural gas in the agreement is linked to a basket of fuels and to the US PPI. There is also a maximum and a minimum price. The hedge was based on the expected quarterly natural gas delivery to the IEC. The actual amount sold will probably deviate from the estimates.

If the quarterly price of gas is lower than the price set in the hedge agreement, the investment bank will pay the partnerships the difference between the prices. If the price of gas is higher than that which is set in the hedge agreement, the partnership and Delek Investments will pay the investment bank the difference. Each payment will be in accordance with the amount of gas that is set in the agreement.

In assurance of the liabilities of the partnerships and Delek Investments, guarantees have been given by Bank Hapoalim and Bank Leumi, the balance of which amounts as at the date of approval of the financial statements, at approximately $11.7 million at Delek Drilling and approximately $11.6 million at Avner. The foreign investment bank also provided bank guarantees.

At the current prices of the components of the above price formula in the future market, the negative fair value as at the balance sheet date for this hedge transaction, classified as hedging and recognized for accounting purposes is approximately NIS 53 million at Delek Drilling and at Delek Investments. This value is based on capitalization of expected cash flows from the transaction, at non-risk interest. An additional increase in the components of the price formula will not affect this sum at all, and a price fall of up to 10% will not substantially affect the fair value.

G. Sensitivity analysis for changes in market factors

According to the principal market risks described above and in accordance with the guidelines of the Securities Authority, the Group effected a number of sensitivity analyses to material financial instruments which the Group holds as at December 31, 2006, with respect to changes to principal market factors.

1) Sensitivity of financial instruments for general businesses:

A. Changes in the fair value of instruments that are sensitive to US dollar exchange rate fluctuations:

	10%	5%	**Fair value**	(5%)	(10%)
Instrument	**Profit (loss) from fluctuation NIS Millions**		**NIS Millions**	**Profit (loss) from fluctuation NIS Millions**	
Current assets	174	87	1,743	(87)	(174)
Long-term deposits, loans and receivables	48	24	479	(24)	(48)
Current liabilities	(176)	(88)	(1,756)	88	176
Long-Term Liabilities	(222)	(111)	(2,217)	111	222
Total	(176)	(88)	(1,751)	88	(176)

B. Changes in the fair value of instruments that are sensitive to Canadian dollar exchange rate fluctuations:

	10%	5%	**Fair value**	(5%)	(10%)
Instrument	**Profit (loss) from fluctuation NIS Millions**		**NIS Millions**	**Profit (loss) from fluctuation NIS Millions**	
Current assets	16	8	160	(8)	(16)
Long-term deposits, loans and receivables	4	2	40	(2)	(4)
Current liabilities	(9)	(5)	(93)	5	9
Long-Term Liabilities	(95)	(48)	(953)	48	95
Total	(85)	(42)	(846)	43	85

C. Changes in the fair value of instruments that are sensitive to Euro exchange rate fluctuations:

	10%	5%	Fair value	(5%)	(10%)
Instrument	**Profit (loss) from fluctuation NIS Millions**		**NIS Millions**	**Profit (loss) from fluctuation NIS Millions**	
Current assets	12	6	119	(6)	(12)
Long-term deposits, loans and receivables	24	12	242	(12)	(24)
Current liabilities	(18)	(9)	(180)	9	18
Long-Term Liabilities	(82)	(41)	(815)	(41)	(82)
Total	(63)	(32)	634	32	63

D. Changes in the fair value of financial instruments that are sensitive to Sterling Pound exchange rate fluctuations:

	10%	5%	Fair value	(5%)	(10%)
Instrument	**Profit (loss) from fluctuation NIS Millions**		**NIS Millions**	**Profit (loss) from fluctuation NIS Millions**	
Current assets	10	5	101	(5)	(10)
Long-term deposits, loans and receivables	33	16	325	(16)	(33)
Current liabilities	(7)	(3)	(66)	3	7
Long-Term Liabilities	(47)	(24)	(470)	24	47
Total	(11)	(6)	(110)	6	11

E. Phantom options:

	10%	5%	Fair value	(5%)	(10%)
Instrument	**Profit (loss) from fluctuation NIS Millions**		**NIS Millions**	**Profit (loss) from fluctuation NIS Millions**	
Phantom options	(5)	(3)	23	3	5

F. Table of sensitivity regarding material transactions in derivatives that are sensitive to exchange rate fluctuations:

	10%	5%	Fair value	(5%)	(10%)
Instrument	**Profit (loss) from fluctuation NIS Millions**		**NIS Millions**	**Profit (loss) from fluctuation NIS Millions**	
Hedge – Euro / Dollar	(12)	(6)	(2)	1	4
Hedge – Shekel / Dollar For hedging - not recognized for accounting	51	23	(17)	(31)	(69)
Total	22	-	(19)	(47)	(82)

G. Changes in fair value of financial instruments sensitive to fluctuations in consumer price index:

	0.2%	0.1%	**Fair value**	(0.1%)	(0.2%)
Instrument	**Profit (loss) from fluctuation NIS Millions**		**NIS Millions**	**Profit (loss) from fluctuation NIS Millions**	
Current liabilities	(1)	(1)	(734)	1	1
Long-Term Liabilities	(10)	(5)	(4,773)	10	5
Total	(11)	(6)	(5,252)	11	6

H. Changes in fair value of negotiable securities:

	10%	5%	**Fair value**	(5%)	(10%)
Instrument	**Profit (loss) from fluctuation NIS Millions**		**NIS Millions**	**Profit (loss) from fluctuation NIS Millions**	
Short term investments	62	31	622	(31)	(62)
Long term investments	92	46	920	(46)	(92)
Total	154	77	1,542	(77)	(154)

I. Changes in fair value of CPI-linked financial instruments sensitive to interest fluctuations:

	10%	5%	**Fair value**	(5%)	(10%)
Instrument	**Profit (loss) from fluctuation NIS Millions**		**NIS Millions**	**Profit (loss) from fluctuation NIS Millions**	
Long term loans from banks and others	13	6	(997)	(6)	(13)
Debentures and debentures convertible into shares in consolidated companies	104	49	(4,422)	(61)	(119)
Total	117	55	(5,427)	(67)	(132)

J. Changes in fair value of financial instruments linked to the Sterling Pound and sensitive to interest fluctuations:

	10%	5%	**Fair value**	(5%)	(10%)
Instrument	**Profit (loss) from fluctuation NIS Millions**		**NIS Millions**	**Profit (loss) from fluctuation NIS Millions**	
Short term credit from banking corporations	2	1	(36)	(1)	(2)
Long term loans from banks and others	22	11	(480)	(11)	(22)
Total	24	12	(516)	(12)	(24)

K. Changes in fair value of financial instruments linked to the Canadian dollar and sensitive to interest fluctuations:

	10%	5%	**Fair value**	(5%)	(10%)
Instrument	**Profit (loss) from fluctuation NIS Millions**		**NIS Millions**	**Profit (loss) from fluctuation NIS Millions**	
Long term loans from banks and others	11	6	(1,024)	(6)	(12)

L. Changes in fair value of financial instruments linked to the Euro and sensitive to interest fluctuations:

	10%	5%	**Fair value**	(5%)	(10%)
Instrument	**Profit (loss) from fluctuation NIS Millions**		**NIS Millions**	**Profit (loss) from fluctuation NIS Millions**	
Long term loans from banks and others	18	9	(786)	(9)	(19)

2) <u>Sensitivity of financial instruments for insurance businesses:</u>

A. Changes in fair value of CPI-linked financial instruments sensitive to interest fluctuations:

	10%	5%	**Fair value**	(5%)	(10%)
Instrument	**Profit (loss) from fluctuation NIS Millions**		**NIS Millions**	**Profit (loss) from fluctuation NIS Millions**	
Debentures, capital notes and loans	(2)	(1)	97	1	2

B. Changes in fair value of foreign currency linked financial instruments that are sensitive to exchange rate fluctuations:

	10%	5%	**Fair value**	(5%)	(10%)
Instrument	**Profit (loss) from fluctuation NIS Millions**		**NIS Millions**	**Profit (loss) from fluctuation NIS Millions**	
Debentures, loans and foreign shares	4	2	39	(2)	(4)

C. Changes in fair value of negotiable securities:

	10%	5%	**Fair value**	(5%)	(10%)
Instrument	**Profit (loss) from fluctuation NIS Millions**		**NIS Millions**	**Profit (loss) from fluctuation NIS Millions**	
Negotiable securities	5	3	52	(3)	(5)

8. Philanthropy

The Company's policy is mainly effected through the Delek Science, Education and Culture Foundation Ltd. (hereinafter: the "Delek Foundation"), which acts as the executive arm of the communal activities of the companies in the Group. The Delek Foundation's policy is to award stipends to students at academic institutions and to pupils at secondary educational institutions, and to give donations to public purposes in the fields of education, culture, medicine and help to the needy. The principal sources of the Delek Foundation's income are donations by companies in the Delek Group.

During the report period, the Delek Foundation donated a total sum of NIS 3,264,000. Of that sum, the sum of NIS 392,000 was donated as scholarships to pupils and students at educational institutions around the country, and the sum of approximately NIS 2,872,000 was donated for various purposes, mainly in the areas of health, culture and assistance to the needy.

On August 30, 2006, the board of directors of the Company resolved to set up a special fund under the Delek Foundation, with the total sum of NIS 18 million, to provide assistance by giving scholarships to soldiers in combat units. Negotiations between representatives of the Delek Foundation and representatives of the IDF and the Ministry of Defense concluded that the scholarships would be given to soldiers discharged from mandatory service with the IDF, who served in combat units, with preference being given to discharged soldiers who are lone soldiers or who live in the peripheral parts of the country, or who require assistance for socio-economic reasons. The intention is to give those entitled scholarships in the sum of NIS 10,000 (per year), each scholarship being for the entire duration of studies (3-4 years). The Foundation intends to grant scholarships to 200 discharged soldiers during the first year, and thereafter, 100 scholarships each year (in addition to the ongoing scholarships which shall be granted to entitled persons who continue their studies).
Recipients of scholarships shall be required to do voluntary communal work as well.

9. Directors Who Possess Accounting and Financial Qualifications and Skills

The Company has prescribed that there shall be a minimum of two directors who possess accounting and financial expertise.

The Company is of the opinion that given the fact that the board of directors of the holding company is small (seven directors) and the fact that the directors have rich commercial experience (even those who do not meet the definition of "accounting and financial experts") the above minimum number enables the board of directors to meet the duties imposed upon it under the law and the Company's documents of incorporation with respect to review of the Company's financial situation and the drafting and approval of its financial statements.
In addition to the above, it should be further added that under the Company's procedures, the auditor of the Company is invited to every meeting of the board of directors at which the financial statements are discussed, and is available to the directors for providing any explanation that may be required in relation to the financial statements, either at the meetings in which he participates, or externally to such meetings.

It should also be noted that, under the law, every director who so desires is entitled, under circumstances justifying such and on such conditions as are set out in the law, to receive professional advice at the Company's expenses, for the purposes of performing his functions, including accounting and financial advice.

The directors with accounting and financial expertise are:

A. **Mr. Moshe Amit** – B.A. (Soc. Sci.). Has worked for over 40 years in various senior positions at Bank Hapoalim. Served as EVP and member of the board of management at the bank for ten years (since 1980) and then as joint CEO (1990), followed by acting CEO (2000-2003). He is also a director of Bank Hapoalim (Switzerland) and is a member of other boards of directors.

B. **Prof. Benzion Zilberfarb (external director)** – Holds a PhD (Econ) from Pennsylvania University, Philadelphia, USA and an MA (Econ) from Bar-Ilan University. BA, Economics and Business Administration– Bar-Ilan University.
Previously served (1998-1999) as Director General of the Ministry of Finance.
Currently serves as Head of the Banking and Capital Market Program and Head of the Global Assets Management Department at Netanya College. Also serves as the Head of the A. Mayer Banking Center at Bar-Ilan University.
In the past, served as Dean of the Social Sciences Faculty at Bar-Ilan University (1993-1997) and as Head of the Economics Department at Bar-Ilan University (1992-1993), Director of the Azrieli Research Center for Israeli Economics (1991-1996) and Head of the Economic Research Institute (1987-1988) at Bar-Ilan University.
Also served – and currently serving – on the boards of directors of various large economic entities, including: Israel Discount Bank, Brimag Digital Age, Fundtech, Clal Provident and Continuing Education Funds, Partner, EuroTrade Bank, Karnit Insurance Company and more.

C. **Mr. Avraham Harel** – Holds an MA (Econ) from Tel Aviv University (1977) and a BA (Econ & Statistics) from Tel Aviv University (1973). Previously served as a lecturer at the Tel Aviv University Economics Department (1973-1984).
Recently served as VP, executive member and Director of the Financial Division and Information Division at Bank Hapoalim. Also served (and continues to serve) as a board member of various businesses, including: Poalim Capital Markets (Chairman), Bank Otsar Hachayal (Chairman), The Tel Aviv Stock Exchange, Maalot Israeli Rating Company Ltd., Continental Mutual Funds Ltd., Hapoalim International (Chairman), Bank Hapoalim (Switzerland), Bank Hapoalim (Luxembourg), Koor, Granite Hacarmel.

10. Dividend

A. On 29 March 2005, the board of directors resolved to pay a dividend out of the profits of 2005, at a rate of 557% of the paid up share capital. The dividend amounted to approximately NIS 61.2 million and was paid on May 1, 2006.

B. The board of directors of the Company resolved, on May 30th 2006, to distribute a dividend out of the 2006 profits at a rate of 1,300% of the paid-up share capital. The dividend amounted to approximately NIS 149.7 million, and was paid on 10 July 2006.

C. On August 30, 2006, the board of directors resolved to pay a dividend out of the 2006 profits, at a rate of 2,150% of the paid up share capital. The dividend amounted to approximately NIS 250.2 million and was paid on October 4, 2006.

D. The Board of Directors of the Company resolved, on November 29, 2006, to distribute a dividend out of the 2006 profits at a rate of 740% of the paid up share capital. The divided amounted to approximately NIS 86.1 million.

E. The Board of Directors of the Company resolved, on March 28, 2007, to distribute a dividend out of the 2006 profits at a rate of 857% of the paid up share capital. The divided amounts to approximately NIS 99.9 million.

11. Disclosure regarding Internal Auditor of Corporation

A. Details of Internal Auditor

1) Name of auditor: Michael Greenberg

2) Date of commencement of office: 2002

3) Qualifying skills:

Possesses degrees in accounting and economics and is a Certified Public Accountant, is a member of the Institute of Internal Auditors Israel, and has considerable experience in the field of auditing (20 years in a variety of different internal audit functions).

4) To the best of the Company's knowledge, the internal auditor is in compliance with the provisions of section 146(b) of the Companies Law 5759-1999 and with the provisions of section 8 of the Internal Audit Law.

5) The internal auditor is an employee of a wholly owned subsidiary of the Delek Group, Delek Investments and Assets Ltd., and is employed full-time.

6) The internal auditor does not hold securities in the Company or in any entities related to it.

7) The internal auditor does not have an interest in the corporation, and is not a relative of a person with an interest in the corporation, and is not the auditing accountant or a person acting on his behalf.

8) The internal auditor does not perform any other function in the corporation other than that of internal auditor. The internal auditor does not perform any function outside of the corporation which gives rise or which might give rise to a conflict of interests with his function as internal auditor.

B. Method of Appointment

The appointment of the internal auditor was approved by the audit committee and the board of directors in 2002. The reasons for approving his appointment include: His education, skills and considerable experience in internal auditing.

C. Identity of Auditor's Superior

The internal auditor reports directly to the CEO of the Delek Group, as is prescribed in the articles of association of the Company.

D. Work Plan

The work plan of the corporation's internal audit is annual.

The considerations employed in setting the annual audit plan at the company are, mainly, the following:

1) The internal auditor's suggestions for the annual work plan.
2) The proposals of the members of the audit committee and the board of directors of the Company based, inter alia, on the internal auditor's suggestions, internal audit matters in previous years and matters discussed at regular meetings of the audit committee and of the board of directors of the Company.
3) The size and organizational structure of the Company, the substance of its commercial operations and the scope thereof.

The plan is drafted by the corporation's internal auditor, and is approved by the Company's audit committee.

Management, the audit committee and the chairman of the board of directors have the ability to extend the scope of the plan, or to instruct that particular changes be made to it, at the request or recommendation of the internal auditor or at the instruction of the committee.

E. Audit of investee companies

The internal work plan includes audit matters that relate to the reporting corporation.

In some of the substantial subsidiaries of the corporation, separate annual audit plans are drafted by the internal auditor, who acts as internal auditor of such corporations as well. The rest of the substantial subsidiaries of the organization have internal auditors who do not report to the Internal Auditor, and the internal work plans in those corporations are drafted by them. The internal audit plans in investee corporations are approved by the board of directors and the audit committees of the above corporations.

F. Scope of employment:

The internal auditor of the Company is employed full time, and acts as internal auditor of the Company and of the corporations that constitute substantial holdings of the Company.
The internal auditor and the professional auditors who are subordinate to him are employed for approximately 3,400 working hours at the corporation, and in the internal audit of investee corporations, whose operations are in Israel and outside of Israel, as set out below:

	Hours invested in internal audit	
	In the corporation	In investee corporations
Operations in Israel	300	2,600
Operations outside of Israel*		500

* Delek Belron International

In addition, operations in Israel of three investee corporations (The Phoenix, approx. 8,000 hours, Matav, approx. 500 hours, Gadot Biochemicals, approx. 450 hours) are audited by additional internal auditors who are not subject to the corporation's internal auditor, in a total sum of approx. 8,950 annual hours.
Operations outside of Israel, in 2 investee companies: Delek USA and Republic, are audited by internal auditors who are not subject to the internal auditor, at approx. 3,430 working hours.

G. Drafting of Audits

According to a notice from the internal auditor, the audits are drafted in accordance with the internal auditing standards employed in Israel and around the world, and in accordance with professional guidelines in the field of internal auditing, including the standards of the Institute of Internal Auditors in Israel and in the USA (CIA), and in accordance with the Internal Audit Law, 5752-1992, and the Companies Law.

H. Access to Information

The internal auditor has full, unrestricted, constant and unfettered access to all of the corporation's information systems, including financial data.

I. Internal Audit Report

The internal auditor's report was submitted in writing.
Audit reports were submitted and discussed by the board of directors of the corporation on the following dates:
- Summary report for 2006: Submitted – February 2007, deliberated – March 2007.
The report was submitted to the chairman of the board of directors, to the CEO of the Company and to members of the audit committee of the Company.

J. Evaluation of internal auditor's work by the board of directors

In the assessment of the board of directors of the Company and the audit committee, the nature and continuity of operations and the internal auditor's work plan are reasonable given the scope, organizational structure, substance of commercial operations and scope thereof, and will serve to achieve the purposes of the corporation's internal audit.

K. Remuneration

The internal auditor is a salaried full time employee of a wholly-owned subsidiary of the Delek Group. The subsidiary charges the Delek Group a total sum of NIS 60,000 for annual internal audit work.
In the opinion of the board of directors, the internal auditor's remuneration shall not affect or harm the application of his professional discretion.

12. Critical Accounting Estimates

In drafting the financial statements in accordance with accepted accounting rules, management of the Company and its subsidiaries are required to use estimates or evaluations regarding transactions or matters the final effect of which on the financial statements cannot be precisely determined at the time of drafting. The principal bases for determining the quantitative value of such estimates are the presumptions that management of the Company resolves to adopt, taking into consideration the circumstances the subject of the estimate, and the best information available to it at the time of drafting. Naturally, as these estimates and evaluations are the result of exercise of discretion in an uncertain environment, at times particularly significant, changes to the basic presumptions as a result of changes that are not necessarily dependent upon management of the Company, as well as the addition of information in the future that was not available to the Company on the date on which the estimate was made, might bring about changes to the quantitative value of the estimate, and therefore, might also effect the financial situation of the Company and the results of its operations. Therefore, even though the estimates or assessments are made in accordance at the best discretion of management, the final quantitative effect of transactions or matters that need assessing can only be clarified when such transactions or matters reach their end. In certain cases, the final result of a matter being estimated can be significantly different, in particular from the quantitative amount prescribed for it on the date of the estimate.

The following are accounting estimates with a particularly high potential effect, which the Company and its subsidiaries employ when drafting their consolidated financial statements.

Changes in the Fair Value of Real Estate Assets in Foreign Affiliated Companies
In certain foreign affiliated companies, the Group's share is based on the balance sheet value of these companies, based on financial statements drafted in accordance with international accounting rules, including implementation of International Accounting Standard 40 under which productive real estate is to be presented in accordance with its fair value. The fair value is established by independent real estate experts. Changes in fair value are ascribed to the profit and loss statement and therefore might more substantially effect the results of operations.

Contingent Liabilities
In assessing the chances of success of lawsuits against the Company or its subsidiaries, the companies rely upon the opinions of their legal counsel. The assessments of legal counsel are based on their best professional judgment, taking into account the stage of proceedings, and the legal experience of the various issues. Since the results of the claims will be determined in the courts, such results may be different from these assessments.

Impairment of Assets
In accordance with the provisions of the Accounting Standards Institute's Accounting Standard 15, on each balance sheet date, the Company and its consolidated companies examine whether events or changes in circumstances have taken place indicating a reduction in value in one or more of the non-monetary assets to which the standard applies. If there are signs of a reduction of value, then an examination is held as to whether the sum in which the investment in the asset is present may be refunded from anticipated cash flows from such asset, and where necessary, a provision is recorded for a reduction of value up to the amount of the sum that can be refunded. The prescription cash flow assessments is based on the past history of the asset or similar assets and on the best judgment of the Company or its subsidiaries, as the case may be, regarding the economic conditions during the remainder of the useful life of the asset.

Evaluating Proven Natural Gas Reserves

The evaluation of proven and developed natural gas reserves serves for determining the amount of depreciation of the assets used in the operations, during the report period.

Depreciation of investments relating to the discovery and production of proven and developed natural gas reserves is via the depletion method, i.e., over the accounting period, the assets are depreciated by the rate prescribed in accordance with the appoint of units of gas actually produced, divided by proven and developed gas reserves remaining according to estimates. The amount of gas estimated in the wells that produce gas during the report period is prescribed each year, *inter alia*, based on the opinions of external experts for assessing the reserves of oil and gas wells. The assessment of proven and developed gas reserves using the above principles is a subjective process, and the assessments of different experts could at times be substantially different. Due to the significance of the depreciation results, the changes set out above could have a substantial effect on the results of operations and on the Company's financial status.

Provision for Doubtful Debts

Provision for doubtful debts is calculated mainly in specific terms for debts, the collection of which is doubtful, in the opinion of management of the Group, and partially, at a specific proportion of the sum of customer debts. In determining the amount to be provided, management relies on the best information available to it and on the assessments of its legal counsel. Changes to these estimates and assessments might affect the results of the Group's operations.

13. Code of Ethics

In its meeting of 30 November 2004, the board of directors approved a code of ethics for the Company and appointed Advocate Liora Pratt Levine to be responsible for implementation of the code of ethics at the Company.

The code of ethics and the rules of business conduct that were adopted under the code, are binding on all of the directors, managers and employees of the Company, including subsidiaries, which were also instructed to adopt the code of ethics.

The purpose of the code of ethics, as expressed in the provisions of it, is to establish criteria which the Company believes will reasonably ensure the prevention of inappropriate conduct and will promote conduct in accordance with the following principles, *inter alia*:

- Fair and ethical conduct, and in particular, ethical treatment of any real or perceived conflict of interest between personal and professional relationships;
- Full, proper, precise, clear and timely disclosure of reports and documents submitted by the Company to all competent authorities by law, and of other public pronouncements made by the Company;
- Compliance with the provisions of the law, including statutes, regulations and relevant rules;
- Immediate internal reporting of any violation of the provisions of the Code of Ethics;
- Responsibility for the existence of a code of ethics;

14. Peer Review

The Company has given its consent to provide material required for implementation of a peer review sampling initiated by the Institute of Certified Public Accountants in Israel subject to the keeping of the secrecy of the data to be provided, and subject to a guarantee of no conflict of interests of those conducting the review.

15. Adoption of international financial reporting standards

In July 2006, the Israel Accounting Standards Board published Accounting Standard No. 29, "Adoption of International Financial Reporting Standards (IFRS)". The International Financial Reporting Standards (hereinafter: the IFRS Standards) comprise standards and interpretations adopted by the International Accounting Standards Board, and include: International financial reporting standards (IFRS), international accounting standards (IAS) and clarifications by the international financial reporting interpretation committee (IFRIC) or by the committee which preceded it in interpreting international accounting standards (SIC). The Standard provides that companies that are subject to the provisions of the Securities Law 5728-1968, and that are required to report according to the regulations published thereunder, will be required to prepare their financial statements in accordance with IFRS starting from the period commencing on January 1, 2008. These companies, as well as other companies, may adopt IFRS early and prepare their financial statements in accordance with IFRS starting with financial statements that are issued subsequent to July 31, 2006.

A company that adopts IFRS commencing from January 1, 2008, and that has elected to include comparative data for only one year (2007) will be required to prepare an opening balance sheet as of January 1, 2007 ("Opening IFRS Balance Sheet"). The Opening IFRS Balance Sheet will require the following:

- Recognition of all assets and liabilities whose recognition is required by IFRS.
- De-recognition of assets and liabilities if IFRS do not permit such recognition.
- Classification of assets, liabilities and components of equity according to IFRS.
- Application of IFRS in the measurement of all recognized assets and liabilities.

In order to ease first-time adoption, a number of exemptions from IFRS have been granted in respect of the Opening IFRS Balance Sheet, which exemptions may be elected, in whole or in part. Exceptions have also been established which prohibit retrospective application of certain aspects of IFRS.

According to the Standard, the Company is required to include in a note to the annual financial statements as of December 31, 2007, a balance sheet as of December 31, 2007, and a statement of income for the year then ended, that have been prepared based on the recognition, measurement and presentation criteria of IFRS.

There are differences between IFRS and generally accepted accounting principles in Israel in the recognition and measurement of assets and liabilities and in reporting and disclosure requirements. These differences could have a material impact on the Company's financial position and results of operations. The Group is in the process of examining the consequences and evaluating the effects expected as a result of the transition to IRFS standards.

Management of the Group has appointed Mr. Alan Gelman, Deputy CEO and VP Finances of the Delek Group to be in charge of adoption of IFRS standards.

The following are the stages of the process as determined by management of the Group:

Acts done as at the date of publication of the financial statements for December 31, 2006:

1. Review of all IFRS standards.
2. Mapping out of the IFRS standards that are relevant to the Group and that require an in-depth examination of the implications of them on the financial statements.
3. Qualitative examination of the main implications likely to be experienced by the Group as a result of adoption of IFRS standards.

Acts required to be done prior to publication of the financial statements for the second quarter of 2007:

1. Quantitative examination of the principal implications likely to be experienced by the Group as a result of adoption of the IFRS standards, as at January 1, 2007.
2. Identification of substantial contracts or agreements which might be affected by adoption of the IFRS standards, whether there is a change in the conditions of them in light of the transition, or whether they are based on data or indices which are expected to change as a result of implementation of the IFRS standards.

Acts required to be done prior to publication of the annual financial statements for December 31, 2007:

1. Completion of qualitative and quantitative examination of additional consequences expected as a result of adoption of IFRS standards.
2. Drafting of a balance sheet for December 31, 2007, and profit and loss statements for the year ending on such date, in accordance with the IFRS standards.

The following is a description of the anticipated effects on the consolidated financial statements of the Delek Group as a result of the transition to IFRS:

A. **Deferred taxes** – pursuant to international accounting standard 1 "presentation of financial statements", deferred taxes are presented long term even if the date of exercise of them is expected in the short term. Under Israeli accounting standard no. 19, "taxes on income", deferred taxes were presented short term or long term, depending on the date of expected exercise. The Group expects a reduction in debtors and debt balances and a corresponding increase in other assets.

B. **Inventory of buildings and land for sale** – under Israeli accounting standard 2 "erection of buildings for sale", upon the existence of certain conditions, it was possible to recognize revenue from the sale of building and land inventory for sale at the rate of completion of the project. Under international accounting standard 18, "income", income can only be recognized upon completion of construction / delivery of apartments to the purchaser. At this stage, the Group is examining the expected affect of the above.

C. **Investments in affiliates** – in light of the changes in the shareholders' equity of the affiliated companies following the transition to IFRS, a change is expect to take place in this item. At this stage, the Group is examining the expected affect of the above.

D. **Investments in other companies** – under international accounting standard 32, "financial instruments: presentation", and international accounting standard no. 39, "financial instruments: recognition and measurement", investments in non-negotiable shares and investments in negotiable shares classified for a group of financial assets that are available for sale shall be presented according to their fair value, the changes in the fair value being accredited to a capital fund. Under Declaration 44 of the Institute of Certified Practicing Accountants, these investments are measured at cost, less depreciations which are not temporary. Under IFRS, in certain cases, certain investments may be designated to groups of financial assets that are measured at a fair value via profit and loss. The significance of this is that the changes in fair value will be credited to the profit and loss statements. The Group expects an increase in investments in investee and other companies and a corresponding increase in shareholders' equity (increase in capital fund or in profit balance, according to the type of investment).

E. **Investment real estate** – according to international accounting standard 40, "investment real estate", either the cost model or the fair value model may be chosen as accounting policy. Under Israeli standards, investment real estate was presented under the cost model, and therefore, the transition to the fair value model will bring about an increase in investment real estate assets and a corresponding increase in profit balance.

F. **Investment in oil and gas exploration and production** – under international financial reporting standard 6, "exploration and evaluation of mineral resources", the accounting treatment prescribed in US standards, as applied in Israel, can still be used, or a transition made to the accounting treatment set out in the international standards. At this stage, the Group is examining the expected affect of the above.

G. **Property, plant and equipment -**

- Under international accounting standard 16 "property, plant and equipment", either the cost method or the re-evaluation method may be chosen as accounting policy. Furthermore, under international accounting standard no 16, each component of property, plant and equipment with a distinct life and cost that is material in relation to total cost of property, plant and equipment is to be depreciated separately. The cost of fixed assets will also include an initial evaluation of costs of the asset's liquidation and evacuation and restoration of the site where the asset is located, which are undertaken by the Group.
- Leases from the ILA of buildings and land do not come within the definition of property, plant and equipment and therefore, those balances must be classified. As a result of first-time application of international accounting standard 17, "leases", the Group expects a reduction in the amount of land leased from the Israel Lands Administration, which, up till now, had been included as part of property, plant and equipment, in light of their being presented according to depreciated cost on the date of transition. These leasing rights will be classified in accordance with international standards as a long-term expense in advance, which shall be presented separately from property, plant and equipment, and shall be amortized over the period of the lease, including taking into account options.

H. **Convertible debentures** – CPI linked convertible liabilities are classified as liabilities under the international standard. For the purpose of measurement, the sum of the liability must be separated into two components: The component of the liability without a conversion right, which is measured according to a depreciated cost in accordance with the effective interest method, and the conversion option which is measured in accordance with fair value. Under Israeli accounting standard no. 22 – "financial instruments: disclosure and presentation", these kinds of liabilities will be treated as a complex instrument and therefore have been separated into a liability component and a capital component. The Group expects an increase under convertible debentures for shares of affiliates and a corresponding decrease in capital funds and profit balances.

I. **Liabilities for termination of employer-employee relations** – under international standards, benefits to employees after retirement, which are not under defined schemes, are measured based on actuarial estimates, taking into account the rate of capitalization, whilst under Israeli standards, liabilities for termination of employer-employee relations are recognized on the basis of the full obligation, under the presumption that all employees will be fired on the balance sheet date, under conditions entitling them to full severance pay without taking into account the rate of capitalization, rate of increase of future wages or future departure of employees. At this stage, the Group is examining the expected affect of the above.

J. **Option warrants** – under IFRS, option warrants issued with a CPI linked exercise supplement are classified as a liability and are measured according to fair value. The Group expects an increase under liabilities and a corresponding decrease in profit balance.

K. **Hedging** – certain hedging transactions were referred to under disclosure in financial statements, however under the international standards, they must be measured at fair value. At this stage, the Group is examining the expected affect of the transition to international standards.

L. **Integrated derivatives** – under IFRS, integrated derivatives must be separated from consolidated instruments. Integrated derivatives that have been separated are measured according to fair value, the changes in fair value being accredited to profit and loss statements. Under Israeli accounting rules, integrated derivatives were not separated out from consolidated instruments. At this stage, the Group is examining the expected affect of the above.

M. **Minority interests** – under international standards, minority interests are set out in shareholders' equity as a separate component.

N. **Contingent liabilities** – Under IFRS, a provision must be recognized if the chances of the obligation existing as at the balance sheet date are more likely than it not existing. Under Israeli accounting rules, the Group recognizes provisions if use of economic resources for the purpose of removing the obligation is probable. At this stage, the Group is examining the expected affect of the above.

O. **Currency of operations** – the criteria set down for currencies of operations under international accounting standard no. 21 "effects of changes in foreign currency exchange rates" are different from the criteria prescribed in Israeli accounting standard no. 13 "effects of changes in foreign currency exchange rates". At this stage, the companies in the Group are examining the expected affect of the above.

P. Partial consolidation – under the international standards, in order to handle investments in an investee company under the partial consolidation method, a joint control agreement is required between the majority shareholders, whilst under Israeli standards, a joint control agreement is required between all of the shareholders. In light of this, investment in a company which, till now, has been dealt with under the balance value method under the Israeli standard, will be handled under the partial consolidation method.

16. Auditors' Fees

	For the Year Ended December 31					
	2006			2005		
	Audit and tax services		**Other services**	**Audit and tax services**		**Other services**
	Hours	NIS '000	NIS '000	Hours	NIS '000	NIS '000
The Company and wholly owned HQ companies						
Kost Forer Gabbay and Kasierer	5,325	1,159	218	5,289	913	181
Other consolidated companies						
Gadot Biochemical Industries Ltd.						
Kost Forer Gabbay and Kasierer	1,160	267	-	2,170	351(1)	90
Other accountants		-	255		-	-
Delek Real Estate Ltd.						
Kost Forer Gabbay and Kasierer	3,095	646	317	2,889	1,638(1)	294
Other accountants	3,405	3,054	3,983	1,411	800	-
Delek Automotive Systems Ltd.						
Kost Forer Gabbay and Kasierer	1,900	557	-	1,750	394	100
Delek Petroleum, Delek Israel and HQ companies in Israel						
Kost Forer Gabbay and Kasierer	6,203	1,040	1,390	5,534	977	-
Other accountants		150	1,019		160	-
ADI Technologies Ltd. – our portion 50%						
Somekh Chaikin	2,430	121	8	1,910	130	54
Other accountants	150	38	75	150	30	103
Delek Energy Systems Ltd.						
Ziv Haft	2,050	440	105	1,645	383	-
For Yam Tethys Venture						
Ziv Half, Alfaya & Alfaya	307	59	-	270	62	-
For Delek & Avner Yam Tethys Ltd.						
Ziv Haft & Kost Forer	110	33	-	105	45	117
Delek USA (2)						
Ernst & Young USA	7,075	6,746	4,610	5,410	5,085	1,795

(1) Including payments for services provided with respect to preparation of a prospectus.

(2) includes payments for services granted as part of purchase of the refinery, preparations to submit a draft prospectus and audit of acquired companies.

17. Company Employees

The Board of Directors expresses its respect and appreciation to the management of the Company, to the management of its subsidiaries and to all of the employees for their dedicated work and for their contribution to promoting the Company.

Sincerely,

Asi Bartfeld	**Gabriel Last**
Managing Director	Chairman of the Board of Directors

March 28, 2007

DELEK GROUP LTD.

FINANCIAL STATEMENTS AS AT DECEMBER 31, 2006

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ERNST & YOUNG

■ Kost Forer Gabbay & Kasierer
3 Aminadav St.
Tel-Aviv 67067, Israel

■ Phone: 972-3-6232525
Fax: 972-3-5622555

Report of Independent Auditors

To the shareholders of DELEK GROUP LTD.

We have audited the accompanying balance sheets of Delek Group Ltd. ("the Company") as of December 31, 2006 and 2005 and the consolidated balance sheets as of such dates and the related statements of income, changes in shareholders' equity and cash flows - of the Company and consolidated - for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's board of directors and management. Our responsibility consists of providing a professional opinion regarding these financial statements, based on our audit.

We did not audit the financial statements of subsidiaries and partnerships, whose assets constitute 17% and 26% of total consolidated assets as of December 31, 2006 and 2005, respectively, and whose revenues constitute 5%, 6% and 33% of total consolidated revenues for the years ended December 31, 2006, 2005 and 2004, respectively. Neither did we audit the financial statements of subsidiaries and partnerships, the investment in which, at equity, amounted to NIS 1,024 million and NIS 672 million as of December 31, 2006 and 2005, respectively, and the Company's equity in their earnings amounted to NIS 361 million, NIS 114 million and NIS 100 million for the years ended December 31, 2006, 2005 and 2004, respectively. The financial statements of those companies were audited by other auditors, whose reports have been furnished to us, and our opinion, insofar as it relates to amounts included for those companies, is based on the reports of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards in Israel, including those prescribed by the Auditors' Regulations (Auditor's Mode of Performance), 1973. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The audit includes sample examinations of evidence supporting the sums and the information appearing in the financial statements. The audit also includes an examination of the accounting principles that were implemented, as well as the material estimations that were made by the Company's Board of Directors and its management, coupled with an estimate of the appropriateness of the overall presentation of the financial statements. We are confident that our audit and the financial statements of the other certified public accountants, provide an appropriate basis for our opinion.

In our opinion, based on our audit and the reports of the other accountants, the aforementioned financial statements present fairly, in conformity with generally accepted accounting principles, in all material aspects, the financial position – of the Company and Consolidated – as at December 31, 2006 and 2005, as well as the results of operations, changes in shareholders' equity and the cash flows – of the Company and Consolidated – for each of the three years in the period ended December 31, 2006. Furthermore, in our opinion, the financial statements referred to above are prepared in accordance with the Securities Regulations (Preparation of Annual Financial Statements), 1993. Based on the fact that the data for the consolidated insurance companies were formulated on the basis of accounting and reporting principles according to the Law for Supervision Over Financial Services (Insurance) – 1981 and the ensuing regulations.

We have also audited the pro forma consolidated statements of income for each of the three years in the period ended December 31, 2006, that are presented in Note 39. These consolidated pro forma financial statements are the responsibility of the Company's board of directors and management. Our responsibility consists of providing a professional opinion regarding these consolidated pro forma financial statements, based on our audit.

We did not audit the financial statements of subsidiaries and partnerships, whose consolidated revenues constitute 5%, 6% and 34% of total consolidated pro forma revenues for the years ended December 31, 2006, 2005 and 2004, respectively. Neither did we audit the financial statements of subsidiaries and partnerships wherein the Company's equity in their earnings amounted to NIS 366 million, NIS 27 million and NIS 74 million for the years ended December 31, 2006, 2005 and 2004, respectively. The financial statements of those companies were audited by other auditors, whose reports have been furnished to us, and our opinion, insofar as it relates to amounts included for those companies, is based on the reports of the other auditors.

In our opinion, based on our audit and the reports of the other accountants, the aforementioned consolidated pro forma financial statements present fairly, in conformity with generally accepted accounting principles, in all material aspects, the pro forma consolidated results of operation for each of the three years in the period ended December 31, 2006, on the basis of the assumptions outlined in Note 39.

As described in Note 2, these financial statements are presented in reported amounts, in conformity with the Accounting Standards of the Israel Accounting Standards Board.

Without qualifying our opinion, we draw attention to the matter discussed in Note 25a and 38h(b) to the financial statements regarding claims filed against investees.

Tel Aviv
March 28, 2007

Kost Forer Gabbay and Kasierer
CPAs

Consolidated Balance Sheets

	Note	As at December 31 2006	As at December 31 2005
		NIS Millions, Reported	
General business assets:			
Current assets			
Cash and cash equivalents	3	881	835
Short-term investments	4	815	681
Accounts receivable - trade	5	2,352	2,356
Other accounts receivable	6	557	546
Inventories	7	1,367	1,463 *)
Real estate held for sale	8	110	41
		6,082	5,922
Long-term investments, loans and receivables			
Investments in investee and other companies	9	2,815	2,586
Real estate for rent	10	3,230	2,316
Land held for construction	11	477	462
Loans, deposits and long-term receivables	12	903	645 *)
Investments in oil and gas exploration	13	969	794
		8,394	6,803
Fixed assets, net	14	3,077	2,518
Other assets and deferred charges, net	15	741	747
Total general business assets		18,294	15,990
Insurance operations assets:	38		
Cash and cash equivalents		1,115	-
Investments		26,018	-
Fixed assets		580	-
Sums to collect		3,880	-
Deferred acquisition expenses and other assets		2,547	-
Total insurance business assets		34,140	-
		52,434	15,990

*) Reclassified

The accompanying notes and appendix are an integral part of the financial statements.

Consolidated Balance Sheets

	Note	As at December 31 2006 Reported	2005 ,NIS Millions
General business liabilities:			
Current liabilities			
Short-term credit from banks and others	16	3,185	3,528
Accounts payable, trade	17	1,298	1,633
Other accounts payable	18	908	634
Dividend declared		86	-
		5,477	5,795
Long-term liabilities			
Long-term loans from banks and others	19	4,880	4,123
Debentures convertible into company shares	20	8	205
Debentures convertible into shares of subsidiaries	21	301	315
Other debentures	22	4,221	2,487
Accrued severance pay, net	23	16	13
Deferred taxes	33e	399	214
Other liabilities	24	337	107
		10,162	7,464
Total general business liabilities		15,639	13,259
Insurance operations liabilities:	38		
Insurance reserves and contingent liabilities		27,841	-
Long-term liabilities		2,253	-
Other liabilities		1,022	-
Total insurance business liabilities		31,116	-
Minority interest		2,232	455
Contingent liabilities, guarantees and commitments	25		
Shareholders' equity	27	3,447	2,276
		52,434	15,990

The accompanying notes and appendix are an integral part of the financial statements.

March 28, 2007			
Date of approval of the financial statements	Gabriel Last Chairman of the Board of Directors	Asi Bartfeld CEO	Alan Gelman Vice CEO and Responsible for Financial Matters

Balance Sheets - The Company

	Note	As at December 31 2006	2005
		NIS Millions, Reported	
Current assets			
Cash and cash equivalents	3	22	12
Short-term investments	4	86	160
Other accounts receivable	6	169	303
		277	475
Long-term investments, loans and receivables			
Investments in investee companies	9	6,344	3,352
Loan to related party	36g	3	5
		6,347	3,357
Deferred charges		-	4
		6,624	3,836
Current liabilities			
Short-term credit from bank	16b	306	76
Current maturities of debentures convertible into company shares	20	4	66
Current maturities of other debentures	22	60	62
Accounts payable (primarily accrued interest)		42	40
Declared dividend		86	-
		498	244
Long-term liabilities			
Long-term loans from consolidated subsidiaries	19	237	225
Debentures convertible into company shares	20	8	205
Other debentures	22	2,384	886
Other liabilities		50	-
		2,679	1,316
Contingent liabilities, guarantees and commitments	25		
Shareholders' equity	27	3,447	2,276
		6,624	3,836

The accompanying notes and appendix are an integral part of the financial statements.

March 28, 2007			
Date of approval of the financial statements	Gabriel Last Chairman of the Board of Directors	Asi Bartfeld CEO	Alan Gelman Vice CEO and Responsible for Financial Matters

Consolidated Statements of Income

	Note	For the year ended December 31		
		2006	2005	2004
		NIS Millions, Reported (Except profit per share data)		
Revenues		26,329	20,347	14,275
Less – excise and royalties		2,211	2,014	2,026
	35b(1)	24,118	18,333	12,249
Cost of revenues	28	21,217	15,802	10,234
Gross profit		2,901	2,531	2,015
Selling, marketing and gas station operating expenses	29	930	861	814
General & administrative expenses	30	441	337	296
Operating income		1,530	1,333	905
Financial expenses, net	31	554	594	342
		976	739	563
Gains from realization of investments in investee and other companies, net	9j	702	139	100
Other income (expenses), net	32	3	113	(28)
Income before taxes on income		1,681	991	635
Taxes on income	33	404	339	189
Income after taxes on income		1,277	652	446
Group's share in profits of affiliates and partnerships, net		591	146	136
Minority interest in subsidiary earnings, net		(355)	(176)	(159)
Income before cumulative effect of change in accounting principle, net		1,513	622	423
Cumulative effect of change in accounting principle, as of the beginning of the year, net	2o	-	-	(20)
Net income		1,513	622	403
Net earnings per share (in reported NIS): *)	34			
Basic net income:				
Income before cumulative effect of change in accounting principle, net		133.4	61.8	43.5
Cumulative effect of change in accounting principle, as of the beginning of the year, net		-	-	(2.1)
Net income				
Diluted net income:				
Income before cumulative effect of change in accounting principle, net		128.7	58.1	41.2
Cumulative effect of change in accounting principle at beginning of year, net		-	-	(1.7)
Net income		128.7	58.1	39.5

*) The 2005 figures were restated – See Note 2T.

The accompanying notes and appendix are an integral part of the financial statements.

Statements Of Income - The Company

		For the year ended December 31		
		2006	2005	2004
	Note	NIS Millions, Reported		
Revenues, net				
Equity in earnings of investees, net		1,351	498	421
Gains from issue of shares to third party		186	111	-
Management fees from investees		4	5	5
		1,541	614	426
Expenditures				
General & administrative expenses		25	7	5
Financial revenues, net	31	(9)	(15)	(2)
		16	(8)	3
Income before taxes on income		1,525	622	423
Taxes on Income (primarily deferred taxes)		12	-	-
Income before cumulative effect of change in accounting principle, net		1,513	622	423
Cumulative effect of change in accounting principle, as of the beginning of the year, net	2o	-	-	(20)
Net Income		1,513	622	403

The accompanying notes and appendix are an integral part of the financial statements.

Statements of Changes in Shareholders' Equity

	Share capital	Premium on shares	Capital reserves *)	Proceeds from convertible options	Retained earnings	Dividend declared after balance sheet date	Total
	NIS Millions, Reported						
Balance as at January 1, 2004	11	770	50	-	373	54	1,258
Conversion of debentures into Company shares	-	1	-	-	-	-	1
Capital reserve from transaction with a controlling shareholder	-	-	-	-	(6)	-	(6)
Losses yet to be realized in interest swap at a foreign associated company	-	-	(2)	-	-	-	(2)
Differences arising from financial statements of investee companies adjusted to foreign currency	-	-	42	-	-	-	42
Dividend	-	-	-	-	(97)	(54)	(151)
Net income	-	-	-	-	403	-	403
Dividend declared subsequent to balance sheet date	-	-	-	-	(104)	104	-
Balance as at December 31, 2004	11	771	90	-	569	104	1,545
Realization of interest-swap transaction at foreign associated company	-	-	11	-	-	-	11
Differences arising from financial statements of investee companies adjusted to foreign currency	-	-	(16)	-	-	-	(16)
Dividend	-	-	-	-	(280)	(104)	(384)
Conversion of debentures into Company shares	1	357	-	-	-	-	358
Exercise of option warrants into company shares	-	140	-	-	-	-	140
Net income	-	-	-	-	622	-	622
Dividend declared subsequent to balance sheet date	-	-	-	-	(61)	61	-
Balance as at December 31, 2005	12	1,268	85	-	850	61	2,276
Splitting of convertible option component of convertible debentures (net of issuing expenses)	-	-	-	6	-	-	6
Differences arising from financial statements of investee companies adjusted to foreign currency	-	-	(76)	-	-	-	(76)
Profits yet to be realized in interest swaps at a foreign affiliate	-	-	5	-	-	-	5
Dividend	-	-	-	-	(486)	(61)	(547)
Conversion of debentures into Company shares	1	262	-	(6)	-	-	257
Exercise of option warrants into company shares	-	13	-	-	-	-	13
Net income	-	-	-	-	1,513	-	1,513
Dividend declared subsequent to balance sheet date	-	-	-	-	(100)	100	-
Balance as at December 31, 2006	13	1,543	14	-	1,777	100	3,447

*) The capital reserves are primarily on account of adjustments from the translation of the financial statements of investee companies.

The accompanying notes and appendix are an integral part of the financial statements.

Consolidated Statements of Cash Flows

	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
Cash flows from operating activities			
Net income	1,513	622	403
Adjustments required to reflect cash flows from operating activities (a)	(471)	(69)	102
Net cash provided by operating activities	1,042	553	505
Cash flows from investing activities			
Acquisition of fixed and other assets	(580)	(322)	(376)
Investments in real estate for construction and leasing	(291)	(347)	(40)
Proceeds from realization of fixed assets and real estate	6	316	111
Realization (acquisition) of marketable securities, net	(20)	(262)	65
Collection of long-term loans granted	117	56	102
Withdrawal (deposit) of deposits, net	(152)	(358)	33
Increase in joint ventures for oil and gas exploration	(121)	(6)	(29)
Proceeds from realization of investments in investee and other companies	58	50	166
Investments in investees and other companies	(844)	(1,130)	(333)
Acquisition of newly-consolidated subsidiaries and operations (b)	(1,879)	(487)	(384)
Proceeds from realization of investments in previously-consolidated subsidiaries (c)	9	192	-
Loans granted to others	(139)	(25)	(50)
Net cash used in investing activities	(3,836)	(2,323)	(735)
Cash flows from financing activities			
Short-term credit from banks and others, net	15	(220)	(10)
Long-term loans received	1,415	1,960	1,102
Long-term loans repaid	(1,183)	(1,978)	(1,108)
Issue of shares to minority interest at consolidated subsidiaries	1,478	163	12
Dividend distributed	(461)	(384)	(151)
Dividend distributed to minority interest in subsidiaries	(120)	(125)	(128)
Sale of debentures held by a consolidated subsidiary	-	-	7
Exercise of option warrants into company shares	13	140	-
Proceeds on account of options exercised into debentures of consolidated subsidiary	2	58	-
Issue of debentures and debentures convertible into shares, net	1,942	2,733	509
Redemption of debentures and debentures convertible into shares	(239)	(296)	(48)
Net cash provided by financing activities	2,862	2,051	185
Translation differences in respect of cash balances held by autonomous investee companies	(22)	9	2
Increase (decrease) in cash and cash equivalents	46	290	(43)
Cash and cash equivalents at beginning of year	835	545	588
Cash and cash equivalents at end of year	881	835	545

The accompanying notes and appendix are an integral part of the financial statements.

Consolidated Statements of Cash Flows

	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
(a) Adjustments required to reflect cash flows from operating activities			
Income and expenses not involving cash flows:			
Depreciation, depletion, amortization and impairment of assets	340	350	295
Deferred taxes, net (1)	162	49	48
Decrease in accrued severance pay, net	2	(4)	-
Rise in value of loans granted, net	(10)	(17)	(2)
Gains from realization of fixed assets, real estate and investments, net	(713)	(246)	(139)
Equity in non-distributed earnings of affiliates and partnerships, net (2), (3)	(545)	(51)	(148)
Impairment (increase) in value of securities and deposits, net	23	1	(30)
Increase (impairment) in value of long-term liabilities, net	(83)	160	(6)
Minority interest in subsidiary earnings, net	355	176	159
Cost of share-based payment	59	-	-
Changes in asset and liability items:			
Increase in accounts receivable – trade	(12)	(605)	(215)
Increase in other accounts receivable	(31)	(86)	(30)
Decrease (increase) in inventories	120	(103)	(63)
Increase (decrease) in accounts payable – trade	(258)	363	166
Increase (decrease) in other accounts payable	120	(56)	67
	(471)	(69)	102
(1) Including cumulative effect of change in accounting principle, as of the beginning of the year, net	-	-	20
(2) Net of dividends received	8	101	8
(3) Net of tax impact on account of group's share in associated company earnings	67	6	20
(b) Acquisition of newly-consolidated subsidiaries and operations			
Deficit in working capital (working capital), net (excluding cash)	49	(211)	226
Fixed assets, real estate, investments and other property	(517)	(339)	(900)
Goodwill	-	-	(255)
Long-term liabilities	690	63	545
Insurance operations assets (excluding cash)	(34,140)	-	-
Insurance operations liabilities	31,116	-	-
Minority interest	923	-	-
	(1,879)	(487)	(384)

The accompanying notes and appendix are an integral part of the financial statements.

Consolidated Statements of Cash Flows

	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
(c) Proceeds from realization of investments in previously-consolidated subsidiaries			
Working capital (excluding cash)	9	27	-
Investments in associated companies	-	(75)	-
Real estate held for leasing and construction, net	-	762	-
Deferred expenses, net	-	33	-
Loans from banks	-	(644)	-
Gains from realization of investments in consolidated subsidiaries	-	89	-
	9	192	-
(d) Significant non-cash operations			
Acquisition of fixed assets on credit	19	22	-
Receivables on account of divestiture of investments	16	13	-
Dividend and earnings to pay to minority interest at consolidated companies	71	72	-
Dividend and earnings to receive from associated companies	-	70	6
Conversion of debentures into Company shares	257	358	1
Conversion of debentures into shares of consolidated subsidiary	3	40	-

The accompanying notes and appendix are an integral part of the financial statements.

Statements of Cash Flows - The Company

	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
Cash flows from operating activities			
Net income	1,513	622	403
Adjustments required to reflect cash flows from operating activities (a)	(1,452)	(478)	(231)
Net cash provided by operating activities	61	144	172
Cash flows from investing activities			
Realization (acquisition) of marketable securities, net	(1)	23	80
Collection of loans granted to investee companies and others	652	532	96
Granting of loans to investee companies and others	(1,958)	(1,299)	(321)
Net cash used in investing activities	(1,307)	(744)	(145)
Cash flows from financing activities			
Exercise of option warrants into company shares	13	140	-
Issue of debentures and debentures convertible into shares, net	1,561	929	-
Redemption of debentures and debentures convertible into shares	(66)	(165)	(23)
Repayment of loans received from investee companies	(21)	-	-
Dividend distributed	(461)	(384)	(151)
Short-term credit from banks, net	230	76	-
Net cash provided by (used in) financing activities	1,256	596	(174)
Increase (decrease) in cash and cash equivalents	10	(4)	(147)
Cash and cash equivalents at beginning of year	12	16	163
Cash and cash equivalents at end of year	22	12	16

The accompanying notes and appendix are an integral part of the financial statements.

Statements of Cash Flows - The Company

	For the year ended December 31		
	2006	**2005**	**2004**
	NIS Millions, Reported		
(a) Adjustments required to reflect cash flows from operating activities			
Income and expenses not involving cash flows:			
Equity in undistributed earnings of investees, net (1)	(1,278)	(362)	(235)
Gains from issue of shares to third party	(187)	(111)	-
Deferred taxes, net	10	-	-
Increase in value of long-term liabilities to investees and others	20	57	25
Increase in value of loans granted to investees and others	(43)	(63)	(13)
Changes in asset and liability items:			
Decrease (increase) in other accounts receivable	2	(4)	2
Increase (decrease) in other accounts payable	23	5	(10)
	(1,452)	(478)	(231)
(1) Net of dividends received	73	136	166
(b) Significant non-cash operations			
Dividend to receive from consolidated subsidiary	-	27	-
Conversion of debentures into Company shares	257	358	-

The accompanying notes and appendix are an integral part of the financial statements.

NOTE 1: - GENERAL

A. Delek Group Ltd. (hereinafter: "the Company") is a holding company for three companies that centralize the operations of the Group companies, as follows: Delek Petroleum Ltd. ("Delek Petroleum") focuses on the gasoline and lubricants business and the operation of gas stations in Israel and in the USA, along with the oil refinery operation and fuel marketing in the USA; Delek Real Estate Ltd. ("Delek Real Estate") focuses on the initiation and development of real estate business in Israel and abroad; Delek Investments and Properties Ltd. ("Delek Investments") that centralizes all the other businesses of the investees, including operations in the automotive market, oil and gas explorations and production, biochemicals, insurance in Israel and in the US, infrastructure and more. As for business segments, see Note 35.

B. Definitions

In these financial statements -

The Company	-	Delek Group Ltd.
The Group	-	The Company and its consolidated subsidiaries and partnerships.
Consolidated Subsidiaries	-	Companies controlled by the Company (as defined in Opinion 57 of the Institute of Certified Public Accountants in Israel) and whose financial statements are consolidated within the Company's own financial statements.
Jointly controlled entities	-	Companies held by several shareholders, possessing a contractual agreement regarding joint ownership and whose financial statements are proportionately consolidated in the financial statements.
Associated Companies	-	Companies in which the Company possesses a material influence and that are not consolidated subsidiaries. The Company's investment in these companies is included in the financial statements on an equity basis.
Investee Companies	-	Subsidiaries, jointly controlled entities or affiliates. The principal investees and partnerships are listed in the appendix to the financial statements.
Other Companies	-	Companies that are not investees and the investment therein is presented at cost.
Controlling Shareholders	-	As defined in the Securities Regulations (Presentation of Transactions Between a Corporation and its Controlling Shareholder in the Financial Statements) - 1996
Interested Parties	-	As defined in the Securities Regulations (Preparation of Annual Financial Statements) – 1993.
Related Parties	-	As defined in Opinion 29 of the Institute of Certified Public Accountants in Israel.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES

The financial statements are prepared in accordance with the Securities Regulations (Preparation of Annual Financial Statements), 1993, taking into consideration the fact that the data for the consolidated insurance companies in Israel were formulated on the basis of accounting and reporting principles according to the Law for Supervision Over Financial Services (Insurance) – 1981 and the ensuing regulations.

The significant accounting policies applied in the preparation of the financial statements on a consistent basis, except as described in Sections T, U and V, below, are as follows:

A. The Reporting Basis of the Financial Statements

1. In the past, the Company formulated its financial statements on the basis of the historical cost convention, adjusted for changes in the Consumer Price Index (CPI). These adjusted amounts, as included in the financial statements as of December 31, 2003, served as a starting point for nominal financial reporting beginning January 1, 2004. Additions made subsequent to the transition date were included at nominal values.

2. In accordance with Accounting Standard No. 12, regarding the discontinuance of the adjustment of financial statements, the said adjustment of financial statements to inflation was discontinued on December 31, 2003 and since that date, the Group has been reporting in reported figures.

3. The amounts of non-monetary assets do not necessarily reflect the realization value or current economic value, but only the reported value of those assets.

4. The term “cost” in these financial statements signifies cost in the reported sum.

5. Condensed financial data of the Company in nominal historical values for tax purposes is presented in Note 40.

B. Consolidation of the Financial Statements

The consolidated financial statements include the accounts of companies over which the Group exercises control. Jointly controlled entities are included by the proportionate consolidation method. Material inter-company transactions and balances have been eliminated in the consolidated financial statements.

Due to the numerous legal restrictions imposed on the ability to use the assets of insurance companies in Israel, by virtue of the Law for the Supervision Over Insurance Businesses – 1981 and the regulations consequently published and in consideration of the unique nature of the insurance operations, that is materially different from the Group’s other operations and whose volume, in relation to the Group’s other operations is highly significant, as well as in light of the special reporting rules applying to this sector that were set by virtue of the regulations, the insurance operations are presented as a separate component (“Insurance Business”) in the consolidated financial statements.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

C. Investments in Investee Companies

1. The investments in investees are presented by the equity method of accounting. The holding company's share is determined based on the issued capital at balance sheet date.

   In certain foreign affiliates the Company's share in the carrying value of these companies is determined on the basis of financial statements prepared in accordance with international accounting principles, including IAS No. 40 according to which investment property is presented at its fair value, with changes in the fair value being allocated to the statement of income.

2. Excess of cost of investment in investees over their book value upon the date of acquisition was attributed – while attributing taxes – to identified assets and liabilities (land, other fixed assets, equity investments in other companies, insurance reserves), is allocated to the statements of income in parallel to the amortization or realization of the assets and liabilities. As for the attribution of the excess of cost of acquisition to intangible assets, see Section 13 below. The excess of cost of acquisition of the investments, not attributed to identified assets and liabilities is allocated to goodwill, as mentioned above.

3. The Group evaluates in each reporting period the necessity to record an impairment loss due to investments in affiliated companies, in accordance with the provisions of Accounting Standard No. 15 (see Section 14 below).

4. Translation of financial statements of foreign operation that is classified as an autonomous held entity ("the entity"):

   In accordance with Accounting Standard No. 13, assets and liabilities, both monetary and non-monetary, of the entity are translated at the closing rate. The components of the statement of income and of the statement of cash flows of the entity are translated at the exchange rates at the dates of the transactions or at average exchange rates for the period if such exchange rates approximate the actual exchange rates. All exchange rate differences resulting from the translation, as above, are classified as a separate component of shareholders' equity ("Foreign currency translation adjustments for investees") until the disposal of the investment.

   Loans that have the characteristics of being part of an investment are treated as part of the cost of investment in the unit, with the exchange rate differentials arising from these loans being allocated to the same item in shareholders' equity.

   Exchange rate differentials arising from liabilities in foreign currency that constitute a hedging of the net investment in a unit are also allocated to the same item in the shareholders' equity.

D. Cash Equivalents

The Group considers all highly liquid investments, including short-term bank deposits purchased with original maturities of three months or less and unrestricted by lien, to be cash equivalents.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

E. Marketable Securities

Short-term investments in marketable securities that may be immediately realized, as well as liabilities for the short sale of marketable securities are presented at quoted market prices as at the balance sheet date. Changes in the value of these securities are allocated to the Finance item of the statement of income.

F. Other Investments

Investment in non-marketable securities and permanent investments in marketable securities are presented at cost, net of provisions for impairment, that management estimates are not of a temporary nature; see Section N(2), below.

G. Inventories

1. Inventories are stated at the lower of cost or market value, with the cost being determined as follows:

Fuel and consumer goods	-	Cost of operating inventory of fuels is determined using the "quarterly weighted average" method. Cost of inventory of consumption products abroad is estimated by the retail method.
Inventories at the refinery	-	The cost of crude oil is determined using the "quarterly weighted average" method. The cost of refined fuel products also includes manufacturing costs.
Vehicles	-	According to specific cost.
Others	-	Primarily by the moving average method.

2. As regards disclosure pertaining to the impact of Accounting Standard No. 26 during the period prior to its implementation, see Section DD(2), below.

H. Buildings and Land for Sale

Buildings and land for sale are presented at identifiable cost, however, not more than the estimated selling price for each building unit.

The Group capitalizes the management and selling expenses which can be clearly and exclusively identified with specific projects to the cost of buildings under construction.

The capitalized costs are carried together with the project's other costs, upon the recognition of revenue. In cases where the construction of the project is expected to generate a loss, the entire anticipated loss from project completion is carried.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

I. Real Estate for Rent

Properties for lease are presented according to the cost of their acquisition (including costs attributed directly to the acquisition of the properties), net of accumulated depreciation. Improvements are added to the cost of the properties whereas maintenance expenses and repairs are carried to the statement of income as incurred.

Depreciation is calculated by the straight-line method over the estimated useful lives of the assets.

The Group evaluates in each reporting period the necessity to record an impairment loss, in accordance with the provisions of Accounting Standard No. 15 (see Section N, below).

As regards disclosure pertaining to the impact of Accounting Standard No. 16 during the period prior to its implementation, see Section DD4, below.

J. Land for Construction

Land for construction is presented at cost that, according to management's estimate, is lower than the estimated selling price. The Group capitalizes borrowing costs to the cost of land under construction which constitute "qualified assets", according to Accounting Standard No. 3 (see Section S, below). The capitalization period begins at the earlier of the request for a building permit or when the construction works began.

The Group evaluates in each reporting period the necessity to record an impairment loss, in accordance with the provisions of Accounting Standard No. 15 (see Section N, below).

K. Provision for Doubtful Debts

The provision for doubtful debts is principally determined in respect of specific debts whose collection, in the opinion of the Group's management, is doubtful and, in part, at a certain percentage of customer debts.

L. Fixed Assets

1. Fixed assets are stated at cost net of accumulated depreciation. Financing costs relating to the financing of the acquisition or the construction of fixed assets until the operation of such assets, appear under the cost of acquisition. Improvements and betterments are charged to the cost of assets while maintenance and repairs are charged to the statement of income as incurred.

   The Group evaluates in each reporting period the necessity to record an impairment loss, in accordance with the provisions of Accounting Standard No. 15 (see Section N, below).

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

L. Fixed Assets (Contd.)

2. Depreciation is calculated by the straight-line method at annual rates which are deemed adequate to depreciate the assets over their estimated useful lives, as follows:

	%	
Buildings	2-10	
Machinery, facilities and equipment	2.5-14	
Vehicles	15-20	
Office furniture & equipment	6-33	
Improvements to Leased Assets		During the lease period, including extension options or over the life span of the improvements, the lowest of the two.

3. The costs of periodical treatments initiated at the oil refinery facilities are depreciated over the period until the next treatment (approx. 4 years).

4. As regards disclosure pertaining to the impact of Accounting Standard No. 27 during the period prior to its implementation, see Section DD3, below.

M. Other Assets and Deferred Charges

1. Goodwill

Until December 31, 2005, goodwill created upon the acquisition of investees was systematically amortized using the straight-line method over a period of 10-20 years. As of January 1, 2006, following the initial adoption of Accounting Standard No. 20 (Revised), the Company discontinued the systematic amortization of goodwill included in the balance sheet in respect of subsidiaries and investments in affiliates(including the Group's share in the existing goodwill in the books of the affiliates), amounting to approximately NIS 55 million for the year ended December 31, 2005.

The impairment of goodwill in respect of a subsidiary is assessed on an annual basis, or more frequently if there are certain indicators of an impairment in accordance with Accounting Standard No. 15 (see Section N, below).

The impairment of goodwill in respect of an affiliate is treated in the context of the assessment of the impairment of the investment as a whole (see Section N, below).

2. Value of Insurance Portfolios

In accordance with Accounting Standard No. 20 (Revised), excess of cost of investment in subsidiaries was also attributed to identified intangible assets (value of insurance portfolios), while allocating taxes according to Accounting Standard No. 19. These assets are amortized using the straight-line method over their useful life span (primarily 7 to 15 years).

The assessment of impairment is made according to Accounting Standard 15 (see Section N1, below).

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

M. Other Assets and Deferred Charges (Contd.)

3. Prepaid expenses and other deferred charges are amortized by the straight-line method over their estimated useful lives.

4. As to the impact of Accounting Standard No. 30 during the period prior to its implementation, see Section DD6, below.

N. Impairment of Assets

1. Impairment of fixed and intangible assets

The Group implements Accounting Standard No. 15 "Impairment of Investments". The Standard applies to all assets appearing in the balance sheet other than: inventories, assets arising from construction contracts, assets originating from employee benefits, deferred tax assets and financial assets (except investments in investee companies that are not subsidiaries). According to the Standard, whenever there is an indication that an asset may be impaired, the Group determines whether there has been an impairment of the asset by comparing the carrying amount of the asset to its recoverable amount. Recoverable amount is defined as the higher of an asset's selling price and its value in use. Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. If the carrying amount of an asset exceeds its recoverable amount, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its recoverable amount. An impairment loss previously recognized should be reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the impairment loss was recognized.

In testing for impairment of fuel stations which a subsidiary operates in Israel, the fuel stations are considered as a single cash generating unit and this, among other things, because of the corporate customer base and the business dependency of the various stations. Nonetheless, in cases where the management of the subsidiary is of the opinion that certain stations do not contribute to the chain of fuel stations, each of these stations is deemed as a separate cash generating unit. In testing for impairment of fuel stations in the U.S., each cluster of stations that is managed and operated together is considered as a separate cash generating unit. The evaluation of the impairment of other assets is performed separately for each asset.

The assessment of an asset's value in use is based on the Group's best estimate of the conditions that will exist over the remaining useful life of the asset and on the asset's present condition.

2. Impairment of Investments in Other Companies

The Group generally evaluates the fair value of its investments in each reporting period whenever changes in circumstances or occurrence of other events indicate a decline in value that is other than temporary.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

N. Impairment of Assets (Contd.)

The evaluation of the fair value takes into consideration, among others, the market value of the investments (in respect of investments in marketable securities), estimates of analysts and valuations of the investments, the conditions of the industry in which the portfolio company is operating, the portfolio company's business condition, off-market transactions in the portfolio company's securities, prices of equity transactions in the portfolio company and additional information that the portfolio company presents to its board of directors (if the Company is represented on the board) or to its shareholders.

Based on the results of the above evaluation, the Group, if necessary, recognizes an impairment loss that is other than temporary in the statement of income.

O. Deferred Taxes

1. Since 2004, the Group has adopted Accounting Standard No. 19 regarding "Taxes on Income" (hereinafter: "The Standard"). The Standard prescribes the principles for recognition, measurement, presentation and disclosure of taxes on income and deferred taxes in the financial statements.

   Deferred taxes are computed in respect of temporary differences between the amounts included in the financial statements and the amounts allowable for tax purposes, as well as losses carried forward for tax purposes, except for a limited number of exceptions, as prescribed in the Standard.

   The deferred tax balances are calculated at the tax rates that are expected to be in effect when these taxes will be charged to the statements of income or to shareholders' equity, based on the tax laws in effect as at the balance sheet date. The sum of deferred taxes in the statement of income originates from changes in these balances during the reported year.

2. Deferred taxes are not provided with respect to taxes that would be incurred if investments in investee companies were realized, as long as it is probable that the sale of the investments in the investee companies is not expected in the foreseeable future. Deferred taxes are provided for an investment whose sale in the foreseeable future is likely.

   Similarly, deferred taxes that would apply in the event of distribution of earnings by investees as dividends – in cases where said dividend distribution does not involve an additional tax liability – have not been taken into account in computing the deferred taxes, since it is the Group's policy not to initiate distribution of dividends that involves an additional tax liability.

3. In cases when there exists uncertainty of taxable income in the future, no deferred tax assets have been recorded in the financial statements.

4. As a result of the early adoption of the Standard in 2004, the Group recorded a loss of approximately NIS 20 million. This sum was included in the 2004 statements of income as a separate item in "Cumulative effect as of the beginning of the year due to a change in accounting principle, net".

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

P. Expenses on Oil and Gas Exploration and Development of Proven Reserves

The investments in oil and gas exploration are presented by the "successful efforts" method, whereby:

1. Costs in respect of participation in geological and seismic exploration and surveys are charged to the statement of income as incurred.

2. Investments in oil and gas drilling in drilling stages for which it was not yet proved whether they produce oil or gas and not yet qualified as non-marketable are presented in the balance sheet at cost.

3. Investments in oil and gas drilling, which were proved as dry and abandoned or qualified as non-marketable or for which development programs were not determined in the near future are written off in full in the statement of income.

4. Expenses relating to drilling, for which it was determined that there are proven gas or oil reserves are recorded in the balance sheet at cost and amortized to operations based on the ratio between the volume of production and the total proved reserves for the same oil asset, as estimated by an expert.

5. Costs accrued in respect of the development of the proven wells of the Yam Tethys joint venture were designated to provide the options for the exploitation, handling, collection and storage of the gas. These costs which include engineering planning, development drillings, purchase and establishment of production facilities and pipes for the delivery of gas to the point onshore are recorded in the balance sheet at cost and amortized to operations based on the relation of the volume of production to total proved reserves, as estimated by an expert

   Expenses relating to purchase of rights to license of possession and preliminary permits to oil and gas drilling, including increasing the Group's share in joint ventures, are treated as aforesaid.

   Excess of cost of investment in companies, partnerships and joint ventures that own wells, as aforesaid, over their book value, was attributed to investment in oil reserves and amortized as aforesaid.

Q. Expenses for obligations associated with the retirement of assets

In relation to certain assets it owns (primarily a natural gas rig opposite the Ashkelon shore and refinery and oil facilities in the USA), the Group implements FAS 143, including FIN 47 that relates thereto), which addresses obligations associated with the retirement of long-lived assets (hereinafter: "The Statement"). This Statement requires that the liability and the related asset for the Group's obligation associated with the retirement of the assets at the end of their utilization period be accounted for consistently and recognized when the liability is incurred. The liability is initially measured at fair value and changes in liability that result from elapsed time are allocated to expense. The asset is depreciated to operations over the asset's useful life, based on a determined depreciation method for that particular asset. See also Section DD3, below, regarding the publication of Accounting Standard 27.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

R. Revenue Recognition

On January 1, 2006, the Company adopted the provisions of Accounting Standard No. 25 regarding revenues ("the Standard"). The Standard deals with the recognition of revenue from three types of transactions: Sale of goods, rendering of services and interest revenues, royalties and dividends – and prescribes the required accounting treatment regarding these three types of transactions.

1. Revenues from sale of goods are recognized once all the significant risks and rewards arising from the ownership over the goods have been assigned to the buyer, the seller no longer maintains continuing decision-making involvement that characterizes ownership and no longer maintains effective control over the sold goods, the amount of revenues can be measured reliably, the economic benefits relating to the transaction are expected to flow to the Company and the costs incurred or to be incurred in respect of the transaction can be measured reliably.

2. Accounting Standard No. 25 and the Securities Authority's Interpretation thereof prescribe that a sales transaction with extended credit terms (compared to the standard credit terms in the industry and the Company's standard credit terms) and/or the existence of alternative payment schedules with different credit terms for the same transaction require separation of the consideration into the sale component and the financing component. The separation will be made according to the prevailing market interest rate.

   The initial adoption of the Standard had no material impact on the consolidated financial statements, since the accepted credit period for Group customers in most areas of operation, does not exceed four months and does not deviate from the accepted norm in the various sectors of operation.

3. Revenues from Interest, Royalties or Dividends

   Interest income is recognized using the effective interest rate method.

   Revenues from royalties are recognized on an accrual basis in accordance with the substance of the relevant agreement.

   Dividends received from investments are recognized when the shareholder's right to receive payment is established.

4. Revenues from rental fees are recognized pro rata over the term of the lease. Fixed rates of increase in long-term lease contracts are spread by the straight-line method over the term of the lease and are presented as part of the revenues.

5. Recognition of Revenue from the Sale of Apartments

   The Group adopted Accounting Standard No. 2, "Construction of Buildings for Sale". The Standard prescribes the accounting principles relating to recognition of revenues from sale of apartments in buildings constructed for sale. According to this Standard, revenues will be recognized upon the sale of apartments, however not before the sales proceeds from the project constitute at least 50% of the anticipated total revenues therefrom and the percentage of completion of the project is at least 25%. In these cases, revenues are recognized based on the product of the sales proceeds by the percentage of completion of the project. Losses are recorded in full as incurred.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

6. Recognition of Revenues from BOT or PFI Projects

A jointly-controlled entity that has established installations for the desalination of seawater is implementing in its financial statements, the principles determined in the position paper published by the Israel Accounting Standards Board regarding settlements for the establishment and operation of public property by the private sector (hereinafter: "The Position Paper"). Until the adoption of an accounting standard in this matter, the Position Paper serves as a guideline for financial reporting that shall apply to settlements between the public sector (hereinafter: "The Ordering Party") and the private sector (hereinafter: "The Operator") for the establishment and operation of public property by the private sector.

The Position Paper is intended to determine whether the Operator must recognize the property as a non-monetary asset or alternately, recognize it as a financial asset on account of which there exists a debt of the Ordering Party. The consolidated company has recognized the property as a financial asset that accrues financial revenues while the specific rate of return on the financial asset is deducted from the revenues associated with the property. The balance of payments (total payments net of principal payments and interest payments) are recognized as operating income concurrently with the operating expenses.

S. Capitalization of credit costs

The Group adopted Accounting Standard No. 3, "Capitalization of Borrowing Costs". The Standard prescribes the accounting and reporting principles relating to capitalization of borrowing costs as part of the cost of "qualified assets", as defined by this Standard. According to the principles of this Standard, costs of specific borrowing in respect of investment in qualifying assets were capitalized and if there is no specific borrowing, the capitalization was computed based on the weighted average borrowing cost of the credit sources.

T. Earnings Per Share

As of January 1, 2006, the Company applies the provisions of Accounting Standard No. 21 regarding earnings per share ("the Standard").

Earnings per share are computed according to the number of ordinary shares. Basic earnings per share will include only shares actually existing during the period, while convertible securities (such as convertible debentures and options) are only included in the calculation of the diluted earnings per share. Moreover,convertible securities that have been converted into shares during the period are included in diluted earnings per share, only until the conversion date, while from that date onward, they will be included in basic earnings per share. Option warrants and convertible debentures are included in diluted earnings when their exercise results in the issuance of shares for a consideration that is less than the market price of the shares. The Company's share in the earnings of investees was calculated based on its share in the earnings per share of the investees multiplied by the number of shares held by the Company.

As a result of the initial adoption of the provisions of the Standard, the basic earnings per share for the year ended December 31, 2005, were restated. The basic earnings per share, as mentioned above (per NIS 1 par value), were NIS 58.0. The diluted earnings per share were presented for the first time in these financial statements.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

U. Financial instruments

As of January 1, 2006, the Company applies Accounting Standard No. 22 regarding Financial Instruments: Disclosure and Presentation ("the Standard").

1. Debentures convertible into shares

The consideration in respect of convertible debentures is split into the liability component and the equity component and recognized separately in the balance sheet. The liability component is independently calculated based on the present value of the future cash flows discounted at the prevailing interest rate for similar debentures without the conversion option. The equity component is a residual amount that is calculated as the difference between the total consideration received for the instrument and the liability component and is presented in shareholders' equity under "Receipts in respect of conversion options".

Transaction costs are attributed pro rata to the different components of the convertible debentures based on the relative portion of the consideration allocated to the components. Transaction costs attributed to the liability component are deducted from the liability component and taken into consideration in the calculation of the effective interest rate. Transaction costs attributed to the equity component, net of the related taxes, are deducted from the equity component.

Convertible debentures and the balance of related transaction costs (issuance expenses) existing as of January 1, 2006 ("the effective date") have been split into the different components as described above. The calculation of the liability component was based on the relevant interest rate prevailing on the original issuance date, and the carrying value of the convertible debentures as of December 31, 2005, represented the consideration for the compound instrument. Comparative data for periods prior to the effective date have not been restated or reclassified.

2. Receipts in respect of warrants

Receipts in respect of warrants are classified in shareholders' equity when they confer the right to purchase a fixed number of shares in consideration for a fixed exercise price. Accordingly, warrants with an exercise price denominated in or linked to a foreign currency or to the Israeli CPI should be classified as a financial liability.

However, in the period between January 1, 2006 and December 31, 2007, the Standard prescribes that an exercise price linked to the Israeli CPI or to a foreign currency will be considered a fixed amount.

3. Cost of Raising Debt and Issuing Debentures

The costs of raising debt and issuing debentures are presented net of the outstanding loans and debentures on account of which they were incurred and are amortized over the term of the loans and debentures using the effective interest rate method.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

As a result of the initial adoption of the provisions of the Standard:

(a) On January 1, 2006, the Group recorded the equity component of debentures convertible into shares of the Company and of its subsidiaries in shareholders' equity as "Receipts from conversion options" and in minority interests thereby increasing the Group's shareholders' equity by approximately NIS 6 million and minority interests by approximately NIS 1 million, while reducing the Group's liabilities in the amount of approximately NIS 7 million.

(b) The balance of issuance expenses and expenses of recruiting debentures and loans, amounting to approximately NIS 160 million as at December 31, 2005, presented in other assets, was offset on January 1, 2006, from the balance of the debentures and loans.

V. Share-Based Payment

On January 1, 2006, the Group adopted the provisions of Accounting Standard No. 24, "Share-Based Payment" ("the Standard") of the Israel Accounting Standards Board. The Standard prescribes rules for measurement and other requirements for three types of share-based transactions:

1. Equity-settled share-based payment transactions;
2. Cash-settled share-based payment transactions;
3. Share-based payment transactions which allow the entity or counterparty to choose the manner of settlement.

The Standard applies to all transactions in which a share-based payment is made in respect of the purchase of goods or services, including transactions with employees or other parties, which must be settled using the Company's equity instruments and granted subsequent to March 15, 2005 but that had not yet vested as of January 1, 2006. The Standard is also applicable to modifications that were made to the terms of equity-settled transactions subsequent to March 15, 2005. As for cash-settled share-based transactions that had not been settled as of the transition date, the Standard's provisions apply retrospectively regardless of the date of grant.

Equity-Settled Transactions

The cost of equity-settled transactions with employees/service providers is measured according to the fair value of the equity instruments on the date of grant. The fair value is determined by an independent appraiser using the Black and Scholes option-pricing model, see more details in Note 9j.

The cost of equity-settled transactions is recognized in profit and loss together with a corresponding increase in shareholders' equity over the period during which the performance and/or service conditions apply and ending on the date of the relevant employees' entitlement to compensation ("the vesting period"). The cumulative expense recognized in respect of equity-settled transactions for each reported period through the vesting date reflects the Group's best estimate of the number of equity instruments that will eventually vest. The charge or credit in the income statement for the period reflects the change in the cumulative expense recognized at the beginning and end of the period.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

In the event of changes in the grant terms of an equity-settled transaction, the expense recognized is the expense that would have been recognized had there not been a change in terms. An additional expense is recognized in respect of any change that increases the total fair value of the share-based payment or that benefits the employee/service provider as measured on the date of change.

The cancellation of an equity-settled grant is treated as if the grant had vested as of the date of cancellation and the as yet unrecognized expense in respect of the grant is recognized immediately. However, if the cancelled grant is replaced by a new grant which is identified as a replacement grant as of the date of grant, both the cancelled grant and the replacement grant are treated as a change in the terms of the original grant as described in the preceding paragraph.

Cash-settled transactions

The cost of cash-settled transactions is measured at their fair value on the date of grant using the Black and Scholes option-pricing model, see more details in Note 9j. The fair value is recognized as an expense over the period until vesting and a corresponding liability is recognized. The liability is re-measured at each balance sheet date until its settlement and the changes in its fair value are recorded in the statement of income.

As a result of the initial adoption of the Standard, the Group included in the statement of income, for year ended December 31, 2006, an expenditure of NIS 59 million in respect of share-based transactions at the Group companies, while also recording a corresponding increase in liabilities and minority interests. The effect on the 2005 data was immaterial.

W. Exchange Rates and Linkage

1. Assets and liabilities in foreign currency, or linked thereto, appear according to the representative exchange rates that were published by the Bank of Israel and were in force at the balance sheet date.

2. Assets and liabilities linked to the CPI appear according to the relevant CPI regarding each linked asset or liability.

3. Presented below are data concerning exchange rates and the Israeli CPI:

	Representative Exchange Rates As at December 31		Annual change		
	2006	2005	2006	2005	2004
			Increase (Decrease)		
	NIS		%		
1 US dollar	4.225	4.603	(8.2)	6.8	(1.6)
100 Japanese yen	3.553	3.921	(9.4)	(6.6)	2.5
1 Swiss franc	3.466	3.499	(0.9)	(8.1)	7.2
1 pound sterling	8.288	7.941	4.4	(4.4)	5.9
1 Canadian dollar	3.641	3.964	(8.1)	10.8	5.0
1 euro	5.564	5.447	2.1	(7.3)	6.2

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

	Consumer Price Index (points) As at December 31		Annual change		
	2006	2005	2006	2005	2004
			Increase (Decrease)		
	NIS		%		
In Israel *)	102.9	103.0	(0.1)	2.4	1.1

*) CPI according to average base, 2002 = 100.

X. Derivative Financial Instruments

The results of hedging transactions designated to hedge assets and liabilities in foreign currency recorded in the balance sheet against the fluctuations in the exchange rates of the above foreign currencies are reported in the statement of income, concurrently with the recording of the exchange rate differences of said assets and liabilities.

The results of hedging transactions for the future purchase or sale of foreign currency, inventories and gas prices that are intended to hedge the cost of purchase or the proceeds of sales against fluctuations in foreign currencies and against changes in inventory and gas prices are reported in the statement of income, concurrently with the recording of the results relating to the transactions they are designated to hedge.

The results of swap transactions designated to hedge the expected cash flows from loans with floating interest are reported in the statement of income, concurrently with the recording of the financial expenses relating to the loans which they are designated to hedge.

Derivative financial instruments that are not recognized as financial hedging transactions, as above, are presented in the balance sheet at fair value. Changes in fair value are recorded in financing in the statement of income as incurred. The fair value of derivative financial instruments is determined based on their market prices and, if there is no price, the fair value is determined using valuation methodologies.

Y. Environment

The Group's accounts include a provision for expected costs related to the purification and rehabilitation of environmental damages. The provision is recorded when management feels it is probable that a liability has been created, whose amount can be reasonably estimated. Environmental liabilities represent the current estimated costs for investigating and rectifying the contamination created.

Management estimate is based on internal and third party assessments of the extent of the contaminations, the existing remediation technology and the review of applicable environmental regulations. Accruals for estimated costs from environmental remediation obligations are generally recognized no later than upon completion of the remedial feasibility study. Such accruals are adjusted as further information develops or circumstances change. Expenditures for equipment necessary for environmental issues relating to ongoing operations are allocated to fixed assets.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Z. Advertising Costs

Advertising costs are reported in the statement of income upon their creation.

AA. Using Estimates in the Formulation of the Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities in the financial statements and the reported amounts of revenues and expenses during the reporting periods. The actual results may differ from these estimates.

BB. Dividend declared subsequent to balance sheet date

Dividends declared subsequent to the balance sheet date and prior to the date of the approval of the financial statements are not recorded as a liability in the financial statements and are presented as a separate component as part of the shareholders' equity.

CC. Transactions between the Group and a controlling shareholder

Transactions between the Group and a controlling shareholder are presented in accordance with Israeli Securities Regulations (Presentation of Transactions Between a Corporation and a Controlling Shareholder Therein in the Financial Statements), 1996. According to these regulations, the excess of proceeds over the cost of assets sold to the controlling shareholder and the difference between the cost of acquisition of assets from the controlling shareholder and their carrying amount in the books of the controlling shareholder in proximity to the date of acquisition are recorded in shareholders' equity.

As regards disclosure pertaining to the impact of Accounting Standard No. 23 during the period prior to its implementation, see Section DD(5), below.

DD. Disclosure of Influence of New Accounting Standards in the Period Prior to Their Implementation

1. Accounting Standard No. 29 - Adoption of International Financial Reporting Standards (IFRS)

In July 2006, the Israel Accounting Standards Board published Accounting Standard No. 29, "Adoption of International Financial Reporting Standards (IFRS)" ("the Standard").

International Financial Reporting Standards comprise standards and interpretations adopted by the International Accounting Standards Board, and include:

(a) International Financial Reporting Standards (IFRS)
(b) International Accounting Standards (IAS)
(c) Interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) and by its predecessor, the Standing Interpretations Committee (SIC).

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Pursuant to the Standard, companies that are subject to the provisions of the Securities Law, 1968, and that are required to report according to the regulations published thereunder, will be required to prepare their financial statements in accordance with IFRS starting from the period commencing on January 1, 2008. These companies, as well as other companies, may adopt IFRS early and prepare their financial statements in accordance with IFRS starting with financial statements that are issued subsequent to July 31, 2006.

For transition purposes, companies that prepare their financial statements in accordance with IFRS will be required to adopt the provisions of IFRS 1, "First-time Adoption of IFRS".

A company that adopts IFRS commencing from January 1, 2008, and that has elected to include comparative data for only one year (2007) will be required to prepare an opening balance sheet as of January 1, 2007 ("Opening IFRS Balance Sheet"). The Opening IFRS Balance Sheet will require the following:

- Recognition of all assets and liabilities whose recognition is required by IFRS.
- De-recognition of assets and liabilities if IFRS do not permit such recognition.
- Classification of assets, liabilities and components of equity according to IFRS.
- Application of IFRS in the measurement of all recognized assets and liabilities.

In order to ease first-time adoption, a number of exemptions from IFRS have been granted in respect of the Opening IFRS Balance Sheet, which exemptions may be elected, in whole or in part. Exceptions have also been established which prohibit retrospective application of certain aspects of IFRS.

According to the Standard, the Company is required to include in a note to the annual financial statements as of December 31, 2007, a balance sheet as of December 31, 2007, and a statement of income for the year then ended, that have been prepared based on the recognition, measurement and presentation criteria of IFRS.

There are differences between IFRS and generally accepted accounting principles in Israel in the recognition and measurement of assets and liabilities and in reporting and disclosure requirements. These differences could potentially have a material impact on the Company's financial position and results of operations. The initial adoption of IFRS will require the Company to identify such differences, a process that will entail a significant amount of time and resources.

The Group's management is evaluating the implications of the new standard on the financial statements.

2. Accounting Standard No. 26 - Inventories:

In August 2006, the Israel Accounting Standards Board published Accounting Standard No. 26, "Inventories" ("the Standard").

The Standard applies to all types of inventories, excluding inventory of work in progress, which is subject to the provisions of Accounting Standard No. 4, "Construction Contracts", inventory of buildings for sale, which is subject to the provisions of Accounting Standard No. 2, "Construction of Buildings for Sale" and financial instruments.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

The Standard determines that inventories will be measured at the lower of cost or net realizable value. Net realizable value represents the estimated selling price during the ordinary course of business with the deduction of the estimated completion costs and costs required for the execution of the sale. The cost of inventory will be determined based on the "First In First Out" method (FIFO) or using weighted average cost, provided that the application in respect of each inventory with a similar nature and use is performed on a consistent basis. The evaluation of inventory based on the "Last In First Out" method (LIFO) is no longer permissible.

In accordance with the Standard, in cases where inventories are purchased under credit terms whereby the arrangement involves a financing component, inventories will be presented at the cost adjusted to the cash purchase cost and the financing component will be recognized as a financial expense over the credit period.

As for burdening costs of conversion to inventories, it was established that if, in a particular period, manufacture is not carried out according to standard production outputs, then cost of inventories will not include additional fixed overhead costs in excess of those required during standard production. Such unburdened costs will be carried as an expense in the statement of income in the period in which they were incurred. Furthermore, cost of inventories is not to include irregular amounts of cost of materials, labor and other costs resulting from inefficiency.

When an impairment of inventories has been recognized and is followed by an increase in value, the impairment recognized in the past is to be canceled. The amount of the impairment or its cancellation will be carried to cost of sales in the statement of income.

The Standard will be applicable to financial statements for periods beginning January 1, 2007 and thereafter. The provisions of the Standard are to be applied retroactively by the restatement of comparative figures relating to previous periods.

The Group believes that the effect of the new Standard on its financial position, results of operations and cash flows is not expected to be material.

3. Accounting Standard No. 27 - Fixed Assets

In September 2006, the Israel Accounting Standards Board published Accounting Standard No. 27, "Fixed Assets" ("the Standard"). The Standard is applicable to financial statements for periods commencing on January 1, 2007 ("the effective date") or thereafter.

The initial recognition of fixed assets will be based on the cost of purchase. Subsequent to the initial recognition, the Standard enables choosing between the cost method or the reevaluation method as the accounting policy and to apply the chosen method consistently with regard to a group of fixed asset items of a similar nature and usage. According to the reevaluation method, fixed assets are to be presented at an amount revalued based on the fair value upon the date of reevaluation, less accumulated depreciation and subsequent impairment losses. The revaluation of fixed assets will be carried to capital reserve in shareholders' equity, net of the tax effect. This capital reserve will be carried directly to retained earnings once the asset has been disposed of, or during the use of the asset (according to the rate of depreciation). Revalued assets will be depreciated based on the revalued amount.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

According to the Standard, each component of fixed assets with a different life and cost that is material in relation to total cost of fixed assets is to be depreciated separately. The asset's depreciation shall be based on its useful life for the Company, which will be tested at year end, and will be discontinued at the earlier of the date of the asset's classification as held for sale or the date of the asset's disposal. An asset held for sale is an asset which is available for immediate sale as is, which the Company has an obligation to sell and in respect of which the sale is expected to be completed within a year from classification. Furthermore, upon the adoption of the Standard, a change in the method of depreciation will be accounted for as a change in accounting estimate, prospectively rather than by way of cumulative effect, as customary prior to the effective date.

The cost of fixed assets obtained in a swap transaction will be measured at fair value unless the transaction is commercially immaterial or if the fair value of the fixed assets obtained or delivered cannot be reliably measured. The Standard actually replaces the restriction for the measurement of similar assets at fair value with a restriction regarding commercially immaterial transactions. A transaction is commercially material if it leads to a change in amount, timing and risk of future cash flows from the asset.

The cost of fixed assets will also include an initial evaluation of costs of the asset's liquidation and evacuation and restoration of the site where the asset is located, which are undertaken by the Company. The evaluation will be recorded at its present value while using a discount rate reflecting the Company's risk.

The transitional provisions of the Standard require retrospective adoption, including the restatement of comparative data, except in the following cases:

(a) A company that elects on the effective date to implement the reevaluation method for a group of fixed assets will carry the difference between the revalued amount in the books and its cost at the effective date to capital reserve in shareholders' equity at the same date. The company will not be required to restate comparative data.

(b) A company that has not included the initial evaluation of costs of the asset's liquidation and evacuation and restoration of the site where the asset is located in cost of fixed assets will be required to:

1) Measure the liability at the effective date, in accordance with generally accepted accounting principles;
2) Calculate the amount that would have been included in the cost of the relevant asset at the date on which the liability was first incurred, by the capitalization of the amount of said liability at the date of its initial incurrence through the company's best estimate of the historical capitalization rates corresponding to the relevant risk in respect of said liability during the elapsed period;
3) Calculate the accumulated depreciation in respect of the capitalized liability on the effective date based on the asset's useful life at that time;
4) Carry the difference between the amount recorded in respect of the asset, pursuant to items 2) and 3) above, and the liability amount, pursuant to item 1) above, to retained earnings.

(c) A company may elect to adopt the exemptions allowed by IFRS 1 in respect of fixed assets (including deemed cost exemption) as of the effective date.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

(d) Companies that are not required and do not intend to adopt IFRS in respect of their financial statements are to prospectively adopt the Standard's provisions regarding exchange of assets and depreciation of components.

The Group believes that the effect of the new Standard on its financial position, results of operations Body text-3 and cash flows is not expected to be material.

4. Accounting Standard No. 16 - Investment Property

In February 2007, the Israel Accounting Standards Board published Accounting Standard No. 16, "Investment Property" ("the Standard") that prescribes the accounting treatment and disclosure requirements in relation to investment property.

An investment property is property (land or a building or part of a building or both) held by the owner or by the lessee under a financial lease, for the purpose of generating rental fees or for capital appreciation or both.

Examples of investment properties: Land held for long-term capital appreciation and not for short-term sale in the ordinary course of business; land held for a currently undetermined future use. If the use of the land as owner-occupied property or as held for short-term sale in the ordinary course of business has not yet been determined, the land will be regarded as held for capital appreciation; a building owned by the entity (or held under a financial lease) and leased under an operating lease; a vacant building that is held to be leased under an operating lease.

Investment property is to be presented using the cost model or the fair value model. According to the cost model, investment property is accounted for pursuant to the cost model in Accounting Standard No. 27, "Fixed Assets". Companies that choose to adopt the cost model are required to disclose the fair value of the investment property. In contrast, under the fair value model, changes in the fair value of an investment property are recognized in the statement of income in the period in which they arise. Investment property that is accounted for under the fair value model is not depreciated.

Property held by a lessee under an operating lease may be considered investment property if, and only if, the property would have otherwise met the definition of investment property and the lessee is using the fair value model prescribed by the Standard (regarding the lease as a financial lease). If the property under operating lease is accounted for as investment property, all properties held by the entity that are classified as investment properties must be accounted for using the fair value model.

In respect of properties that comprise a portion that is held to earn rental fees or for capital appreciation and another portion that is held for owner-occupied use, each portion is accounted for separately only if each portion can be sold separately. Otherwise, the property is accounted for as investment property only if the portion held for owner-occupied use is insignificant.

The Standard is applicable to financial statements for periods commencing on January 1, 2007 or thereafter. The effect of the adoption of the Standard in respect of the fair value model will be reported as an adjustment of the opening balance of retained earnings as of January 1, 2007.

The Group believes that Investment Property will be presented at cost – at this stage – and consequently, the Group estimates that the effect of the Standard on its financial position, results of operations and cash flows is not expected to be material

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

5. Accounting Standard No. 23 - Accounting Treatment of Transactions between an Entity and its Controlling Shareholder

In December 2006, the Israel Accounting Standards Board published Accounting Standard No. 23, "Accounting Treatment of Transactions between an Entity and its Controlling Shareholder" ("the Standard"). The Standard is applicable, inter alia, to transactions involving the transfer of assets, the assumption of liabilities, indemnification, waiver and the granting of loans between a company and its controlling shareholder and between companies under common control that occur subsequent to January 1, 2007 ("the Effective Date"). The Standard is also applicable to loans granted to or received from the controlling shareholder prior to the effective date and as of its application. The Standard supersedes the provisions in respect of such transactions in the Securities Regulations (Presentation in the Financial Statements of Transactions between an Entity and its Controlling Shareholder), 1996, according to which, transactions involving the transfer of assets were generally recorded at cost in the transferor's books of account.

The Standard is not applicable to business combinations of companies under common control. In cases of transactions that possess the characteristics of shareholders' investments, the Standard may also apply to transactions with shareholders, by virtue of their capacity as shareholders.

The Standard provides that the assets and liabilities involved in a transaction between a company and its controlling shareholder or between companies under common control be recognized at their fair value on the date of the transaction. The difference between the fair value and the consideration stipulated in the transaction is to be allocated to shareholders' equity, net of taxes. A debit to equity essentially represents a dividend, thereby resulting in a reduction in retained earnings. A credit to equity essentially represents a shareholders' investment and will therefore be presented as a separate item in shareholders' equity that will appear as "capital reserve from transactions between an entity and its controlling shareholder". If the Company is not wholly owned by the controlling shareholder, the minority's share in the difference, whether a debit or credit, will be recorded in the minority interest in the statement of income.

The amount recorded in shareholders' equity will not be transferred to the statement of income, even if in subsequent periods, the items that were the subject of the transactions are derecognized from the financial statements.

The fair value of an asset or liability is to be determined based on the most current quoted market prices of identical or similar assets and liabilities and, in their absence, based on acceptable valuation methodologies.

An intangible asset with no active market (as defined in Accounting Standard No. 30), which is transferred to the Company from its controlling shareholder, is to be measured at its carrying value in the controlling shareholder's books of account and the difference between the consideration and the carrying value is to be recorded in shareholders' equity, net of taxes.

In the event of a transaction in which a liability to a third party is assumed or a liability is waived, the difference between the carrying value of the liability and its fair value upon settlement is to be recorded in the statement of income. The difference between the fair value of the liability and the consideration is to be recorded in shareholders' equity.

In the event of grant or receipt of a loan from the controlling shareholder, the loan is to be presented at fair value on the date of the transaction and in subsequent periods, at amortized cost using the effective interest method. A loan for which a repayment date has not been fixed will be considered as if it had been granted or received for a period of one year, thus, its fair value will be determined annually based on the present value of the expected cash flows from the loan, discounted at the Company's interest rate for each year.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

The Company's management believes that the effect of the new Standard on its financial position, results of operations and cash flows is not expected to be material

6. Accounting Standard No. 30 - Intangible Assets:

In March 2007, the Israel Accounting Standards Board published Accounting Standard No. 30, "Intangible Assets" (hereinafter: "the Standard") – based on International Accounting Standard 38 – that prescribes the accounting treatment, recognition, measurement and the disclosure requirements regarding intangible assets that are not dealt with in another standard.

An intangible asset is an identifiable non-monetary asset without physical substance. The definition of an intangible asset requires that such an asset be identifiable to distinguish it from goodwill. An asset is identifiable when it complies with one of the following criteria: It is separable; or it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

In a business combination, the acquirer recognizes the intangible assets of the acquiree separately from goodwill, even if the assets had not been recognized in the financial assets of the acquiree prior to the business combination. Accordingly, the acquirer recognizes the acquiree's in-process research and development project as an asset separately from goodwill provided it meets the definition of an intangible asset and its fair value can be reliably measured.

Costs incurred during the development stage shall be recognized as an expenditure in the statements of income. On the other hand, costs incurred during development shall be capitalized to the assets if, and only if, the conditions stipulated in the Standard are met, including technical feasibility, the intent and ability to complete the intangible asset and use or sell it, probable future economic benefits deriving from the asset, the availability of technical, financial and other resources and the ability to reliably measure the expenditures attributable to the asset during its development.

Subsequent to initial recognition, the cost model or revaluation model will be applied for every group of intangible assets. The revaluation model will be applied only when there is an active market for the asset.

An intangible asset with a finite useful life is systematically amortized and the amortization period and method are reviewed at each year-end. By contrast, an intangible asset with an indefinite useful life is not systematically amortized but is subject to a test for impairment annually (or more frequently if there are changes in circumstances).

The Standard is applicable to financial statements for periods commencing on January 1, 2007 or thereafter. The Standard is to be applied by retrospective restatement.

As an exception, the Standard will apply to business combinations that occur subsequent to January 1, 2007. As for in-process research and development projects acquired prior to January 1, 2007, that met the definition of an intangible asset on the date of acquisition but were recognized as an expense according to previously accepted accounting principles, on January 1, 2007, the entity will recognize the in-process research and development project as an asset (less accumulated depreciation and impairment losses) and the resulting adjustment will be credited to retained earnings on that date.

The Company believes that the effect of the new Standard on its financial position, results of operations and cash flows is not expected to be material.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

EE. Significant accounting policies relating to main sections of the insurance operations

The financial statements of the insurance operations are presented in conformity with the accounting, reporting and presentation principles established by the Supervision over Insurance Business (Reporting Details) Law – 1998 and the ensuing regulations, including reporting regulations and the Circular of the Supervisor of Insurance pertaining to financial reporting of insurance companies and which applies IFRS 4 – Insurance Contracts to insurance companies.

A. Valuation and presentation of assets and liabilities

1. Non-marketable assets

Non-marketable assets, except for assets held against the liabilities of profit-sharing insurance policies, are included in the balance sheet on the basis of the last Index published before the balance sheet date, in accordance with the contractual terms of the assets. When the nominal value of the asset is guaranteed to the Company, even if it is higher than the Index-adjusted value, the investment is presented at its nominal value.

Non-marketable assets held against liabilities of profit-sharing insurance policies are included in the balance sheet at fair value.

2. CPI-linked liabilities are included in the balance sheet based on the index last published prior to the balance sheet date, as per contract terms.

3. Investments in securities

a. Non-marketable debentures held against profit-sharing policies are presented at fair value, as mentioned in Section 1 above. The remainder of the non-marketable debentures are presented at principal amount, plus premium or less unamortized discount, plus accrued interest income to the balance sheet date, at their adjusted values as per the terms of issue.

b. Marketable debentures are presented at market value as at the balance sheet date.

c. A portfolio of marketable debentures held as a permanent investment by an insurance company overseas, is presented according to the principal, in addition to a premium or net of a discount that were not yet deducted, plus accrued interest.

d. Marketable shares and options are presented at market value at the balance sheet date.

e. Participation certificates in mutual funds are stated at their balance-sheet-date redemption value.

f. Non-marketable shares, venture capital funds and investment funds held against profit-sharing policies are presented, commencing in the reporting year, at fair value. The remainder of the non-marketable shares, venture capital funds, and investment funds are stated at cost. In the event of impairment, which Management determines to be non-temporary in nature, a provision is made in respect thereof.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

g. Derivative financial instruments not stemming from hedging existing assets and liabilities are presented on the balance sheet at their fair value. Any changes in fair value are carried to the statement of income, on an ongoing basis. The fair value of derivative financial instruments is determined on the basis of their market value. In accordance with the Reporting Regulations, net financial derivative instruments held by insurance companies are presented in the "Securities" item.

h. Other investments are presented as permanent investments at cost, pursuant to Opinion 44.

4. Loans and Deposits

Loans and deposits held against profit-sharing policies are presented at fair value. The remainder of the deposits and loans are included at their original values, plus accrued income as of the balance sheet date. Loans are presented net of the provision for doubtful debts.

5. Investments in Investee Companies

Investments in investee companies are accounted for in the financial statements by the equity method.

6. Rental real estate, office buildings, and other fixed assets

a. Rental properties are included at cost less accumulated depreciation and less provision for impairment in accordance with Accounting Standard No. 15 of the Israel Accounting Standards Board.

b. Depreciation is computed by the straight-line method, at rates considered adequate to depreciate the assets over their expected useful lives.

7. Office buildings and other fixed assets

a. Office buildings are included at cost less accumulated depreciation less provision for impairment in accordance with Accounting Standard No. 15 of the Israel Accounting Standards Board.

b. Other fixed assets are presented at cost, less accumulated depreciation.

c. Leasehold improvements are depreciated on the straight-line method over the duration of the lease, which is less than the expected life of the leasehold improvement.

d. Depreciation is computed by the straight-line method, at rates considered adequate to depreciate the assets over their expected useful lives.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

8. Buildings under construction

Buildings under construction are presented at cost, less a provision for impairment, in accordance with Accounting Standard No. 15 of the Israel Accounting Standards Board. Cost includes the direct cost of land, materials, wages, subcontractors, other direct costs, and credit costs deriving from the investment in constructing the buildings, in the event that they comply with the definitions of Accounting Standard No. 3 (capitalization of credit costs). In addition, administrative and selling expenses are capitalized if they can be clearly and uniquely identified with the specific project. The capitalized costs are carried together with the project's other expenses upon the recognition of revenue.

9. Works of art

The investment in works of art is presented at cost, net of a provision for impairment, which, in management's opinion, is not of a temporary nature, and in accordance with Accounting Standard No. 15 of the Israel Accounting Standards Board.

10. Deferred acquisition costs and other assets

a. For information pertaining to deferred acquisition expenses in life, general, and hospitalization insurance, see Sections b6 and c6, below.

b. Original differences and goodwill

1. Original differences generated on the purchase of the Hadar subsidiary, attributable to the value of Hadar's life insurance portfolios, and expenses in respect of the acquisition of life insurance portfolios, are amortized at equal annual installments over a period of 10 years (10% per annum), which management believes reflects the average life of the policies.
These amortization rates are subject to annual reassessment of the value of the life insurance portfolio, taking into consideration the estimated life expectancy of the portfolio that existed at the time of acquisition.

2. Original differences generated on the purchase of insurance agencies, attributable mainly to commission portfolios, are amortized on the basis of the life expectancy of the commission portfolio and change in accordance with the preservation of the portfolio. The Company periodically assesses the remaining expected life of the portfolios and adjusts the rate of amortization accordingly.

11. Provision for Doubtful Debts

a. The provision in respect of premiums receivable, loans and other debts was computed specifically for accounts whose collection, in management's estimation, is uncertain.

b. Regarding debts of re-insurers see section d, below

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

B. Life insurance business

1. Life insurance premiums, including savings premiums, are recorded as revenues upon the due date. Cancellations are recorded when notice is received from the policy owner or are initiated by the Company due to payments in arrears, all based on the type of policy and subject to any legal provisions.

2. The payout of a policy is recorded as of the redemption date of the policy.
   Annuities are recorded on their redemption date.
   Redemptions are recorded upon payment.
   Deaths are recorded when the event becomes known to the Company.

3. Life-insurance reserves, the share of re-insurers therein and the assessment of the fairness of the allocation of life insurance deferred acquisition costs to future life insurance profits (see Section 7, below) were determined based on the declarations of the Phoenix actuaries and those of the Hadar subsidiary (Mr. Arie Wurtzburger, an officer of Phoenix and Mrs. Mimi Frankel, a Phoenix employee). The actuaries declared that these amounts were computed on the basis of the Companies' databases, in accordance with accepted actuarial methods in Israel, and in accordance with the data that were used by the companies in their various insurance plans, consistent with the preceding year. In making their calculations, the actuaries used the relevant coverage data, such as: The age of the policyholder, seniority of coverage, type of insurance, amount of insurance, etc.

   In respect of collective nursing-care and dental insurance policies, an actuarial reserve is calculated and includes a reserve for expected loss and a reserve for revenue sharing.

4. Life insurance reserves linked to the CPI and the investments used to cover such reserves, are included in the financial statements based on the index last published prior to the balance sheet date (the index for the month of November), including life insurance reserves pertaining to policies linked to the CPI semi-annually (June); this presentation does not reflect the sum of the Company's contractual obligations for said policies, and has no impact on the business results.

5. The reserve for extraordinary risks intended to serve the Group in case of future calamity, was calculated as a percentage of the amount at risk under principles determined in the draft regulations on this matter, published in 2002, by which insurance companies shall gradually increase the reserve for extraordinary risks in life insurance up to a rate of 0.2% of the amount at risk of the self residual extant on December 31, 2006.

   A provision in respect of the change in the amount of the self residual risk between any given reporting year and the previous year, commencing on January 1, 2002, will be set up in equal parts over a period of no more than eight reporting years.

   In March 2004, the International Accounting Standards Board published an international accounting standard for "insurance contracts" (IFRS4). This standard specifies that a provision for reserve for extraordinary risks is not in line with provisions of the standard, and must be cancelled.
   In view of the above and in order to classify the reserve for extraordinary risks in life insurance, included in financial statements of insurance companies in Israel as shareholder's equity, an interim order was published within the Israel Economy Settlement Law (Legislation Amendments for Attaining the Budget Objectives and the Economic Policy for Fiscal Year 2007), 2007 which exempts from taxation classification of a reserve for extraordinary risks as shareholders' equity at a rate of up to 0.17% of the amount at risk of the insurer's self residual. Any additional amount transferred to shareholders' equity, as per the above, will be taxable for a period of 4 years starting in 2007.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

In February 2007 the Supervisor issued a circular, stipulating that starting in Q1 2007, the provision for reserve for extraordinary risks in life insurance would be cancelled in financial statements of insurance companies.

Under the aforementioned circular, cancellation of the provision will be recorded on the income statement as a special item, less tax effect if any.
Concurrently, a capital requirement was specified at a rate of 0.17% of the amount at risk in the self residual. Nevertheless, the circular specified that the minimum capital requirement for the amount at risk would not be lower than the requirement on the data of the transfer.

As of December 31, 2006, the consolidated insurance company has a reserve for extraordinary risks amounting to NIS 177.5 million, which is 0.17% of the amount at risk in the self residual.

The above is not expected to have a significant influence on the Group's financial statements, in light of the allocation of of the original difference to this reserve during the Phoenix acquisition.

6. Deferred acquisition costs (DAC) in respect of policies sold commencing January 1, 1999 were calculated using the deferred acquisition cost method, in accordance with the guidelines set forth in the Reporting Regulations (hereinafter – the "New Guidelines").
According to the new guidelines, deferred acquisition costs (DAC) include commissions to agents and purchase supervisors and other expenses related to the acquisition of new policies, including part of the general and administrative expenses. According to these guidelines, deferred acquisition costs are amortized in equal installments over the period of the policy, not to exceed 15 years. Deferred acquisition costs in respect of policies that were cancelled are erased upon cancellation of the policy.

   Deferred acquisition costs in respect of policies issued until December 31, 1998 continue to be included on the basis of the "Zillmer deduction" at percentages of the premium or the amount at risk, in accordance with the various policies.
The Company checks to see that the total of the expected future profits from life insurance policies in respect of which deferred acquisition costs were paid is not less than the balance of deferred acquisition.

7. Pending claims, less the share of reinsurers therein, were computed individually, on the basis of the evaluations of the Company's experts, based on notifications in respect of insurance events and insurance amounts.
The provision for claims incurred but not reported (IBNR), and provisions for extended payout claims in disability and nursing-care insurance were included in the insurance reserves.

8. Under the Supervisor circular dated January 7, 2007, investment contracts are defined as contracts having a legal structure of insurance contracts, which do not expose the insurer to significant insurance risk.

   Investment contracts include:

   (1) Policies with 100% savings, withdrawn as a lump sum with no insurance riders.

   (2) Pension policies for a guaranteed term.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

The accounting treatment of investment contracts is as follows: Proceeds for investment contracts are not included in the premiums item of the statement of life-insurance business, but are charged directly to life insurance reserves; redemptions for these contracts will not be charged to the redemptions item, but are directly deducted from insurance reserves. In the statement of life-insurance business, the financial margin between the return on investments and the return guaranteed to policyholders will be charged for these contracts, as well as agent commissions and general and administrative expenses.

In 2006, pursuant to the aforementioned circular, insurance products were defined as investment contracts only products including no insurance risk whatsoever.
Starting in 2007, pursuant to the aforementioned circular, additional insurance products will be defined as investment contracts with an insignificant insurance risk component.
In 2007, discussions will be held between representatives of the insurance companies and the Insurance Supervisor on the definition of policy types included under investment contracts.

9. Phoenix Insurance is committed under modified re-insurance agreements ("mod-re") with foreign insurance companies participating in part of the life-insurance policies. The results of "mod-re" are presented separately in the consolidated statements of insurance business. According to the Reporting Regulations, the total amount of commissions, including the excess reinsurance commission received from reinsurers in respect of policies issued commencing January 1, 1999, are spread out on the basis of the deferred acquisition costs.

10. The management fees presented in the statement of life-insurance business are computed in accordance with the guidelines of the Supervisor of Insurance (Procedure for Computation of Yield on Profit-Participating Policies) on the basis of the monthly yields and balances of the insurance reserves.

11. Bonuses paid to employees on the basis of volume of business are included under "General and administrative expenses".

C. General insurance business

In Israel

1. Insurance premiums are recorded as revenues in the year in which the policy starts and relate mainly to insurance periods of one year. In the area of compulsory automobile insurance in Israel, since the commencement of the coverage is contingent upon the payment of the premium, the premiums are recorded as revenues once paid. In the areas of hospitalization and illness insurance, marine insurance, contractors, sick pay and travel insurance, premiums are recorded on a monthly or daily basis.
The part of the premium that relates to the period subsequent to the balance sheet date is recorded as a reserve for unexpired risks. See Section 2, below.
Premiums from policies whose coverage commences subsequent to the balance sheet date or premiums relating to periods exceeding one year, are recorded as prepaid income.
Monthly production reports, mainly in the areas of property and apartment insurance, include automatic renewals of policies whose renewal date has already passed. Revenues included in the financial statements are net of cancellations made by policyholders, and net of cancellations and reserves as a result of non-payment of premiums, subject to the provisions of the law.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

2. The reserve for unexpired risks, deferred acquisition costs and pending claims, including the share of reinsurers therein, has been computed in conformity with the Regulations of the Supervision over Insurance Business (Manner of Computing Provisions for Future Claims in General Insurance) – 1984 and is presented in accordance with the Reporting Regulations and their related clarifications.

   The reserve for unexpired risks reflects the premium component that relates to the period subsequent to the balance sheet date (the unearned premium), in accordance with generally accepted accounting principles. These reserves do not reflect the actuarial liability of the unexpired risks.
   Notwithstanding the above, the reserves in the areas of comprehensive automobile, apartments and businesses, include where necessary, reserves for the premium that does not cover the expected cost of the claims (hereinafter – a "short" premium), calculated on the basis of a model set out in the regulations for computing reserves in general insurance. In addition, reserves are set up for "short" premiums in the area of health insurance on the basis of actuarial estimates.

   The insurance reserves include provisions for expected losses associated with collective health insurance business, calculated as per instructions of the Insurance Supervisor.

3. Pending claims, net of the share of reinsurers therein, are included on the basis of actuarial estimates, except for certain branches of insurance.

   In accordance with the Regulations for the Computing of Provisions in General Insurance, an insurance company should not recognize the excess of revenues over expenses less provisions (hereinafter – the "Accrual") in branches having a long claims tail (branches in which the time it takes to give notice of damages that were incurred and/or to determine the damages and the compensation therefore may last a number of years), such as compulsory automobile and other liabilities, before the end of the third year from the policy-issuance date, with these profits computed in accordance with the regulations. The accumulation recorded in respect of an excess is included in "pending claims" and in respect of a deficit is expensed.
   In respect of areas in which the actuarial reserve is computed by the method of surplus revenue over expense, the actuarial reserve in the financial statements for those years shall not fall below the surplus of revenue over expense.

4. The reserve for individual health insurance, such as medical expenses, organ transplants, is calculated on an actuarial basis.

   In respect of collective health insurance policies, the computed actuarial reserve includes a reserve for expected loss and a provision for revenue sharing. In the event that there is a collective group in respect of which a loss is forecasted, the financial statements include a reserve on an actuarial basis in respect of the loss. The actuarial estimate was prepared by Ms. Dafna Vairuch, an employee of Phoenix Insurance (except for reserves for the travel and personal accident segments – which were prepared by Mr. Moti Mor) who declared that the amounts calculated by her were based on Phoenix Insurance data consistently with the previous year, pursuant to instructions of the Insurance Supervisor and to rules and methods set forth in Note 38e(2).

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

5. Collective dental insurance involves an actuarial assessment in regard to the overall profit or loss expected from each collective separately.
The actuarial estimate was prepared by Ms. Dafna Vairuch, who declared that the amounts calculated by her were based on Phoenix Insurance data consistently with the previous year, pursuant to instructions of the Insurance Supervisor and to rules and methods set forth in Note 38e(2).

6.

a. The part of the commission paid and other acquisition costs attributable to the unearned premium is carried forward to the following year as deferred acquisition costs. These expenses are calculated at the lower of actual rates or on the basis of standard rates for each area separately, in accordance with the Standards and are expensed to the general insurance business statements over the duration of the policies.

b. Commencing on January 1, 2005, the Company started implementing the directives of the Supervisor of Insurance pertaining to the calculation of deferred acquisition costs (hereinafter – "DAC") of hospitalization and illness policies sold subsequent to January 1, 2005. According to these directives, DAC are calculated in accordance with the guidelines stipulated in respect of the DAC of life insurance (see B6 above) and are amortized in equal installments over the life of the policy. However, in respect of policies covering a period of more than six years, the DAC can be amortized over a shorter period, but not less than six years.

Deferred acquisition costs in respect of policies that were cancelled are erased upon cancellation of the policy.

7. Business obtained from the pool, from other insurance companies and underwriting agencies are included on the basis of bills received until the balance sheet date, plus provisions where applicable, all on the basis of the percentage at which the Company participates therein.

8. Investment income is allocated to the various areas of insurance on the basis of the ratio of the opening balance of pending claims and insurance reserves, less deferred acquisition costs, plus half of the total premiums less claims and expenses paid during the reporting period.

9. General and administrative expenses are allocated among the various branches of general insurance on the basis of a model that takes into account output and claim volumes, on the basis of the circular of the Supervisor.

10. The reserve in respect of group health insurance includes, among other things, a provision in respect of profit sharing accumulated for policyholders. When amounts are refunded to policyholders, the refunded amount is deducted from "insurance fees".

11. Subrogation is included when received as a reduction in claims paid. In addition, subrogation is taken into account in the data base which serves as the basis for the actuarial estimates of pending claims. In branches which are not statistical, subrogation is taken into account when assessments are made of the overall risk in claims portfolios on an individual basis. Remnants of accidents, mainly of motor vehicles, are recorded as reductions of cost of claims on the basis of the expected realization thereof.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Overseas (outside Israel)

1. Losses and expenses for discharging claims, less subrogation, are charged as claims upon creation. The estimate of the total claims for losses and expenses for discharging unpaid claims, is based on projections of claim development, which were developed by actuaries using analytical methodology commonly used in property and accident insurance. Liabilities for losses and expenses for discharging claims are based on: (1) accumulated individual estimates for losses on reported claims; (2) estimates of losses and expenses for discharging claims incurred but not reported, based on past experience; (3) estimated expenses for investigation, update and protection against claims based on past experience; and (4) estimates for collection of remnants and subrogation. From time to time, the Company updates its liabilities for losses and expenses for discharging claims with regard to changes in product mix, underwriting standards, loss trend due to cost erosion and other factors.

2. Policy acquisition expenses, such as commissions, wages, premiums, taxes and certain underwriting and marketing expenses directly associated with production and variable in line with it are deferred and depreciated over the effective term of the referring insurance policies. The recoverability of deferred acquisition costs for policies is reviewed in every reporting period, in order to determine whether a shortfall is expected. A shortfall in premium reflects estimated expected losses, expenses for discharging claims and depreciation of deferred acquisition costs for the policies, over and above the referring unearned premium and the profit from associated future investments. If a shortfall is found in premiums, the total shortfall will be decremented from the deferred acquisition cost asset of Company policies for the relevant business, and will be deducted as an expense from the revenue report in the period when the shortfall was created. Should the total shortfall in premiums exceed the balance of deferred acquisition costs for the policies, the shortfall would be recorded as a liability, and will be decremented from the new revenue for that period.

3. Premiums are earned over the term (usually one year) of the referring policy. Earned insurance premiums, net are part of the earned premiums, net for the reported period. At the end of each reporting period, the unearned part of the premiums is included in liabilities for unearned premiums, and is realized as revenue over the remaining term of the policy.

4. The consolidated insurance companies abroad charge insurance fees for re-insurance transactions ("fronting") from insurers to whom they provide fronting services. Fronting fees are also collected from unaffiliated agencies for policies which they sign on behalf of the company. Revenues from fronting operations are presented net of expenses associated with generation of such revenues. Fronting fees are charged as revenue over the term of the referring policies.

D. Reinsurance

1. The liability of re-insurers towards insurance companies does not excuse insurance companies from their liabilities towards policyholders under the insurance policies.

   Any re-insurer who fails to meet its commitments under re-insurance contracts may cause insurance company losses.

2. In accordance with the Reporting Regulations, the liabilities of re-insurers at the balance sheet date in respect of their share in insurance reserves and pending claims, net of the provision for doubtful debts based on management estimates (see 3, below), are presented separately in the balance sheets, under "Sums to collect".

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

3. The insurance companies provide for doubtful debts in respect of the debts of re-insurers, the collection of which is doubtful on the basis of individual risk assessments. In addition, in respect of the share of re-insurers in pending claims and insurance reserves, The insurance companies take into consideration, among other things, assessments of the possibility of collection from re-insurers, with the share of the re-insurers being computed on an actuarial basis. The share of those re-insurers who are undergoing difficulties is computed on the basis of the actuary's recommendation which takes into consideration overall risk factors. When re-insurers experience difficulties, they may raise various claims regarding to the recognition of the debt. In such cases, when computing the provisions, Phoenix Insurance takes into consideration the readiness of the re-insurers to reach "cut-off" agreements.

E. Revenues from investments

Investment revenue is included in the statements of income on the basis of investments corresponding to shareholders' equity and to liabilities which are not attributed to insurance business.

F. General and Administrative Expenses

General and administrative expenses directly relating to insurance business are charged to the appropriate business statements. Other expenses are charged on the basis of the principles stipulated in the Reporting Regulations, based mainly on the breakdown of salaries, office area, and turnovers.

G. Recognition of income from the sale of works of art

Gains on the sale of works of art are recognized on the date of sale, in the event of a contractual agreement that binds the purchaser, as long as there is a good chance that the Company will receive the consideration for the sale.

H. Changes to accounting principles

1. Instructions of the Supervisor on reserves for pension payments

In a circular issued in February 2007 by the Insurance Supervisor on calculation of reserves for pension payments in life insurance policies, provides updated instructions for calculation of the provisions, due to improvement rate of life expectancy, which requires monitoring of the adequacy of reserves for insurance policies allowing for pension payments, and for properly adjusting them.

The circular requires immediate adjustment of the reserve, as required, for policies where pension is being paid or the policyholder has reached retirement age or a non-profitable group of policies.

For other policies, the insurer may adjust the reserves over the term of the policies, provided that the actuary in charge estimates that the specific group of policies may be profitable under conservative assumptions.

Adjustment over the term of the policies may be implemented using a geometric formula specified, or using a more accelerated method – as the insurer prefers.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

The assumptions on which the insurer must base the calculations refer to mortality charts, discount rates, expected retirement age for policyholders, redemption rates, probability of drawing a pension, distinction between monies deposited in different periods (subject to different taxation, which may influence the probability of drawing a pension), expenses associated with pension payments etc.

In order to substantiate the above assumptions, the insurer will be required to conduct research and various measurements. As an interim stage for financial statements for 2006, a series of sector assumptions was put in place, referring to the major factors affecting the calculation of provisions, which may be relied upon for the reporting periods through September 30, 2007.

The circular also stipulates that adjustment of the reserve for a positive difference calculated as of December 31, 2006 between the provision for reserves for pension payments calculated under instructions in the circular and provision for reserves for pension payments calculated under the method and assumptions relied upon by the insurer in financial statements for Q3 2006, may be conducted gradually starting in Q4 2006 and no later than Q4 2009, in a uniform manner.

Pursuant to the decision of Phoenix Insurance management, and to estimates of the actuary in charge of life insurance for Phoenix Insurance which relies on the aforementioned circular, in 2006 a full provision was recorded for liabilities in policies for which pensions are already being paid and a further provision amounting to NIS 5 million for liabilities in policies in the savings period.

Due to the above, the profit from life insurance business and the income before taxes on income for the year ended December 31, 2006 decreased by NIS 9 million. The net income decreased by NIS 5.1 million.

2. Loading of indirect expenses for pending claims

Pursuant to instructions of the Insurance Supervisor, starting on Jan-01-06 the provisions for pending claims in general insurance also include indirect costs for settlement of claims referring to policies issued for the 2006 underwriting year and onwards, as well as a provision for indirect costs for settlement of claims in life insurance and health insurance. The total aforementioned provision amounted to NIS 18 million. Of which NIS 3 million caused a reduction in excess reserves (accumulation) and NIS 15 million caused a reduction in profit and loss before taxes.

NOTE 3: - CASH AND CASH EQUIVALENTS

	Consolidated		The Company	
	December 31		December 31	
	2006	2005	2006	2005
	NIS Millions, Reported			
In Israeli currency	121	105	22	12
In foreign currency	760	730	-	-
	881	835	22	12

NOTE 4: - SHORT-TERM INVESTMENTS

	Weighted annual interest rate (1)	Consolidated December 31		The Company December 31	
		2006	2005	2006	2005
	%	NIS Millions, Reported			
Bank deposits:					
In U.S. dollars	5.1	176	215	-	-
In Canadian dollars		-	6	-	-
In unlinked NIS	3.5	16	35	-	-
Loans to consolidated subsidiaries:					
Unlinked		-	-	-	76
Marketable Securities:					
Debentures and Short-Term-Loans (STL)		531	395	86	84
Mutual Funds		-	17	-	-
Shares		92	13	-	-
		815	681	86	160

(1) As at December 31, 2006.

NOTE 5: - ACCOUNTS RECEIVABLE - TRADE

	Consolidated	
	December 31	
	2006	2005
	NIS Millions, Reported	
Open accounts *)	1,706	1,681
Checks to collect and credit card companies	790	823
	2,496	2,504
Less - provision for doubtful debts	144	148
	2,352	2,356

*) Including revenues to collect from apartment buyers, as follows:

Revenues recognized from construction of buildings for sale	77	110
Less – proceeds from apartment buyers	73	107
	4	3

NOTE 6: - OTHER ACCOUNTS RECEIVABLE

	Consolidated		The Company	
	December 31		December 31	
	2006	2005	2006	2005
	NIS Millions, Reported			
Prepaid expenses and advances to suppliers	129	80	-	-
Current maturities of long-term debts and receivables	47	84	-	-
Deferred taxes (1)	21	33	-	-
Related Parties	4	7	166	276
Institutions	86	40	-	-
Dividend and distributable earnings to collect	18	70	-	27
Joint ventures for oil and gas exploration, net	29	24	-	-
Derivative Financial Instruments	-	30	-	-
Deposits (2)	67	103	-	-
Loan to shareholder in consolidated subsidiary (3)	86	-	-	-
Other receivables	70	75	3	-
	557	546	169	303

(1) See Note 33e.
(2) As at December 31, 2006, including deposits of NIS 44 million held in trust to secure the liabilities of subsidiaries related to the leasing of assets in England and in Canada.
(3) The loan is linked to the GBP. The loan was repaid in January 2007.

NOTE 7: - INVENTORIES

	Consolidated	
	December 31	
	2006	2005
	NIS Millions, Reported	
Fuel products at stations and facilities	315	*) 250
Consumer goods inventories at stations	121	102
Petroleum and distillates at refinery	254	309
Vehicles and spare parts	609	741
Others	68	61
	1,367	1,463

*) Reclassified; See Note 12a(6), below.

NOTE 8: - BUILDINGS AND LAND FOR SALE

	Consolidated	
	December 31	
	2006	2005
	NIS Millions, Reported	
Composition:		
Land, commercial space and office space for sale	6	5
Buildings for sale *)	104	36
	110	41
*) Inventory of buildings for sale, net		
Cost of buildings for sale	437	302
Less – Costs allocated to statement of income	313	250
	124	52
Less – Advances from buyers	20	16
	104	36
Sum of sales contracts signed in the course of the year	239	127
Proportion of cumulative sum of sales contracts yet to be recognized as revenues by end of reported year	176	63

NOTE 9: - INVESTMENTS IN INVESTEE AND OTHER COMPANIES

A. Composition:

	December 31					
	2006			2005		
	Shares	Loans and capital notes	Total	Shares	Loans and capital notes	Total
	NIS Millions, Reported					
Consolidated						
Affiliates and partnerships (1)	1,658	367	2,025	1,908	262	2,170
Other Companies	790	-	790	416	-	416
	2,448	367	2,815	2,324	262	2,586
The Company						
Consolidated subsidiaries (1)	3,566	2,778	6,344	2,106	1,246	3,352

(1) See b below.

B. Composition of investments in investee companies:

	Consolidated		The Company	
	December 31		December 31	
	2006	2005	2006	2005
	NIS Millions, Reported			
Cost of investment	824	1,700	874	874
Earnings accumulated since acquisition date (net of dividends), net	834	229	2,732	1,206
Capital reserves, net	-	(21)	(40)	26
	1,658	1,908	3,566	2,106
Loans and capital notes (see H, below)	567	340	2,778	1,246
Less loans received from affiliates *)	200	78	-	-
	2,025	2,170	6,344	3,352

*) As a result of the refinancing of subsidiaries of Delek Real Estate, cash surpluses were created at subsidiaries that were made available as loans to companies in the Delek Real Estate Group. The repayment dates of these loans have yet to be set.

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

C. The unamortized balance of original difference:

	Consolidated	
	December 31	
	2006	2005
	NIS Millions, Reported	
On account of affiliates and partnerships:		
Surplus cost of investment over fair value upon acquisition	513	850
Less - accumulated amortization	225	42
Unamortized balance	288	808

D. The latest audited financial statements of investees prepared as of the date of the Group's balance sheet serve as a basis for the computation of the carrying amount, except one affiliate whose latest financial statements have been prepared as of September 30, 2006.

E. The change in investments in 2006:

	Consolidated			The Company
	Affiliates & partner-ships	Other	Total	Consolidated Subsidiaries
	NIS Millions, Reported			
Balance at beginning of year	2,170	416	2,586	3,352
Changes during the year:				
Investments in shares	248	386	634	-
Loans and capital notes, net	41	-	41	1,532
Earnings from issue to third party	10	-	10	221
Initial consolidation of affiliate	(1,023)	-	(1,023)	-
Group's share in earnings, net *)	658	-	658	1,351
Dividends and distributable profits	(46)	(3)	(49)	(46)
Financial statement translation differences	15	-	15	(70)
Changes in other capital reserves	2	-	2	4
Realization of investments in shares	(48)	-	(48)	-
Transition from investment in affiliate to investment in cost	(2)	-	(2)	-
Impairment of investments	-	(9)	(9)	
Balance at end of year	2,025	790	2,815	6,344

*) In the consolidated - apart from approximately NIS 6 million which were taken into account in change in deferred taxes (see Note 33e(2)).

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

F. Dividends from investee companies and partnerships:

	For the year ended December 31	
	2006	2005
	NIS Millions, Reported	
Consolidated		
Affiliates and partnership	46	165
Company		
Consolidated Subsidiaries	46	163

G. Investments in shares listed for trade on the stock exchange:

	December 31, 2006		March 25, 2007	December 31, 2005	
	Balance sheet	Market Value	Market Value	Balance Sheet	Market Value
	NIS in Millions, Reported				
Consolidated subsidiaries *)	4,648	10,977	11,958	912	4,508
Affiliate and partnership **)	636	990	1,017	1,331	1,636
Others	603	924	1,007	233	352

*) The composition of investment in shares of consolidated subsidiaries registered for trade on the stock exchange is as follows:

	December 31, 2006		March 25, 2007
	Balance sheet	Market Value	Market Value
	NIS Millions, Reported		
Delek US Holdings Inc.	1,246	2,721	3,098
Phoenix Holdings Ltd.	1,919	2,583	2,301
Delek Real Estate Ltd.	985	2,447	3,130
Delek Energy Systems Ltd.	21	1,500	1,564
Delek Automotive Systems Ltd.	266	1,469	1,606
Gadot Biochemical Industries Ltd.	164	180	181
Delek Drilling – Limited Partnership	47	77	78
	4,648	10,977	11,958

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

**) The composition of investment in shares of affiliated company and partnerships listed for trading on the stock exchange is as follows:

	December 31, 2006		March 25, 2007
	Balance sheet	Market Value	Market Value
	NIS in Millions, Reported		
Avner Oil Exploration – Limited Partnership	331	568	553
HOT Cable Communications Systems Ltd.	305	422	464
	636	990	1,017

H. Loan linkage terms and interest rates:

	Weighted annual interest rate	Consolidated December 31		The Company December 31	
		2006	2005	2006	2005
	% (1)	NIS Millions, Reported			
Linked to the Consumer Price Index (2)	2.8	67	63	2,533	1,162
In U.S. dollars	4.7	20	11	-	84
In U.S. dollars	-	112	-	-	-
In Canadian dollars	-	14	-	-	-
In GBP	-	146	80	-	-
In Swedish krona	9.0	3	31	-	-
Unlinked (2)		2	13	245	-
In euro	7.5	156	93	-	-
Unlinked, interest-free capital notes	-	-	11	-	-
Linked capital notes	-	19	-	-	
In Swiss francs	-	28	38	-	-
		567	340	2,778	1,246

(1) As at December 31, 2006.
(2) Company – Weighted annual interest rate of approximately 5.1%.
(3) A maturity date for most of the loans has not yet been determined.

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

I. The Group's share in the financial statements items of jointly controlled entities included by the proportionate consolidation method:

	December 31	
	2006	2005
	NIS Millions, Reported	
Current assets	136	147
Non-current assets	162	157
Current Liabilities	111	109
Long-Term Liabilities	129	140

	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
Revenues	165	164	215
Costs and expenses	139	149	209
Net Income	26	15	6

J. Principal changes in investees:

A. Real estate operations

1. In 2005, Delek Real Estate Ltd. (hereinafter: "Delek Real Estate") conducted public offerings of shares, debentures and convertible debentures. Subsequent to the issuances, as stated above, the Group's holding rate in Delek Real Estate decreased to approximately 80%. As a result of these issuances, the Group recorded gains totaling approximately NIS 111 million. The said gains are included as "Gains from sale of investments in investees and other companies" in the year 2005.

2. On January 26, 2006, Delek Real Estate allocated to Tarshish Holdings and Investment Hapoalim Ltd. (hereinafter: "Tarshish") (a company wholly owned by Bank Hapoalim Ltd.), 12,461,673 ordinary shares of Delek Real Estate, representing 11% of the share capital of Delek Real Estate, in return for NIS 260 million (approx. NIS 252 million after dividend adjustment and issuing expenses). Tarshish was also granted an option for an additional period of 18 months, to acquire – by private placement and at the same price at which the shares were allocated (linked to the US$ and with interest equal to Libor + 2%) – a quantity of shares equal to 12.36% of the shares allocated by Delek Real Estate as a result of the exercise of options that shall be allocated to employees of Delek Real Estate or as a result of a conversion into shares of the debentures (Series C) issued by Delek Real Estate.

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

At the same date (January 26, 2006), Delek Real Estate acquired all the rights (13.04%) of Diyur BP Ltd. (hereinafter: "Diyur") (a company wholly-owned by Bank Hapoalim Ltd.) in the share capital of Industrial Buildings Ltd. (hereinafter: "Industrial Buildings") in consideration of NIS 258 million (including expenses related to the acquisition). Together with previous holdings of Delek Real Estate in Industrial Buildings, Delek Real Estate held 13.38% of the Industrial Buildings shares at that date. In the course of 2006, Delek Real Estate acquired additional shares of Industrial Buildings from third parties in consideration of NIS 19 million, thereby bringing its holding percentage as at December 31, 2006, to 14.14% (approx. 13% fully diluted). Delek Real Estate possesses an agreement with Jerusalem Economic Corporation Ltd. (controlling shareholder in Industrial Buildings) whereby Delek Real Estate possesses the right to appoint two directors in Industrial Buildings if and when Delek Real Estate shall hold at least 15% of the shares of Industrial Buildings. Subsequent to the balance sheet date, Delek Real Estate acquired additional shares of Industrial Buildings in consideration of approximately NIS 40 million, thereby bringing its total holdings as at the date of approval of the financial statements to 14.8%.

Moreover, Delek Real Estate granted two options, whereby Diyur and one of its investee companies (at a rate of 20%) shall be eligible to demand that Delek Real Estate acquire from them their rights to real estate on which the Bavli Project is intended to be developed. The said options expired on June 15, 2006.

Subsequent to the issuance of shares, as stated above, the Group's holding rate in Delek Real Estate has decreased to approximately 72%. The earnings generated for the Group as a result of this offering amounted to NIS 123 million and were included in the statement of income as "Gains from realization of investments in investee and other companies".

3. In December 2006, Delek Real Estate allocated to Migdal Insurance Company Ltd. and Hamagen Insurance Company Ltd. (hereinafter: "The Offerees"), 3,578,240 ordinary shares (representing some 3.16% of its issued and outstanding share capital) in total consideration of NIS 130 million.

   In addition, Delek Real Estate allotted the offerees, for no consideration, 2,000,000 option warrants. Each option warrant can be exercised into one Ordinary share of Delek Real Estate until December 4, 2008, in return for an exercise price of NIS 47.5. The exercise price is linked to the consumer price index, and shall be adjusted upon the payment of dividends by Delek Real Estate.

   The earnings generated for the Group as a result of the said allocation amounted to NIS 62 million and were included in the statement of income as "Gains from realization of investments in investee and other companies".

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

4. In December 2006, Delek Real Estate allocated to a third party shares which, post allocation, account for 1.92% of its issued and paid-up capital, in exchange for NIS 86 million. The allocation agreement stipulates that NIS 10 million would be received in cash, and NIS 75 million would be provided as a loan from Delek Global – a subsidiary of Delek Real Estate. The loan would be linked to GBP and repaid in one installment on Jan-15-07. Simultaneously with the allocation of shares, Delek Global entered into an agreement with a foreign company controlled by the third party (hereinafter: "Blenheim") for the acquisition of holdings in 15 different foreign companies that hold real estate assets and wherein Delek Global and Blenheim possess joint holdings (hereinafter: "the acquisition"). The value of the holdings sold was estimated at GBP 91 million. The acquisition is contingent of a Delek Global issuance on the London stock exchange no later than Sep-30-07. It has been agreed that the proceeds would be paid by means of private allocation of 4.9% of Delek Global shares, at the price upon issuance, with the balance paid in cash. Delek Global also granted Blenheim a Put option (hereinafter: "The Option") – valid through January 15, 2007 – pursuant to which Blenheim will be able to obligate Delek Global to acquire from Blenheim part of the shares in the said foreign companies, in consideration of approximately 10 million GBP (approx. NIS 91 million. The options are not contingent on issuance of Delek Global. Blenheim exercised its option in January 2007 and Delek Global subsequently acquired holdings in some of the foreign companies. Since the share allocation transaction was not completed in 2006, the profit of NIS 40 million arising from this allocation has been deferred. The Group is reviewing the accounting treatment in view of completion of this transaction in 2007.

   Furthermore, in March 2007, Delek Global granted Blenheim an option that will enter into effect if and when the Delek Global shares are issued to the public. The option will obligate Delek Global to acquire all the Blenheim holdings in certain affiliates (including some of the affiliates that are included in the aforementioned memorandum of understanding). The option is valid through October 1, 2007 and the exercise price is based on the asset value (value of the real estate assets less the value of certain liabilities) of the affiliates at the date of exercise of the option.

   In addition to the aforesaid, Blenheim was granted an option to obligate a consolidated subsidiary of Delek Real Estate (90 days subsequent to the Delek Global IPO) to acquire all the Blenheim holdings (4.9%) in Delek Global, at the market price of the Delek Global shares as at the date of the demand.

   Delek Global intends to issue its shares on the London stock exchange at the end of March 2007. Should the issuance be completed, the holdings of Delek Real Estate in Delek Global are expected to decrease to 70%-75%.

5. As a result of this placement of shares, the rate of the Group's holdings in Delek Real Estate decreased to approximately 67.9%. In the event that all the option warrants (including options allocated to employees as set forth in section 6 below) and debentures issued by Delek Real Estate are exercised and converted, the holding percentage of the Group in Delek Real Estate will decrease to 62%.

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

6. In January 2006, a plan was approved for the allocation of 7,317,474 option warrants to employees and directors of Delek Real Estate. These may be exercised into 7,317,474 ordinary shares of Delek Real Estate, in accordance with the directives of Section 102 of the Income Tax Ordinance. Of the said sum, 926,262 options were granted to the Group's CEO (currently serving as Chairman of the Board of Delek Real Estate). The eligibility to exercise the options will be formulated over 5 years in accordance with predetermined conditions (approx. 20% every year). The economic value of the options granted totaled NIS 78 million (the share of the Group's CEO is NIS 9.9 million) and was allocated to the statement of income over the period of eligibility.

7. On January 25 and on February 16, 2006, the board of directors of Delek Real Estate and the general meeting of shareholders of Delek Real Estate, respectively, approved the engagement of an associated company of Delek Real Estate (hereinafter: "The Agreement") with R.G. Naor Management Services Ltd. (hereinafter: "Naor"), a company wholly-owned by the son-in-law of the controlling shareholder in the Group.

   Pursuant to the agreement, Naor shall be eligible to receive a special (phantom) bonus (hereinafter: "The Bonus") once a year starting June 1st 2006, for a period of five years (five batches), provided that Naor continues to provide the Company with services pursuant to the agreement for provision of consulting services between them, dated June 21, 2004. The level of the bonus for each year will be derived from the difference between the price of the shares of the parent company on the stock exchange and the exercise price as determined between the parties, subject to adjustments, for each eligibility date multiplied by 416,818 shares.

   The payment of the bonus will be made by written demand that Naor shall submit to Delek-Belron and its level will be determined at the date the demand was submitted, provided that the demand letter is submitted subsequent to Naor's eligibility for the said bonus, as stated above and no later than December 31, 2010. In the event that Naor does not demand the bonus on account of a particular year, this eligibility will be preserved and will accrue until the end of the said period.

   According to the Black and Scholes calculation formula, the economic value of all the bonus options that were granted to Naor according to the said plan, on the date of approval of the general meeting, is NIS 19.9 million. A sum of NIS 5 million was paid to Naor in 2006, on account of the first tranche of the aforementioned bonus. The fair value of the outstanding options as at December 31, 2006 amounted to NIS 18 million.

   Furthermore, the management of Delek Real Estate decided, on May 31, 2006, to grant two of its employees a special (phantom) bonus (hereinafter: "The Bonus") that will enter into effect once every year starting June 1, 2006, for a period of five years (five tranches), provided they continue to be employed by the Company at the date of eligibility. The level of the bonus for each year will be derived from the difference between the price of the Delek Real Estate shares on the stock exchange and the exercise price as determined between the parties, subject to adjustments, for each eligibility date, multiplied by 83,365 shares (the said total for both employees together).

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

The payment of the bonus will be made by written demand submitted by the employees and its level will be determined at the date the demand was submitted, provided that the demand letter is submitted subsequent to the employees' eligibility for the said bonus, as stated above and no later than December 31, 2010. In the event that the employees do not demand the bonus on account of a particular year, this eligibility will be preserved and will accrue until the end of the said period.

According to the Black and Scholes calculation formula, the total fair value of the bonus options that were granted to the employees pursuant to the said plan, as at May 31, 2006, is NIS 4.5 million. The fair value of the options as at December 31, 2006 amounted to NIS 4.6 million.

8. Some of the associated companies of Delek Real Estate formulate their financial statements according to international GAAP, including the implementation of International Accounting Standard 40, stipulating that income-generating real estate be presented according to fair value. The associated companies examined the fair value of the real estate they own during the reported period, and consequently, Delek Real Estate included its share in gains from the increased value of income-generating real estate at associated companies in 2006, in the sum of NIS 425 million (after influence of taxes) (NIS 77 million and NIS 76 million in 2005 and 2004, respectively). The fair value of the income-generating real estate was determined based on a valuation by external experts.

9. As at December 31, 2006, Delek Real Estate holds 17.3% of the share capital of Hof Hacarmel Recreation and Tourism 89 Ltd. (hereinafter: "Hof Hacarmel") that is engaged in the establishment and operation of a hotel and apartment hotel.

   As at December 31, 2006, Hof Hacarmel has a shareholders' equity deficiency amounting to approximately NIS 172 million and a working capital deficiency amounting to approximately NIS 399 million. The construction of the apartment hotels Almog and Pnina (which represent the principal properties of Hof Hacarmel) is primarily financed by a bank as part of financial support agreements, the balance of credit of which at balance sheet date totals approximately NIS 373 million, as well as by long and short-term credit available from related parties the balance of which at balance sheet date totals approximately NIS 36 million (the share of Delek Real Estate is approximately NIS 10 million).

   In their opinion on the financial statements as at December 31, 2006, the auditors of Hof Hacarmel draw attention to the fact that the continuing business operations of Hof Hacarmel are dependent upon continuing credit provided by external entities, mainly by banks. It is the estimate of the management of Hof Hacarmel which is based, among other things, on the financial support agreements with the said bank and on a perpetual guarantee provided by the shareholders in favor of said bank, that Hof Hacarmel will be able to fulfill its obligations and to continue its operations.

   Delek Real Estate is conducting negotiations with the shareholders of Hof Hacarmel and the bank, pursuant to which Delek Real Estate will acquire the outstanding shares of Hof Hacarmel, while revoking all the guarantees granted to the bank. These negotiations are still ongoing as at the date of approval of the financial statements.

   As for guarantees that Delek Real Estate provided to Hof Hacarmel, see Note 25b(3).

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

10. In the course of 2006, a Delek Real Estate consolidated subsidiary acquired – through associated companies (in which the holdings amount to 40%-45%) – income-generating assets that are leased for extended periods, in Germany, Finland, Switzerland and Canada. The scope of asset purchases effected by the associated companies amounted to approximately NIS 2.7 billion. Asset purchases were financed primarily using non-recourse loans from banking corporations and via shareholders' loans (Delek Real Estate's portion being approximately NIS 201 million).

11. In 2006, a foreign subsidiary of Delek Real Estate signed an agreement for the acquisition of 90% of the shares of foreign companies that own 73 income-generating assets that include convenience stores and fuel stations throughout Finland, that are leased under long-term contracts. A foreign subsidiary also completed the acquisition of 80% of the shares of a foreign company with income-generating real estate holdings in Berlin that are leased for the long term.

    The assets were acquired in consideration of 117 million euro (approx. NIS 631 million). The acquisition of the assets was financed primarily by a non-recourse loan from banks.

    The financial statements of the said foreign companies were consolidated for the first time in the Group's 2006 financial statements. The following is a summary from the financial statements of these companies, as they appeared in the consolidated financial statements:

	December 31, 2006
	NIS Millions, Reported
Total assets	881
Total liabilities	802

	For the period from the date of acquisition to balance sheet date
	NIS Millions, Reported
Revenues	10
Net Income	4

Furthermore, subsequent to the balance sheet date, the acquisition was completed of 90% of the share capital of an additional foreign company that holds an additional office building in Germany, in consideration of 26 million euro (approx. NIS 147 million).

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

12. In 2006, a foreign subsidiary of Delek Real Estate sold two associated companies that hold income-generating assets in Sweden and in Germany, in consideration of a total of NIS 990 million. The proceeds of the sale reflect the value of assets as they were included in the financial statements of the associated companies at the date of the sale (subsequent to valuation).

13. Delek Real Estate is conducting advanced negotiations with Azorim with the intention of merging/selling Dankner Investments Ltd. (a wholly-owned Delek Real Estate subsidiary) to Azorim. The income-generating assets in Israel, the construction operations in Central Europe and the project for the construction of the second cargo terminal at Ben Gurion International Airport will not be merged and will be transferred to the ownership of Delek Real Estate. Based on the negotiations, the value of Dankner Investments, in addition to additional projects that will be transferred to Azorim, amounts to $95 million. In consideration of its holdings in Dankner and the projects that shall be transferred from the company as stated above, Delek Real Estate will receive shares in Azorim plus a cash sum.

    The transaction was approved by the respective Board of Directors of Dankner Investments and Azorim. Delek Real Estate undertook not to deal in residential construction in Israel subsequent to the completion of the transaction.

14. Foreign subsidiaries of a consolidated subsidiary of Delek Real Estate intend to acquire – jointly with others (the subsidiaries' share = 17%) – rights in a foreign company that has entered into a agreement with Royal Bank of Scotland (RBS) for the acquisition of all the RBS holdings in the share capital of companies that own 47 hotels located throughout the UK (hereinafter: "Marriott Hotels"). The hotels are managed by the Marriott Chain under a 30-year agreement with an extension option for Marriott for an additional 10 years.

    The cost of the hotels is 1.07 billion GBP (approx. NIS 8.8 billion). The shareholders' equity that will be required for the transaction is 0.2 billion GBP (approx. NIS 1.7 billion). In order to finance the transaction, RBS has approved a loan of 0.86 billion (NIS 7.1 billion) to the investors, for a period of seven years, with a fixed interest rate. As at December 31, 2006, a sum of NIS 78 million was paid as an advance, on account of the said investment.
    The transaction is scheduled for closing within the next several months.

15. On March 1, 2007, a foreign subsidiary of a consolidated subsidiary entered into an agreement for the acquisition of all the share capital of a British company that holds 29 Motorway Service Areas in the UK, under the RoadChef brand. These include filling stations operated by the acquired company, 15 hotels, restaurants and stores.

    The closing of the transaction is contingent upon several conditions that the sellers must meet by the closing date. The price that will be paid for the shares (including related expenses) is estimated at 177 million GBP.

    At the signing date of the said agreement, Delek Real Estate entered into an agreement with Delek Petroleum Ltd. (wholly owned by the Group) pursuant to which, subject to receiving the approval of third parties, Delek Petroleum would acquire from the sellers 25% of the shares upon closing.

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

16. On March 18, 2007, a consolidated subsidiary of Delek Real Estate entered into partnership with additional parties in an investment fund for hotel ventures in Europe (hereinafter: "The Fund"). The Fund intends to acquire hotels in various cities in Europe, that will be managed by the Fattal Europe Hotels Chain.

    The total equity that will be invested by the partners in the Fund is 100 million euro. The remaining financing of the acquisition of the hotels will be made using non-recourse bank loans. The Fund's life span will be 7-10 years. The share of the Delek Real Estate consolidated subsidiary in the Fund partnership will be 21% and its investment therein is expected to total 21.33 million euro.

B. Fuel and Refinery Activities in The USA

1. In May 2006, a consolidated subsidiary in the USA, Delek US Holdings Inc. (hereinafter: "Delek US") conducted an IPO on the New York Stock Exchange, within whose framework Delek US issued 11,500,000 shares at a price of $16 per share.

    Following the offering, the Group's holdings in Delek US have decreased to approximately 77.4%. The Group recorded capital gains of NIS 443 million, that were included under the item "Gains from realization of investments in investee companies".

    Following the Delek US IPO, option warrants that were previously granted to the Delek US CEO have now vested and may be exercised into 3.9% of the issued and outstanding share capital of Delek US (post-IPO). In December 2006, the CEO of Delek US exercised part of the options he was granted in consideration of $507.5 thousand (NIS 2,119 thousand). As a result of the exercise of the options, the holding rate of the Delek Group in Delek US has decreased to 77%. The gains recorded by the Group as a result of the exercise of options amounts to immaterial sums.

    In addition, Delek US granted to Delek US employees and directors shares and options exercisable for about 3% of the capital of Delek US, as follows:

    1. 1,652,952 option warrants exercisable for 1,652,952 Delek US ordinary shares. Out of these option warrants, some 75% are exercisable at an exercise price of $16-18 per option warrant, and the vesting period is of 3-5 years. The remaining option warrants are exercisable at an exercise price of $21-25 per option warrant, vesting 4 years from the grant date. The term of the above option warrants is 10 years.

    Of these option warrants, 28,000 option warrants have been allocated to the Group CEO, who also serves as a director in Delek US, with an exercise price of $17.64 per option warrant. The options will vest within four years of their issue (December 2006).

    Furthermore, subsequent to the balance sheet date, in January 2007, Delek US allocated 28,000 options, which may be exercised into 28,000 Ordinary shares of Delek US, to the Group's Chairman, who also serves as a Director of Delek US. The exercise price is $16 per option. The options will vest within four years of their issue.

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

2. 71,500 restricted shares allocated to directors, valuated as of the issue date at $15.15 per share. The vesting period for restricted share is 4 years from the public offering date of Delek US.

The financial value of the shares and option warrants granted as part of the issue amounts to $9 million, and is charged to the income statement over the vesting period.

In the event that all the options issued by Delek US are exercised, the Group's holdings in Delek US are expected to decrease to 72%.

2. In July 2006, Delek US closed a transaction for the acquisition of ownership and leasehold rights to 43 gas stations and convenience stores in Georgia and Tennessee, in the USA, in consideration of NIS 230 million (approx. $51 million).

The cost of the acquisition will be carried to the assets and liabilities of the acquired operations, as follows:

	NIS Millions, Reported
Fixed Assets	180
Current assets (primarily inventories)	19
Other assets (primarily goodwill)	42
Long-Term Liabilities	(11)
	230

3. In August 2006, Delek US completed a transaction for the acquisition of various oil refinery and fuel marketing assets from a third party, in consideration of NIS 248 million (approx. $56 million), The acquired assets include terminals for the marketing of fuel products, transport pipelines, tanks for the storage of fuel products and various refinery facilities. As part of the acquisition, Delek US also acquired the fuel product marketing, supply and distribution operations of the third party.

The cost of the acquisition will be carried to the assets and liabilities of the acquired operations, as follows:

	NIS Millions, Reported
Fixed Assets	154
Inventories	3
Long-term agreement for fuel purchasing	54
Goodwill	46
Long-Term Liabilities	(9)
	248

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

4. Subsequent to the balance sheet date, in February 2007, a wholly-owned subsidiary of Delek US signed an agreement for the acquisition of 107 gas stations with convenience stores in return for $65 million (excluding inventories). The gasoline and convenience stores are located in the area of eastern Tennessee and Georgia, and operate under the brand name "Favorite Markets". Completion of the transaction is subject to preconditions.

C. Fuel Sector Operations in Israel

In July 2005, as part of the approval of the employment conditions of the new CEO of Delek - The Israel Fuel Corporation Ltd. (hereinafter: "Delek"), Delek's Board of Directors approved, among other things, the granting of stock options representing 5% of the issued and outstanding share capital of Delek, at no consideration, to the CEO of Delek. The CEO of Delek is entitled to exercise the options over a period of 5 years from the date of commencement of employment, at terms and exercise price as determined in a detailed agreement to be signed by the parties. The terms of the option were not yet formulated as at the date of approval of the financial statements.

D. Operations in the Automobile and Spare Parts Sector

1. In January 2006, Delek Automotive Systems (hereinafter: "DAS") allocated 9,000,000 ordinary shares of NIS 1 par value each, to the CEO of DAS, in return for NIS 255 million (after deducting issuing expenses). Approximately half of the said proceeds were allocated to the DAS shareholders' equity on the issue date, while the second half was recorded under liabilities, in light of the option granted to DAS and/or the DAS CEO to acquire (sell) the DAS CEO's blocked shares in the event of termination of employment, and will be allocated to shareholders' equity in line with the liberation of the blocked shares. The DAS CEO assumed two bank loans for the purpose of acquiring the shares: The first for financing the unblocked shares and the second for financing the blocked shares, each in the sum of NIS 120 million. (The said loans were assumed in Japanese yen, euro and US dollars and carry interest). In order to secure the repayment of half of the loan for the acquisition of the restricted shares, the parent company - Delek Investments and Properties Ltd. – made available a limited guarantee in the sum of NIS 60 million, while the DAS CEO made available NIS 60 million in collateral to the bank.

   A first-degree lien was placed on all the shares in the benefit of the bank. The blocked shares also have a second-degree lien in favor of Delek Investments.

   The benefit that is inherent in the guarantee granted by Delek Investments to the DAS CEO, as described above, is estimated at NIS 2 million (approximately NIS 1.5 million, taking into account the blockage component).
   The said benefit (net of the blockage component) will be recorded as an expenditure in the statement of income over the period of the blockage, while recording a parallel increase in minority interests.

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

Subsequent to the issuance of shares, the Group's holding percentage in DAS has decreased to approximately 55%. The overall gains to the Group as a result of the said issuance total NIS 112 million, of which NIS 59 million were recorded to the statement of income in the first quarter of 2006, under the item "Gains from realization of investments in investee companies". The remaining gains are recognized and adjusted over the lock-up period, in consideration, inter alia, of the current earnings of DAS, the liberation of the blocked shares and the non-exercise of the Delek Investments guarantee by the bank.

2. In April 2006, a sum of 2,720,000 option warrants were granted free of charge to the employees of Delek Motors Ltd. (a DAS subsidiary). These may be exercised into 2,720,000 ordinary shares of DAS, each of NIS 1 par value. The eligibility to exercise the options will be realized in four tranches, starting April 10, 2008.

   According to a valuation obtained by DAS, the fair value of all the options granted pursuant to the plan, as at the date of the grant, amounts to NIS 17 million and was allocated to the statements of income over the period of eligibility.

   In the event that the said options are exercised, the Group's holding rate in DAS will decrease to approximately 54%.

E. Operations in the Telecommunications Sector

In May 2006, Matav – Cable Communications Systems (hereinafter: "Matav"), 40% of which are held by the Group, signed an agreement with Golden Channels Group and the banks that hold the Tevel shares, pursuant to which the operations of all the CATV companies (Golden Channels, Tevel and Matav) will be merged in the CATV sector and in landline communication services (hereinafter: "The Transaction").

On December 31, 2006, the cable companies' merger transaction (hereinafter: "the Merger"), under which Matav purchased all of the operations of the other parties to the transaction, was concluded.

As part of the acquisition, Matav has allocated shares to shareholders and rights owners in the cable companies whose operations and assets were transferred to Matav. Furthermore, consequently to completion of the merger transaction, decisions approved by the general meeting of Matav have become effective, whereby Matav was renamed HOT Cable Media Systems Ltd. (hereinafter: "HOT"), and Matav's articles were amended so as to reflect the change of name as well as the new structure of the board of directors. Following the allocation, Delek Investments holds some 16% of HOT shares, and this investment is presented using the book value method. The said placement generated neither gains nor losses to the Company.

Furthermore, as part of the conclusion of the Merger, a right of first refusal agreement came into effect between the four large banks and the principal shareholders of the merged company HOT, regarding the sale of shares that each of the parties to the right of first refusal agreement shall hold, immediately after conclusion of the Merger, and which shall be in force for five years following the date of conclusion of the Merger.

F. Operations in the Biochemicals Sector

1. In 2005, a subsidiary, Gadot Biochemical Industries Ltd. (hereinafter: "Gadot"), completed a public issuance of shares and convertible debentures (series A) on the Tel Aviv Stock Exchange.

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

Subsequent to the issuance, as stated above, the Group's holding rate in Gadot decreased to approximately 64% (on a fully diluted basis after exercise of debentures and stock options granted to Gadot employees, the holding rate is expected to decrease to about 55%). As a result of this issuance, the Group derived gains totaling approximately NIS 10 million which were included in "Gains from sale of investments in investees and other companies".

2. Gadot deals primarily in the manufacture of Fructose that serves as a raw material in the manufacture of premium sweeteners, as well as citric acid and citric-acid salts (derivatives of citric acid) for the food, pharmaceutical and detergents industries. After discussions in the European market forums over 2004-2005, resolutions were taken subsequent to the balance sheet date, regarding changes in the Sugar Regime, and as of July 1, 2006 changes in the Sugar Regime will go into effect, bringing about in the end a reduction in the amount of sugar produced in Europe and a significant fall in the market price of sugar in Europe. In this capacity, it was determined that sugar prices will decrease by 36% in the years 2008-2009, along with a resolution to sharply decrease the export quotas for sugar from Europe that are eligible for subsidies, leading to their complete cancellation by 2010, a reduction in sugar manufacturing quotas in Europe and more. The new format of the Sugar Regime will be effective until 2014-2015. The said changes may significantly affect sugar prices in Europe and consequently – also fructose prices. Consequently, the said changes may have a significant adverse effect on Gadot's business.

3. In September and December 2006, Gadot signed framework agreements with Tate & Lyle Investments Limited (hereinafter: "T&L") for the establishment of a joint venture for the construction of a raw sugar refinery plant. (hereinafter: "the Agreement"). The joint venture will be made through Tate & Lyle Gadot Manufacturing Ltd. (hereinafter: "Talgam"), that will be held by Gadot (35%) and T&L (65%). The cost of establishing the plant is estimated at $18 million. The plant construction will be financed by loans from the Talgam shareholders and by bank loans. Gadot's share in the shareholder loans amounts to $2,328 thousand (approx. NIS 9.8 million). Gadot will also make available to Talgam a guarantee for obtaining bank financing. As at December 31, 2006, the said guarantee has yet to be forwarded.

4. Subsequent to the balance sheet date, on March 23, 2007, a contract was signed between Gadot and a Chinese partner to create a joint venture in China which is to create and operate a plant producing citric acid and citric acid salts. The joint venture will be based on a company to be incorporated in China, and will be owned by the Company (51%) and the Chinese partner (49%).

   The total anticipated investment in construction and operation of the plant is $30 million, with up to $12 million financed by shareholders' equity provided by the parties, and the balance by bank financing.

   The above agreement is subject to approval by Chinese authorities. Should the aforementioned approval not be obtained within 3 months from March 16, 2007 or should the Chinese authorities demand changes to the agreement which are not acceptable to one or more parties, then any party may terminate the agreement, rendering it null and void.

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

G. Operations in the Insurance Sector

1. In April 2006, Delek Investments exercised an option it was granted for the acquisition of an additional 5% of the issued and outstanding share capital of Menora Insurance Company Ltd. (hereinafter: "Menora") in return for $23.3 million (approx. NIS 107 million). Subsequent to the exercise of the said option, Delek Investments holds 14.4% of the issued and outstanding share capital of Menora.

   Subsequent to the balance sheet date, in January and February 2007 and in light of the demand of the Anti-Trust Supervisor (see also Section 2, below), Delek Investments has sold approximately 12.2% of the Menora shares to a third party, in return for a total of NIS 392 million. As a result of the said sale, Delek Investments' share in Menora has dropped to 2.2%. The gains recorded by Delek Investments as a result of the above sales amounted to approximately NIS 142 million (before taxes) and will be included in the Group's results of operation in the first quarter of 2007.

2. In December 2005, Delek Investments acquired approximately 25% of the issued and outstanding share capital of Phoenix Holdings Ltd. (hereinafter: "The Phoenix") in consideration of NIS 720 million. Moreover, in June 2006, Delek Investments exercised its option to acquire an additional 8% of the issued and outstanding share capital of Phoenix in return for NIS 213 million.

   Furthermore, on November 17, 2006, a Delek Investments subsidiary, Delek Capital Ltd. (hereinafter: "Delek Capital" - see also Section 4 below), finalized an agreement for the acquisition of an additional 28.5% of the issued and outstanding share capital of Phoenix in consideration of $214 million (approx. NIS 940 million, including transaction costs). Following the closing of the transaction, the Group holds approximately 61.5% of the issued and outstanding Phoenix share capital.

   As part of the approval of the Phoenix acquisition transaction by the Anti-Trust Supervisor, it was determined that by May 13, 2008, Delek Investments would sell part of its holdings in Menora, so as not to hold more than 5% of its issued and outstanding share capital (see also Section 1, above).

   Furthermore, as part of the authorization of the transaction that was obtained from the Insurance Supervisor (hereinafter: "The Authorization"), Delek Investments undertook to supplement the shareholders' equity of Phoenix Insurance Company Ltd. (a consolidated subsidiary of Phoenix, hereinafter: "Phoenix Insurance") and that of additional institutional bodies held by Phoenix, to the sum stipulated in the Insurance Supervision Regulations and in the Law for the Supervision of Financial Services. Regarding Phoenix Insurance, the sum of the said liability will be the lowest of 50% of the equity required by the regulations, or the sum of NIS 557 million. The liability for the supplemental equity will be implemented only in the event that the equity of the relevant bodies is negative. The authorization also stipulates certain restrictions on the transfer of control over Phoenix and the Group, as well as restrictions on the distribution of dividends by Phoenix (see also Note 38i).

   Excess of cost of investment over the book value created in the three said acquisitions amounted to NIS 962 million.

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

In accordance with Accounting Standard No. 20 (Revised) and on the basis of an external appraiser's report, this excess of cost was attributed to the Phoenix assets and liabilities as follows (net of tax influence):

	NIS Millions, Reported	Amortization Period
Reserve for extraordinary risks in life insurance	104	In parallel to utilizing the reserve for extraordinary risks
Outstanding value of the existing life insurance portfolio	360	15 years
Existing general insurance portfolio	26	In parallel to releasing the accumulated sum to the statement of income (approx. 3 years).
Balance of the existing life insurance portfolio	23	Approx. 3-7 years.
Investments in associated company, real estate assets and others	66	In parallel to realization of investments (approx. NIS 10 million were amortized in the second quarter of 2006 following the realization of real estate investments)
Goodwill	383	
	962	

Proforma consolidtaed statements of income that were formulated subsequent to the closing of the said transactions, are presented in Note 39.

3. In December 2006, Phoenix allocated 20,500,000 ordinary shares, each of NIS 1 par value and 6,000,000 option warrants to institutional investors in total consideration of NIS 374 million. As a result of the allocation of shares, the Group's holding percentage in Phoenix has decreased to 55.5% of the Phoenix issued and outstanding share capital. The gains generated for the Group as a result of this decrease in the holding percentage amounted to NIS 10 million and were included in the statement of income as "Gains from realization of investments in investee companies".

4. Delek Capital was incorporated in the second quarter of 2006. A 94% stake in Delek Capital is held by Delek Investments, 5% by the CEO of Delek Capital and 1% by the Group's CEO. Delek capital was formed in order to deal in finance and insurance – in Israel and internationally.

   In August 2006, Delek Capital – operating through a wholly-owned American subsidiary – entered into an agreement for the acquisition of all the shares of Republic Companies Group Inc. (hereinafter: "Republic"), in consideration of a total of $290 million (approx. NIS 1,248 million). Republic is a company dealing in general insurance, whose shares (prior to the merger) were publicly traded in the United States.

   In December 2006, the merger transaction was finalized.

   Excess of cost of investment over the book value of this acquisition amounted to US$ 110 million (approx. NIS 466 million).

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

In accordance with Accounting Standard No. 20 (Revised), the excess of cost of acquisition was attributed to the Republic assets and liabilities as follows (net of tax influence):

	NIS Millions, Reported	Amortization Period
Fixed Assets	(17)	According to depreciation rate
Investment in affiliate	(42)	In parallel to realization of investment
Intangible assets with a definite useful life span	15	Average of approx. 7 years
Tax reserve	(23)	
Intangible assets with an indefinite useful life span	48	
Goodwill	485	
	466	

5. As a result of the finalization of the transactions for the acquisition of Phoenix and Republic shares in November and December 2006, as mentioned above, the financial statements of these companies are consolidated within the Group's financial statements as of December 31, 2006. For details regarding the assets and liabilities included in the financial statements as a result of the initial consolidation, see "Insurance Business assets and liabilities" item in the balance sheet, as well as Note 38 below. The Group's share in the financial results of these companies – through to the consolidation date – were included according to the equity method.

6. In December 2006, several senior managers at Republic were granted options that may be converted into Republic shares over a period of five years, in consideration of an exercise price that varies over the period of vesting, as stipulated in the terms of the options. A plan for the allocation of blocked shares was also approved (representing 1.15% of the Republic share capital). These shares will be unblocked in two tranches over a period of four years, subject to variables associated with the Republic results. The managers were granted the option and blocked shares to sell the shares to Republic subsequent to the various lockup periods, as stipulated in the option and blocked shares terms – as long as Republic remains a privately-held company. As at December 31, 2006, the fair value of the blocked shares and the options amounted to $4 million, that will be carried to the statement of income over the period of eligibility. In the event that all the option warrants are exercised and the all the blocked shares granted to the Republic executives are liberated, the Group's holding rate in Republic is expected to decrease to 97%.

7. In February 2007, Delek Capital signed an agreement with Barak Capital Ltd. (hereinafter: "Barak Capital") (hereinafter: "the Option Agreement"), pursuant to which Delek Capital shall be entitled to purchase shares in Barak Capital during a period of six months, in consideration for payment of the sum of approximately NIS 24 million and the provision of shareholders' loans, on conditions as agreed in the option agreement, such that if and when such sale is concluded, Delek Capital shall hold up to 49.9% of the issued and paid-up capital of Barak Capital. Barak Capital deals in financial operations which include, mainly, trading in securities.

8. As to investments in affiliates in the insurance sector – See Note 38a(5).

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

H. Operations in Other Sectors

1. An agreement regarding delivery of electricity to the desalination facility in Ashkelon

On August 5, 2002, Delek Investments established an indirectly wholly owned subsidiary called IPP Delek Ashkelon Ltd. (hereinafter: "Delek Ashkelon"), which deals in the construction of an electric power generation facility to provide electricity to the desalination plant in Ashkelon (as part of the BOT agreements with VID and the State) and to others. At the end of the contractual period, the electricity facility will be transferred to the State.

The date of activation of the power station shall only occur upon completion of land-based pipelines for the transportation of natural gas to Ashkelon by the government gas company Natural Gas Lines Israel Ltd. (hereinafter: "Gas Lines"). As at the date of approval of the financial statements, the construction of the said gas lines was completed, although no approval was received for its operation. At this stage, such an approval is expected to be obtained in the course of the fourth quarter of 2007, although this date is uncertain.

In December 2006, Delek Ashkelon signed an agreement for the transportation of gas with Gas Lines, in return for transportation fees as outlined in the agreement.

With the completion of the mechanical establishment of the power station (August 2005) and until the arrival of the natural gas in Ashkelon via the national transportation network, the power station is being maintained by the construction contractor, in accordance with an agreement between the contractor and Delek Ashkelon, pursuant to an applicable maintenance program. With the completion of the construction, Delek Ashkelon is no longer capitalizing credit costs to the asset construction costs.

At this stage, Delek Ashkelon provides electricity to VID using the national power grid and the transformation station that was built on-site.

Delek Ashkelon has reached a settlement with Israel Electric Company (IEC) whereby IEC paid a sum of $8 million (approx. NIS 38 million) as compensation for the failure to transport natural gas to Ashkelon. In parallel, Delek Ashkelon undertook that until the time that the gas reaches Ashkelon, it shall purchase from IEC all the electricity that it requires and that Delek Ashkelon shall release IEC from any claim or demand in connection with the relocation of the entry point of gas from Ashkelon to Ashdod.

The Group consequently recorded revenues of NIS 32 million in 2006 in its statement of income, equal to the level of operating loss accrued by Delek Ashkelon as of the commencement date of the supply of electricity to VID. The remaining compensation of NIS 6 million will be carried to the statement of income in 2007, in parallel to the operating loss that will be recorded by Delek Ashkelon as a result of the delay in the arrival of natural gas.

Despite having received all the compensation sums and special fees as detailed above, at this stage it is impossible to determine the scope of the additional cost that Delek Ashkelon will incur on account of the delay in the arrival of the natural gas, since it is currently impossible to determine with certainty the date when the provision of natural gas will begin to the power station, through the national transportation network.

NOTE 9: - INVESTMENTS IN INVESTEES AND OTHER COMPANIES (CONT'D)

2. In September 2006, an investee company (50%) of IDE Technologies Ltd. secured a tender published by the Government of Israel for the design, financing, construction, operation and maintenance – under the BOT method – of a seawater desalination plant in the Hadera region, with a capacity of 100 million cubic meters per annum.

3. Subsequent to the balance sheet date, in February 2007, Delek Investments acquired approximately 3.5% of the issued and outstanding share capital of Oil Refineries Ltd. ("ORL"), in consideration of NIS 235 million. The ORL shares are publicly traded on the Tel Aviv Stock Exchange.

I. As for claims against investees, see Note 25a.

J. The list of the Group's principal investee companies and partnerships is presented in an appendix to the financial statements.

K. As for liens, see Note 26.

NOTE 10: - REAL ESTATE FOR RENT

A. Composition:

	NIS Millions, Reported
Consolidated	
Cost	
Balance as at January 1, 2006	2,604
Adjustment on account of translation of financial statements of foreign investees	(98)
Additions during the year	154
Additions for companies consolidated for the first time	892
Balance as at December 31, 2006	3,552
Accumulated Depreciation	
Balance as at January 1, 2006	269
Adjustment on account of translation of financial statements of foreign investees	(9)
Additions during the year	45
Balance as at December 31, 2006	305
Depreciated cost as at December 31, 2006	3,247
Provision for impairment, net	17
Balance of depreciated cost as at December 31, 2006	3,230
Balance of depreciated cost as at December 31, 2006	2,316
Annual depreciation rates	1%-4% (mainly 1%-2%)

(1) Most of the other land is either freehold land or land leased for generations.
(2) Capitalized borrowing costs:

Consolidated	
December 31	
2006	2005
NIS Millions, Reported	
12	12

(3) As for liens, see Note 26.

NOTE 11: - LAND FOR CONSTRUCTION

The balance represents land reserves and residential construction projects whose construction has yet to begin, in various areas of the country. Some of the projects are in collaboration with third parties, partially as combination projects.

As to negotiations regarding the sale of the residential real estate operations in Israel – see Note 9(j)a(13).

NOTE 12: - LOANS, DEPOSITS AND LONG-TERM RECEIVABLES

A. Composition:

	Weighted annual interest rate	Consolidated December 31	
		2006	2005
	% (1)	NIS Millions, Reported	
Financial asset in Cypriot pounds (2)	6.2	66	76
Loans (3)			
Linked to the Consumer Price Index (5)	5.6	132	168
Linked to the U.S. dollar	3.5	9	6
Convertible loan (7)	6.3	205	-
Unlinked	-	6	7
		352	181
		418	257
Less – current maturities		47	84
		371	173
Loan to Fuel Administration (6)		186	(* 216
Long-term trade receivables		66	64
Restricted deposits (4)	4.7	162	141
Others		118	51
		903	645

(* Reclassified, see Section 6, below.

(1) As at December 31, 2006.
(2) See Note 2R(6).
(3) Including loans of NIS 76 million provided to owners of gas stations and to other Delek Israel customers.
(4) Primarily on account of the issuing of debentures.
(5) As at December 31, 2006, includes approximately NIS 13 million to related parties, see also Notes 36f and 36g.(6) The balance is on account of fuel inventories acquired by Delek Israel on behalf of the Fuel Administration. Delek Israel's management decided that due to the nature and financial indicators of Delek's engagement with the Fuel Administration regarding the defense inventory balances, the debt of the Fuel Administration as regards this inventory will be presented as part of the long-term receivables. In light of the above, the comparison figures relating to this debt have been reclassified. The debt is linked to the dollar exchange rate and carries interest at Libor + 0.75%. Its repayment date has yet to be determined.
(7) An agreement was signed in October 2006, between Delek Real Estate and Vitanya Ltd. (hereinafter: "Vitanya") and its shareholders, pursuant to which Delek Real Estate made available to Vitanya a loan of $48 million (approx. NIS 205 million), convertible into 50% of the Vitanya shares in the course of ten years from the date granted. Under certain conditions, the Vitanya shareholders may obligate Delek Real Estate to convert the loan into Vitanya shares. Vitanya deals primarily in income-generating real estate holdings in Tel Aviv and Herzlia.

NOTE 12: -LOANS, DEPOSITS AND LONG-TERM RECEIVABLES (CONT'D)

The loan carries interest at US$ Libor + 1%. In the event that the loan is not converted into shares within ten years, then Vitanya shall repay the loan, plus interest accrued thereupon, net of an agreed-upon sum equal to the difference between the accrued interest on the loan and an interest rate equal to Libor less 1.5% on account of years four through seven.

The loan is secured by a lien on half the Vitanya shares held by the current shareholders.

According to the agreement, the parties undertook that certain income-generating real estate development projects will first be offered to Vitanya.

B. Repayment dates:

	Consolidated
	December 31 2006
	NIS Millions, Reported
First year – current maturities	47
Second year	41
Third year	35
Fourth year	34
Fifth year	25
Sixth year and thereafter	220
To be determined	16
	418

C. Details of the loans by the balances of the borrowers as at December 31, 2006:

Balance of borrower loans in NIS millions	No. of Loans	Total NIS Millions, Reported
Up to 1	41	11
From 1 to 5	24	55
From 5 to 10	3	18
Above 10	4	334
	72	418

D. As for liens, see Note 26.

NOTE 13: -INVESTMENTS IN OIL AND GAS EXPLORATION

A. Investments in Oil and Gas Exploration

Delek Investments and Delek Energy Systems Ltd. ("DES") hold the Yam Tethys venture through Delek Drilling Limited Partnership and Avner Oil Exploration – Limited Partnership ("Avner"). Delek Investments also holds the Yam Tethys venture directly. The investments in Avner appear in the financial statements by the equity method and their balance as at December 31, 2006 and 2005 amounts to NIS 331 million and NIS 326 million, respectively.

NOTE 13: -INVESTMENTS IN OIL AND GAS EXPLORATION (CONTD.)

The financial figures in the financial statements of the Yam Tethys joint venture, that serve Delek Investments and DES in the preparation of their financial statements are based on documents and accounting information conveyed to the joint venture by the American operator of the joint venture ("Noble Energy").

Composition:

	Consolidated	
	December 31	
	2006	2005
	NIS Millions, Reported	
Cost of assets in Yam Tethys joint venture (1)	903	863
Less - accumulated amortization (2)	145	80
	758	783
Cost of assets in Vietnam joint venture (Section F, below)	92	11
Cost of acquiring rights in gas and oil assets in joint ventures in the USA	121	-
Less - accumulated amortization	2	-
	119	-
	969	794

(1) The cost of the assets of the Yam Tethys joint venture includes mainly capitalized drilling expenses and costs relating to the production and transmission array, as well as attributed surplus costs.

(2) The assets are depreciated to operations based on the relation of the volume of production to total proved reserves, as estimated by an expert (see Note 2P).

B. Marine drilling in the Yam Tethys project

During the years 1999-2001, the Yam Tethys joint venture performed several marine drillings at the Noa site (Noa and Noa South I) and at the Ashkelon site (Mary I, Mary II and Mary III) where gas in commercial quantities was discovered. In 2003, the establishment of a production facility over the Mary gas area and laying the underwater pipe to Ashdod shore were completed. It should be noted that the connection of the Noa reserve to the said production facility involves a considerable financial investment. The transmission of natural gas to the Eshkol power station in Ashdod from the Mary gas reserve, commenced on February 18, 2004, according to the agreement signed with the Israel Electric Corporation Ltd. ("the IEC"). For additional details regarding engagements for the delivery of natural gas, see Section d(2), below.

NOTE 13: -INVESTMENTS IN OIL AND GAS EXPLORATION (CONTD.)

C. Gas Reserve Quantities

According to an assessment of an independent foreign company, the proved gas reserves at the Mary and Noa wells as of March 2001 were 32.7 BCM (of which about 26.5 BCM at Mary well and the remainder at Noa well).

The Mary gas reserves are inspected once a year by an independent foreign company. According to estimates obtained for the years 2004-2006, a decrease of 0.8 BCM was recorded in the proven gas reserves in relation to the original estimate. Following the sale of gas in the years 2004-2006 as a total quantity of 5.2 BCM and the updated evaluation of the reserves as mentioned above, the proven gas reserves as at December 31, 2006, at the Mary and Noa reserves total 26.7 BCM.

D. Engagements for delivery of natural gas

1. Agreement with the Israel Electric Corporation for delivery of natural gas

On June 25, 2002, the partners of Yam Tethys group and the Israel Electric Corporation Ltd. ("IEC") signed an agreement for the delivery of natural gas to the IEC ("the agreement").

According to the terms of the agreement, Yam Tethys group shall provide natural gas to the IEC for a period of 11 years or until such point as it has supplied IEC approximately 18 BCM of natural gas. According to the terms outlined in the agreement.

The monetary scope of the transaction (for all partners) is estimated at approximately $ 1.5 billion. The effective revenues of Yam Tethys group will be the outcome of several conditions, mainly world market prices of fuel, delivery terms and pace of establishing the inland natural gas transmission array, actual quantity taken by the IEC etc. and they might be significantly lower compared to the above estimates. According to the agreement, the gas price was determined in U.S. dollars per basic transmission unit (BTU) and it is linked to the basket of fuel and to the American Producer Price Index based on the mechanism fixed in the agreement with a maximal and minimal price (see also Note 37e regarding a transaction signed for the fixation of the price for gas).
On February 18, 2004, the joint venture for delivery of natural gas to the facilities of the IEC in Eshkol Ashdod power station began.

During the reported period, the partners in the Yam Tethys project entered into a supplementary agreement with Israel Electric Company (hereinafter: “IEC”), pursuant to which IEC was granted an option to acquire additional quantities of natural gas. The said option will remain valid until the end of 2007 and relates to additional quantities of gas that were acquired starting July 2006. The purchase price of the gas, according to the terms of the supplementary agreement, is higher than the price at which the IEC buys natural gas, according to the original agreement.

2. Additional Agreements

The partners in the Yam Tethys Group possess agreements for the provision of natural gas to several entities (including Delek Ashkelon, Oil Refineries and AIPM) for periods ranging between 5-15 years at a total scope of 3.5 BCM and an estimated financial volume of $320 million. The actual revenues will be affected by a host of conditions, as detailed in the agreements.

NOTE 13: -INVESTMENTS IN OIL AND GAS EXPLORATION (CONTD.)

3. Establishment of inland transmission array for natural gas

The cabinet for social and economy affairs of the Government of Israel approved in its decision principles for financing, building and operating an inland transmission array for natural gas. The principles approved, as above, determined the sections of the array which will be built by the IEC and the conditions for this approval and the establishment of a Government gas company to be responsible for implementing, planning, supervising and building the array and for its operation.

The Government company that was established (Israel Natural Gas Lines Ltd.) commenced its operations for implementing the ground route. The ability of the partners in the Yam Tethys project to sell the gas that they own to other potential consumers and to increase the quantity of gas supplied to the IEC is dependent, among other things, on settling the issue of the establishment of inland transmission array for natural gas. As of the date of preparation of the financial statements, the date for completion and operation of the array cannot be determined with certainty.

E. Royalties to the State and to others

The commissioner in charge of petroleum affairs at the Ministry of National Infrastructures informed the joint venture that the State has decided not to receive in kind the royalties to which it is entitled from gas discoveries but rather to receive the market value of the royalties per well in U.S. dollars.

According to the commissioner's announcement dated July 19, 2004, and a summary of a meeting held with the Commissioner, the method of computing royalties to the State was agreed upon. In accordance with the agreements, royalty payments to the State were included in the financial statements, representing 10.39% of gross sales. The method of computation of royalties, as described above, is also used to compute the market value per well based on the super royalties payable to the Group companies and others.

F. Oil and Gas Exploration Off the Vietnam Shore

Delek Energy (Vietnam) LLC (hereinafter: “Delek Vietnam”) (wholly-owned by DES) owns the rights to a project participating in oil and gas exploration opposite the Vietnam shore (“The Project”). The project includes the oil assets in two adjacent blocks(12W and 12E) covering a total area of 6,900 km^2 (subject to the partners’ agreement to forfeit 25% of the area, in accordance with the agreed-upon work plan with the Vietnamese authorities).

Premier Oil Vietnam Offshore B.V. (hereinafter: “Premier Vietnam”), a Premier Oil subsidiary, is a British company with international oil exploration and production operations, that holds 37.5% of the project and serves as the Project Operator.

It should be stated that according to two Production Sharing contracts relating to blocks 12E and 12W, the National Oil Company of Vietnam is eligible – in the event of a commercial find – within one year of the declaration of the commercial find, to participate in 15% of the projects included in the said blocks, in return for a relative reimbursement of expenses.

During the reported period, the parent company of the project operator (Premier Oil PLC) announced the discovery of oil and gas in several drills at the Dua field. Furthermore, several drills were performed in order to assess the potential of the oil and gas reserves. Moreover, the above-mentioned company announced that production tests were conducted at two reserves. The main target reserve yielded oil at a steady pace of 5,543 barrels per day, in addition to 6.76 million cubic feet of natural gas per day. The project operator will assess the results and prepare an evaluation report regarding the reserves.

NOTE 13: -INVESTMENTS IN OIL AND GAS EXPLORATION (CONTD.)

In addition, during the account year, drilling was effected on the Blackbird prospect, which is approximately 21 km south west of the drilling at the Dua field. This exploration uncovered four oil-bearing strata, which were examined using logs, with oil samples being taken for ongoing evaluation. The parent company of the project operator also gave notice that production testing had been conducted on two strata in which oil was flowing at a cumulative production rate, in both of them, of approximately 6,000 barrels of oil per day. In January 2007, a diagonal exploration was completed, the aim of which was to obtain additional information from the reservoir, and to enable preparation of reports, estimating the size of the gas reserves and evaluating the reservoirs.

According to the project operator's initial evaluations regarding the quantities that can be produced from the Dua and Blackbird oil fields, based on current information, it is most likely that approximately 80 million barrels of oil could be produced from the field, subject to the following. At this stage, this is merely an assessment of the quantities that could be produced, in respect of which there is no certainty, and the assessments might change the more geological and engineering information becomes available and/or as a result of unexpected factors relating to oil and gas exploration. Note that as is common in the area in which the Company operates, there are many risk factors including the investment required for development of the oil fields, which may affect the project and its economic feasibility.

The initial production of oil from the fields is currently planned for 2010.

As mentioned above, the national petroleum company of Vietnam (Petro-Vietnam) possesses the right to purchase 15% of the rights to the project, in return for refund of expenses, and that the Vietnamese government and Petro-Vietnam are entitled to participate in the yields, royalties and taxes on the yields from this project.

G. During the reported period, Delek Energy Systems Ltd., operating through a wholly-owned subsidiary that was incorporated in the United States (hereinafter: "DES USA") entered into an agreement for the acquisition of 83.49% of the rights to a limited registered partnership in the USA named AriesOne Limited Partnership (hereinafter: "AriesOne"), that deals in oil and gas exploration and production.

DES USA paid a sum of NIS 34 million in consideration of the said rights. DES USA also committed to invest a sum of $2 million in performing drillings by AriesOne.

As part of the agreement, DES USA has also assumed the current liabilities (equal to its share in the partnership) on account of hedging transactions on the prices of oil and gas, made by the partnership prior to the acquisition (approx. NIS 80 million). The sum of the acquisition cost that was attributed to investments in oil and gas assets given the said undertaking, amounted to NIS 116 million.

H. An agreement was signed in October 2006, between DES USA and Jay Petroleum LLF, a company owned by Isramco Inc. (hereinafter: "Jay"), of the first part, and McCommons Oil Company (hereinafter: "The Seller"), an American company dealing in the energy sector, of the second part. According to the agreement, DES USA and Jay have each acquired 50% of the right to explore and produce natural gas and/or oil in a certain area in Texas. In return for the said rights, DES USA and Jay have each paid the seller a sum of $1.2 million (approx. NIS 5 million).

NOTE 13: -INVESTMENTS IN OIL AND GAS EXPLORATION (CONTD.)

I. Agreement for the acquisition of rights to produce oil in Guinea-Bissau

In February 2007 an agreement was signed between Delek International Energy Ltd. – a wholly owned subsidiary of DES (hereinafter: "Delek International") and Premier Oil West Africa B.V. (hereinafter: "Premier Africa"). Pursuant to the agreement, Delek International has acquired from Premier Africa 11.43% of the rights to two marine franchises in Guinea Bissau in West Africa. The work plan for these concessions included two drillings at a total cost of $58 million. In return for the said rights, Delek International undertook to cover 22.86% of the drilling expenses, up to a total cost of $29 million per drilling and to cover its relative share (11.43%) of any other project expenses.

During March 2007 the first drilling was conducted (at a cost estimated at $35 million) and it has been decided to abandon it. The share of Delek International in the cost of the drilling is estimated at $7.3 million. The second drilling is scheduled for April 2007, at a budget of $30 million. In the event of a commercial discovery, the national petroleum company of Guinea Bissau is entitled to purchase 30% of the rights in the project.

J. Michal and Matan licenses

Delek Drilling and Avner each hold 15.1% of the Michal and Matan drilling licenses. Under these licenses, the Tamar drilling is expected to be conducted in 2007, being an offshore drilling in deep water west of Haifa, primarily intended for gas targets. The total budget for the project in 2007 is estimated at $71 million.

NOTE 14: -FIXED ASSETS

A. Composition and changes:

	Consolidated				
	Land and Buildings	Machines, facilities & equipment	Vehicles	Office furniture & equipment	Total
	NIS Millions, Reported				
Cost					
Balance as at January 1, 2006	1,683	1,907	65	221	3,876
Additions during the year	207	639	10	31	887
Financial statements adjusted to foreign currency	(82)	(77)	(1)	(3)	(163)
Disposals during year	(3)	(8)	(4)	-	(15)
Balance as at December 31, 2006	1,805	2,461	70	249	4,585
Accumulated Depreciation					
Balance as at January 1, 2006	370	776	44	144	1,334
Additions during the year	61	103	8	12	184
Financial statements adjusted to foreign currency	(9)	(12)	(1)	(2)	(24)
Disposals during year	(2)	(4)	(3)	-	(9)
Balance as at December 31, 2006	420	863	48	154	1,485
Depreciated cost as at December 31, 2006	1,385	1,598	22	95	3,100
Less – Provision for impairment, net	(17)	(6)	-	-	(23)
Balance of depreciated cost as at December 31, 2006	1,368	1,592	22	95	3,077
Balance of depreciated cost as at December 31, 2006	1,296	1,124	21	77	2,518

Capitalized borrowing costs

December 31	
2006	2005
NIS Millions, Reported	
39	32

B. As for liens, see Note 26.

NOTE 15: -OTHER ASSETS AND DEFERRED CHARGES

	Consolidated				
	Goodwill from acquisition of consolidated subsidiaries	Deferred Taxes	Loan recruiting and debenture offering expenses (1)	Prepaid and other expenses	Total
	NIS Millions, Reported				
Cost	700	57	-	137	894
Accrued amortization	134	-	-	19	153
Depreciated cost as at December 31, 2006	566	57	-	118	741
Depreciated cost as at December 31, 2005	521	77	115	34	747

(1) Since January 1, 2006, these expenses are offset from the loan and debenture balances, See Note 2U.

NOTE 16: -SHORT-TERM CREDIT FROM BANKS AND OTHERS

A. Composition:

	Annual interest rate (1)	Consolidated December 31	
		2006	2005
	%	NIS Millions, Reported	
From banks			
In foreign currency:			
In US dollars or linked thereto	5.8	265	277
CAD	5.1	5	96
GBP	6.8	36	-
Yen	1.0	37	2
Euro	5.6	92	2
		435	377
In Israeli Currency:			
Linked to the Consumer Price Index	3.9	6	180
Unlinked	5.6	1,014	1,362
Liabilities in respect of short sale (2)		51	78
		1,071	1,620
From others			
Marketable Securities:			
Unlinked	5.5	671	151
Linked to the U.S. dollar	3.3	13	10
		684	161
Current maturities of debentures convertible into Company shares		4	66
Current maturities of debentures convertible into consolidated company shares		-	-
Current maturities of other debentures		401	654
Current maturities of long-term debt		590	650
		995	1,370
		3,185	3,528

(1) Most of the loans bear interest at a variable rate. The rate presented is a weighted average as at December 31, 2006.
(2) In respect of short sale of marketable securities (referring primarily to short-term loans, and Galil-type Government bonds).

B. At the company – Unlinked commercial securities bearing variable interest equal to the Bank of Israel (BOI) rate plus 0.4%-0.5% (as at December 31, 2006: 4.9%-5%).

C. As for obligations to comply with financial covenants, see Note 19c.

D. Regarding securities (collateral): See Note 26.

NOTE 17: -ACCOUNTS PAYABLE, TRADE

	Consolidated	
	December 31	
	2006	2005
	NIS Millions, Reported	
Primarily open accounts -		
In Foreign Currency or Linked Thereto	1,114	1,267
In Israeli Currency	184	366
	1,298	1,633

NOTE 18: -OTHER ACCOUNTS PAYABLE

	Consolidated	
	December 31	
	2006	2005
	NIS Millions, Reported	
Institutions	224	174
Advanced revenues and expenses to pay	7555	78
Advances from customers	5552	45
Salaries and related expenses *)	5599	86
Dividends and profit to minority at affiliates and partnerships	73	72
Related Parties	-	1
Liabilities on account of derivative transactions	51	-
Oil & gas exploration transactions	49	8
Interest to pay	134	38
Others and accrued expenses	171	132
	908	634

*) As at December 31, 2006, including an amount of approximately NIS 15 million (NIS 19 million in 2005) relating to liabilities of a subsidiary in the U.S. to its employees due to certain privileges given to them (such as medical insurance, sick leave, etc.) and relating to other potential liabilities of the subsidiary. The subsidiary computes the above liabilities in accordance with the prescribed liability limit per each potential type of claim and based on claims filed and estimates as to claims whose cause had occurred but were not yet reported to the subsidiary. Employee privileges in excess of certain limits are secured.

NOTE 19: - LONG-TERM LOANS FROM BANKS AND OTHERS

A. Composition and terms:

	Annual interest rate	Consolidated		The Company	
		December 31		December 31	
	(1)	2006	2005	2006	2005
	%	NIS Millions, Reported			
Bank loans:					
In US dollars or linked thereto	7.1	1,751	1,570	-	-
In GBP	6.7	476	499	-	-
In Canadian dollars	6.3	995	1,044	-	-
In Swiss francs or linked thereto	4.0	44	56	-	-
In euro or linked thereto	5.1	780	-	-	-
Linked to the Consumer Price Index	5.0	995	986	-	-
Unlinked	6.0	273	303	-	-
Liabilities in respect of short sale (2)	6.1	156	162	-	-
		5,470	4,620	-	-
Loans linked to CPI from consolidated subsidiaries	5.5	-	-	237	225
Loans from others – linked to the CPI		-	153	-	-
		5,470	4,773	237	225
Less – current maturities		590	650	-	-
		4,880	4,123	237	225

(1) Most of the loans bear interest at a variable rate. The rate presented is a weighted average as at December 31, 2006.

(2) In respect of short sale of marketable securities (relating primarily to Galil-type Government bonds).

B. Repayment dates:

	Consolidated	The Company
	December 31	
	2006	2006
	NIS Millions, Reported	
First year – current maturities	598	650
Second year	919	775
Third year	722	852
Fourth year	657	225
Fifth year	1,540	426
Sixth year and thereafter	1,034	1,586
To be determined	-	259
	5,470	4,773

NOTE 19: - LONG-TERM LOANS FROM BANKS AND OTHERS (CONT'D)

C. Additional Details

(1) The Company, Delek Investments and Delek Capital have committed, in conjunction with short- and long-term loans from banking corporations, whose balance as at December 31, 2006 amounts to NIS 1,400 million, to the following:

- The Company's tangible shareholders' equity shall not be lower than 35% of the balance sheet total for Delek Group. Furthermore, the Company's tangible shareholders' equity shall not be less than NIS 2,800 million at any time.
- The tangible shareholders' equity of Delek Investments, plus owner's loans, would not be lower than NIS 1,500 million at any time; and the tangible shareholders' equity of Delek Investments, plus long-term owner's loans, would not be lower than 35% of the balance sheet total of Delek Investments at any time. Furthermore, Delek Investments committed that its shareholders' equity would not be lower than NIS 800 million at any time.
- The Company and Delek Investments committed that the ratio of liabilities to tangible shareholders' equity would not exceed 225% for the years 2006-2008 and would not exceed 220% from 2009 onwards.
- The Company and Delek Investments have committed that the total amount of guarantees would not exceed a cumulative total of NIS 1 billion.
- The ratio of dividends and management fees obtained from Group companies to total general and administrative expenses plus financing expenses would not be lower than 2 at any time.

Moreover, under the terms of the credit agreement, the Company is required to comply with certain covenants when distributing dividends exceeding 70% of the annual profit.

As at December 31, 2006, the Group is in compliance with the said covenants.

(2) Delek Israel has granted irrevocable covenants to several banks in Israel (hereinafter: "The Banks"), whereby:

1. Shareholders' equity in the Company's consolidated balance sheet will not fall below NIS 680 million.

2. The Group's operating income shall exceed its financial expenses in respect of non-recourse loans given to the Group companies, plus financial expenses in respect of loans to finance the reserve inventory of fuels and 140% of the other financial expenses of the Company.

If these covenants are not satisfied, the banks may either demand additional collaterals or reduce the amount of loans provided to Delek Israel. The undertaking toward each of the banks is in effect as long as the liabilities to that bank in respect of loans are not below $50 million (in certain banks - the lower of $50 million or 60% of approved obligo).

(3) On account of liabilities toward banks of subsidiaries in the USA in the amount of $266 million (approx. NIS 955 million), it was determined that in the event that the subsidiaries shall fail to comply with certain financial covenants, the banks shall have the right to demand the early repayment of the said loans. As at December 31, 2006, the subsidiaries are complying with the above financial covenants.

NOTE 19: - LONG-TERM LOANS FROM BANKS AND OTHERS (CONT'D)

(4) In connection with loans from banks whose balance as at December 31, 2006 is approximately NIS 501 million, additional subsidiaries have undertaken to maintain certain financial covenants mainly in connection with the amount of their shareholders' equity, the ratio of credit to balance sheet total and the ratio of equity to balance sheet total. As of the date of the financial statements, the subsidiaries are complying with the required financial covenants, as above. Furthermore, some of the companies have undertaken to the banks that as long as the loans are not repaid, the companies may not distribute dividends in excess of a preset percentage of the net income.

D. As for additional collateral, see Note 26.

NOTE 20: -DEBENTURES CONVERTIBLE INTO COMPANY SHARES

Consolidated and The Company

A. The debentures are linked to the CPI and are composed of the following series:

	Nominal Value	Net balance	Net balance	Interest rate	Exercise price In NIS Par Value *)
	As at December 31, 2006	As at December 31, 2006	As at December 31, 2005	As at December 31, 2006	
	NIS Millions	NIS Millions, Reported		%	
Debentures (Series A 2)	-	-	36		
Debentures (Series B 2)	-	-	1		
Debentures (Series E)	12	12	234	5.5	340
		12	271		
Less – current maturities		4	66		
		8	205		

*) Exercise price (after adjustment), as at December 31, 2006, reflects the par value in NIS that is convertible into one ordinary share of the company.

B. As to the conversion of debentures into company shares in the course of 2006 and subsequent to the balance sheet date, see Note 27.

C. Maturity dates as of December 31, 2006:

	Consolidated and The Company
	NIS Millions, Reported
First year – current maturities	4
Second year	4
Third year	4
	12

NOTE 21: - DEBENTURES CONVERTIBLE INTO SHARES OF SUBSIDIARIES (CONSOLIDATED)

A. The debentures are linked to the CPI and were issued at the following companies:

	Nominal Value	Net balance	Net balance	Interest rate	
	As at December 31, 2006	As at December 31, 2006	As at December 31, 2005	As at December 31, 2006	Effective interest rate
	NIS Millions	NIS Millions, Reported		%	%
Delek Real Estate – for conversion into Delek Real Estate shares (1)	210	219	229	6	5.2
Gadot – for conversion into Gadot shares (2)	81	82	86	4.5	5.0
		301	315		

(1) The debentures are scheduled to mature in 4 equal annual installments on the 30th of May of each of the years between 2008 and 2011.

The exercise price per share, through to May 30, 2008 is NIS 29.32 par value, subject to adjustments and for the period between May 31, 2008 and May 15, 2011, it is NIS 33.92 par value.

(2) The debentures are scheduled to mature in two equal annual installments in June of each of the years 2008 and 2009.
The exercise price per share is NIS 58.58 par value, subject to adjustments.

B. As at December 31, 2006, the market value of the debentures in circulation that were issued by Delek Real Estate and by Gadot is equal to NIS 379 million and NIS 82 million, respectively.

C. Maturity dates as of December 31, 2006:

	Consolidated
	NIS Millions, Reported
Second year	96
Third year	96
Fourth year	55
Fifth year	54
	301

NOTE 22: -OTHER DEBENTURES

A. Composition:

	Effective interest rate	Weighted interest rate December 31 2006	Consolidated December 31 2006	Consolidated December 31 2005	The Company December 31 2006	The Company December 31 2005
	%	%	NIS Millions, Reported			
Debentures linked to the CPI:						
Debentures issued by the Company	5.1	5.1	2,444	948	2,444	948
Debentures issued by consolidated subsidiaries *)	5.3	5.8	1,656	1,502	-	-
Debentures linked to the US$, issued by consolidated subsidiaries	6.6	5.7	522	691	-	-
			4,622	3,141	2,444	948
Less – current maturities			401	654	60	62
			4,221	2,487	2,384	886

*) The market value of marketable debentures whose balance as at December 31, 2006 is NIS 760 million, is NIS 800 million.

B. Details regarding debentures issued by the Company in 2006

(1) The Company effected a private placement of debentures (Series K) in the third quarter of 2006, at a par value of NIS 468 million. The debentures are linked to the Israeli CPI and bear annual interest at a rate of 5.4%, payable quarterly. The principal of the debentures is redeemable in one single payment in July 2018.

(2) In November 2006, the Company issued NIS 1.1 billion in debentures (Series L), by private placement. The debentures are linked to the Israeli CPI and bear annual interest at a rate of 5.35%, payable biannually. The principal of the debentures will be repaid in three equal annual installments between the years 2015 and 2017.

C. Details regarding debentures issued by Consolidated Subsidiaries

(1) The outstanding debentures as at December 31, 2006, include a sum of NIS 500 million that was issued in March 2005 by Delek and Avner-Yam Tethys Ltd. ("SPC") to institutional investors in the U.S, at a total scope of $275 million (hereinafter: "the Debentures") in accordance with Rule 144A., of which $175 million with fixed interest of 5.326% per annum and $100 million with variable interest at a rate of Libor for three months plus a margin of 1.1% per annum (6.46% as at December 31, 2006).

The SPC is a special-purpose company that was established for the new financing round by Delek Investments, Delek Drilling - Limited Partnership and Avner Oil Exploration - Limited Partnership (collectively, "the sponsors") based on their pro-rata holdings in the Yam Tethys project.

NOTE 22: -OTHER DEBENTURES (CONT'D)

As collateral for the redemption of the debentures, the sponsors and SPC pledged their rights in several properties among which are Ashkelon drilling and the license to operate the rig, the contract with the IEC, insurance policies, shares of Yam Tethys Ltd. (the owner of a license for the pipeline), the hedge contracts and SPC bank accounts (including, among other things, the revenue account in which the revenues from IEC are deposited, and reserve accounts in which "security cushions" have been deposited, such as for debt servicing and for construction of the entry station).

It is emphasized that the debentures are non-recourse for the sponsors, excluding a recourse right for assets out of the assets pledged as above; It is emphasized that agreements for the sale of gas with other customers and Noa drill are not part of the pledged assets.
Subsequent to the issuance, other Delek Group companies were released from the collaterals that they provided in favor of Delek Drillings and Avner.

In addition to said collaterals, the sponsors committed to several covenants including, among other things, the following:

1. Not to decrease their ownership in the Ashkelon drill.

2. Not to vote in the operating committee in favor of the execution of additional activities not for the purpose of producing gas for its supply to the IEC (hereinafter: "additional activities") unless one of the following takes place:

3. Not to commit or to agree to an extension or change in the production array unless the following take place:

(2) In the course of 2006, Delek Real Estate issued additional debentures (Series D) that are traded on the Tel Aviv Stock Exchange, in return for NIS 400 million. The debentures are linked to the CPI, carry interest at an annual rate of 6% and are scheduled to mature in equal installments between 2007 and 2012.

(3) Subsequent to the balance sheet date, in February 2007, Delek Real Estate raised NIS 753 million by way of a private placement of debentures to institutional investors. The principal of the debentures is linked to the CPI and is scheduled to mature in seven equal installments, on February 27th of each of the years between 2013 and 2019. The principal of the debentures will bear a fixed annual interest rate of 5.4%, until the date of their registration for trade and 4.8% thereafter. Delek Real estate undertook to register the debentures for trade within 18 months.

NOTE 22: -OTHER DEBENTURES (CONT'D)

D. Redemption dates subsequent to the balance sheet date are as follows:

	December 31, 2006	
	Consolidated	The Company
	NIS Millions, Reported	
First year – current maturities	401	60
Second year	696	113
Third year	474	113
Fourth year	510	229
Fifth year	475	202
Sixth year and thereafter	2,066	1,727
	4,221	2,384
	4,622	2,444

E. As part of the rating of some of the debentures issued by consolidated subsidiaries, the determined rating was made contingent upon maintaining certain financial covenants. As at December 31, 2006, the subsidiaries are complying with the determined covenants.

NOTE 23: -ACCRUED SEVERANCE PAY, NET

A. Composition:

	Consolidated	
	December 31	
	2006	2005
	NIS Millions, Reported	
Reserve for pension and severance pay	19	18
Less - deposits with severance pay funds	3	5
	16	13

B. The Group companies' liabilities for severance pay to most of the employees are covered by current payments to provident and pension funds and to insurance companies. The amounts deposited with provident and pension funds and with insurance companies are not under the control and management of the companies and, therefore, they and the respective liabilities are not reflected in the balance sheet. The Group companies' liabilities for severance pay not included in pension and insurance plans are recorded in the balance sheet according to the law and labor agreements and this also taking into account past experience and the anticipated dismissal in the future.

The amounts accrued in compensation funds include retained earnings and can be withdrawn only upon the fulfillment of the obligations under labor agreements or the Severance Pay Law.

NOTE 24: -OTHER LIABILITIES

	Consolidated	
	December 31	
	2006	2005
	NIS Millions, Reported	
Liabilities for rectifying environmental damage (see Note 2.25)	39	33
Deferred gains from issue of shares at consolidated subsidiary (See Note 9j(a)(4))	40	-
Costs on account of liability for retirement of long-lived assets (see Note 2Q)	82	32
Others (primarily on account of rental fees and deferred revenues)	74	42
Liability on account of issue of blocked shares at consolidated subsidiary (See Note 9j(d)(1))	102	-
	337	107

NOTE 25: -CONTINGENT LIABILITIES, GUARANTEES AND COMMITMENTS

A. Contingent Liabilities

1. In previous years, two requests to authorize class action lawsuits at substantial amounts were filed against an affiliate, Amisragas - the American Israeli Gas Corporation Ltd. (hereinafter: "Amisragas") and other gas companies.

   As for one claim which relates to an alleged breach of a liability to perform safety checks on the part of Amisragas, the Court has dismissed the financial aspect of the request and has approved to file a class action suit calling for a declaratory judgment concerning the right of customers to reclaim from Amisragas all amounts paid by them in cases where safety checks were not performed. The defendants filed an appeal on this decision with the Supreme Court. A settlement agreement was approved by the District Court in February 2006.

   As for the second claim which relates to the plaintiffs argument that the collection of fixed monthly fees from customers with central gas installation constitutes a breach of agreement, the Court has not yet given its decision. In the context of this lawsuit, the amount claimed from Amisragas is approximately NIS 200 million.

   In December 2003, a third lawsuit, to request to authorize a class action lawsuit was filed with the Tel Aviv District Court against Amisragas and three other gas companies in the aggregate amount of NIS 1 billion. The claim relies on a claim that was filed in April 2004 by the Anti-Trust Authority against the defendants concerning the existence of a cartel and coordination of prices between them in 1994 to 1999.

   Moreover, in November 2006, an additional request to authorize a class action lawsuit was filed with the Tel Aviv District Court against Amisragas and two additional gas companies. The applicants claim that Amisragas and the two additional gas companies were derelict in their duty to perform periodical inspections of gas meters installed at consumer homes – as required – every several years. The aggregate amount of the lawsuit is NIS 190 million.

NOTE 25: -CONTINGENT LIABILITIES, GUARANTEES AND COMMITMENTS (CONT'D)

Furthermore, the Tax Authorities issued to Amisragas orders relating to the period 1987-1990 in which Amisragas' appeal to the District Court was dismissed and, later, Amisragas submitted an appeal to the Supreme Court. In November 2006 the Supreme Court rejected Amisragas' appeal. Amisragas has filed a request for an additional hearing regarding this ruling. The outcome of the rejection of the appeal as mentioned is that Amisragas must pay an amount estimated at NIS 60 million for the period 1987-1990. In addition, Amisragas has received orders relating to the period 1991-2002, which were also appealed by Amisragas.

Amisragas estimates that it is impossible to anticipate the outcomes of the aforementioned proceedings.
As of December 31, 2006, the Group's investment in Amisragas totals approximately NIS 144 million, and its effective holding rate is 39%.

2. In November 2005, a request to authorize a class action suit was filed against a subsidiary, Delkol Ltd. ("Delkol") and two other fuel companies. The amount claimed by the plaintiff totals NIS 450 and the amount claimed from Delkol, if the request is authorized as a class action suit, aggregates to approximately NIS 1,664 million, plus NIS 27.5 million for mental anguish.

   The request to authorize a class action suit principally relies on the argument that Delkol marketed engine oil and at the same time presented this oil as complying with certain American and European standards. The plaintiff argues that the above presentation is a misrepresentation.
   It is the opinion of Delkol's management that it has acted legally and that the engine oil which it markets in Israel indeed complies with the specifications of the aforementioned standards.

   It is the estimate of the Delkol management, based on the advice of its legal counsel, that the appeal's chances of being accepted are remote and, accordingly, no provision has been made in respect thereof in the financial statements.

3. Claims filed against Gadot and others addressing the activities of Gadot in the area of the Kishon river, pertaining to bodily damage and damage to property total hundreds of millions of NIS (as for details, see Gadot's financial statements).

   Most of the above proceedings are in preliminary stages. In practice, part of the cases have not yet been heard and part are only in early proceedings. Hearings in some of the cases have not yet taken place and in most cases not all parties have submitted their opinions and affidavits. Moreover, the above claims contain difficult factual disputes and many of the facts that have to be decided upon are yet unknown to Gadot. In addition, the complexity and problematic character of the above procedures is extreme and it derives, among other things, from the fact that most of the claims address events which span many years, the number of entities involved is large, including the Government and local authorities, so that the responsibility and share of each party in the claim cannot be assessed and there is a scientific problem to determine the proximate cause between the flow of waste water and the damage claimed by the plaintiffs. Based on the professional opinion of its legal counsel, in view of all the uncertainty factors that exist in all of said claims and proceedings and due to their complexity and difficulties, at this stage the outcome of these claims and procedures cannot be assessed and, accordingly, no provision has been made in respect thereof in the financial statements.

NOTE 25: -CONTINGENT LIABILITIES, GUARANTEES AND COMMITMENTS (CONT'D)

4. In 2004, the Fuel Administration filed a comprehensive claim of approximately NIS 120 million (Delek's share is approximately NIS 50 million), against Delek, three other petroleum companies, ORL and Petroleum and Energy Infrastructures Ltd. ("PEI"). The Administration argues that the sued companies have allegedly neglected in treating reserve inventory of crude oil, which, as ORL claims has turned into "sludge" and that the Fuel Administration is entitled to be compensated for amounts paid to the defendants in connection with storage, financing and insurance of the inventory since 1989. It is the opinion of Delek's management, based, among other things, on the advice of its legal counsels, that the main claims are against ORL and PEI and, therefore, the chances of the claim to prevail against Delek are remote and, accordingly, no provision has been made in respect of this lawsuit in the financial statements.

5. In conjunction with the cable companies merger (see Note 9j), HOT has assumed the existing lawsuits filed against the cable companies in their previous structure. Several lawsuits have been filed against the cable companies in previous years. In preceding years, several lawsuits were filed against the cable companies which aggregate in significant amounts (hundreds of millions of NIS). Some of the lawsuits address the following issues: A failure to connect residents of peripheral settlements to the cable networks, non-compliance with the conditions of the Council for Cable and Satellite Broadcasting as to broadcasting a certain channel, claims for alleged breach of copyrights of various producers and breach of agreements to purchase various transmission rights, etc. Moreover, in May and June 2006, three petitions for class action lawsuits were filed against the cable companies and against HOT Telecom Ltd. (a Matav investee company) and others. One lawsuit concerns the legality of the basic package for CATV subscribers that was offered by the cable companies to their subscribers, starting in the early 1990s. The amount of the lawsuit is NIS 4.9 billion. The second claim relates to damages incurred by telephony subscribers, caused as a result of communication problems that took place in May 2006. The amount of the lawsuit is NIS 100 million. The third lawsuit relates to the broadcasting of ads, in conflict with the directives of the Ministry of Communications and the CATV and DBS Broadcasting Council. The amount of the claim is approximately NIS 106 million. Furthermore, in January 2007 a lawsuit and motion for approval of class action status have been filed against the cable companies and additional communications companies, for the amount of NIS 11 billion – with the cable companies' share being NIS 500 million.. The lawsuit involves claims that the cable companies and other communications companies operate in violation of the Communications Act, by not allowing number portability when transferring phone lines between companies.

   It is the opinion of HOT's management, based on the opinion of its legal counsel, that, at this stage, the chances of the above claims cannot be assessed and, accordingly, no provision has been made in respect of most of these lawsuits in the financial statements of HOT. For additional details, see Note 20a to HOT's financial statements, that are publicly available.

6. Several lawsuits were filed against investees of Delek Real Estate in connection with projects in the field of real estate in which the investees participated. The amounts sued up to the date of filing the lawsuits total approximately NIS 135 million. It is the opinion of the management of the investees of Delek Real Estate, among other things, based on the advice of their legal counsel, that the amounts to be charged from the companies in most of the cases will not exceed the provisions made in the financial statements.

NOTE 25: -CONTINGENT LIABILITIES, GUARANTEES AND COMMITMENTS (CONT'D)

7. In the past, three foreign airlines filed claims against Aviation Services Ltd. and against its shareholders (Paz, Sonol and Delek) totaling approximately NIS 50 million (as of the date of filing). In 2000, Delek's share in Aviation Services Ltd. was sold (subject to the possibility to indemnify Aviation Services for claims relating to the period preceding the selling of the holdings therein, based on Delek's holding in Aviation Services at the eve of the sale, i.e.- 22.5%). It is the opinion of Delek's management, based, among other things, on the advice of its legal counsel, that the plaintiffs will meet substantial difficulties at the stage of proof of damage and it estimates that the amounts that Delek will be required to pay in connection with this claim, if any, will not exceed the provision made in respect thereof.

8. In November 2002, Delek together with two other petroleum companies filed a comprehensive lawsuit of approximately NIS 25 million against the Fuel Administration, ORL and Petroleum and Energy Infrastructures Ltd. ("PEI") relating to inventories of crude oil which the plaintiffs stored in the past with ORL and PEI in accordance with the instructions of the Fuel Administration and which ORL refuses to return to the plaintiff claiming that it is sludge (unusable sediment of crude oil). The suing companies demand to restore the crude inventory with the addition of financial expenses as from September 2000 or, alternatively, to compensate them in the amount of the monetary value of the inventory with the addition of financial expenses as above.

   It is the estimate of Delek management, based, among other things, on the advice of its legal counsel, that there are fairly good chances that the claim is accepted and, accordingly, no provision has been made in respect of the outstanding debt of the Fuel Administration for the above in the total of approximately NIS 11.6 million.

9. The Ministry of the Environment has notified a subsidiary that in the event that it is discovered that environmental damage had occurred during the 40 years of operation of the subsidiary in the Ashdod facility, it will have no recourse but to treat the environmental damages prior to leaving the facility. The subsidiary estimates, based also on ground drilling that surveyed the possibility of soil and ground water contamination at the facility area and the opinions of its legal counsel, the risk of investing heavily in soil purification expenses is slim.

10. In March 2006, a request to authorize a class action lawsuit was filed against a consolidated subsidiary - Delek Israel and other petroleum companies. The petitioner claims that Delek Israel charged a full service fee from handicapped individuals at stations where there exist self-service fuel pumps, whereas such a fee should not be charged to vehicles possessing a handicapped badge. The petitioner is suing the entire group of defendants for NIS 22 million (Delek Israel's share is estimated by the petitioner at 27%) on account of the pecuniary damage and is also suing for non-pecuniary compensatory damages with no proof of damage, according to the Court's discretion.

    Delek Israel's management estimates, based on the opinion of its legal counsel, that, at this preliminary stage of the proceedings, the chances of the above request cannot be assessed. It does appear that Delek Israel possesses strong defensive claims to counter the petition and the ensuing sum demanded of Delek. Accordingly, no provision has been made in the financial statements.

NOTE 25: -CONTINGENT LIABILITIES, GUARANTEES AND COMMITMENTS (CONT'D)

11. In November 2006, three requests to authorize class action lawsuits were filed against Delek Israel, third parties and Delek Israel's Deputy CEO. The petitioners claim that Delek Israel – in conjunction with the additional defendants – acted in a fraudulent, misleading and negligent manner, while disregarding statutory duty. The said claims and petitions were filed following an investigation that is being conducted by the Israel Police regarding the diluting of fuel, that was discovered to have taken place at several fuel stations that market Delek Israel fuel, in light of potential damages caused as a result thereof. The aggregate amount of the petitions is NIS 1,409 million.

    In all of the proceedings Delek filed motions to dismiss out of hand, motions to try all three proceedings by the same judge and motions to extend the deadline for responding to the motion for approval until after the hearing on the motion to dismiss out of hand. The court accepted the motions to try all three proceedings by the same judge and further instructed all parties not to submit responses to the motions for approval nor to the motions for dismissal out of hand prior to the date of the aforementioned hearing.

    Delek's management estimates, based on the opinion of its legal counsel, that, at this preliminary stage of the petitions and due to the vague nature of any factual claims made in the motions for approval, the chances of the above proceedings cannot be assessed and, accordingly, no provision has been made in the financial statements.

12. Various lawsuits that arise in the ordinary course of business have been filed against the Group companies. It is the opinion of the companies' management that the provisions made in respect of said claims, as well as the existing insurance coverage, are adequate.

13. Delek Refining, a wholly owned subsidiary of Delek US, is subject to the provisions of the law, acts, regulations, licenses and environmental supervision, which are promulgated by the authorized authorities at the federal, state and local levels in its business jurisdiction. These provisions address the entire activity of Delek Refining both in the field of refining and fuel products which it manufactures and in the field of transmission (pipeline). The environmental legislation is complex and is constantly changing and updating.

    The main environmental legislation that applies to the activity of Delek Refining addresses issues of quality of the air, quality of waste water, solid/toxic waste and prevention of pollution of soil and ground water.

    The environmental authorities conducted two investigations against the former owners of the refinery and the pipeline, which Delek Refining has acquired, in connection with pollution discovered in the soil and in the ground water in the area of the refinery and the pipeline. The process of cleansing and purifying the said contaminants has yet to be completed.

    As part of the acquisition of the refinery and the oil pipe, Delek Refining assumed the liability in connection with the existing pollution, in respect of which the investigation and cleanup and purification processes still continue, as well as the liabilities that were imposed on the former owners due to said contamination in an amount which is estimated by Delek Refining at approximately $8 million. Delek Refining is not entitled to be indemnified by the former owners in respect of environmental damages that it was aware of at the date of acquisition, but it is entitled to a limited indemnification (in amount and time) in respect of costs that it may incur in the future as a result of discovering environmental hazards that had been caused before its acquisition of the refinery but then unknown.

NOTE 25: -CONTINGENT LIABILITIES, GUARANTEES AND COMMITMENTS (CONT'D)

It is also indicated that Delek Refining acquired an environmental insurance policy that covers certain environmental damages that may be discovered in the future.

15. As to lawsuits filed against consolidated insurance companies – See Note 38h(b).

B. Guarantees

The following guarantees were provided as at December 31, 2006:

	Consolidated	The Company
	NIS Millions, Reported	
Guarantees for consolidated subsidiaries (1)	-	879
Guarantees for affiliates (3)	158	-
Guarantees for others (4) (5) (6)	540	-
	698	879

1. As collateral for the liabilities of a subsidiary to banks, the Company provided guarantees in unlimited amounts. The liabilities in connection with these guarantees total approximately NIS 17 million as at December 31, 2006. In addition, the Company guarantees the liabilities of subsidiaries to banks and to third parties. The liabilities in respect of these guarantees total approximately NIS 862 million as at December 31, 2006. Furthermore, Delek Group and Delek Investments have provided, at the request of a bank, mutual guarantees in the amount of the liability of each company to the said bank.

2. In addition to the said guarantees in Section 1, above and in the context of agreements relating to the establishment of the desalination facility in Ashkelon by a jointly controlled entity, the Group has undertaken various covenants towards the State, the financing institutions, and VID in connection with the liabilities of the subsidiary, the contractor and the operator. The guarantees granted by the Group as at December 31, 2006, total NIS 40 million.

3. Primarily as collateral for the liabilities of Hof Hacarmel to a bank, Delek Real Estate provided perpetual guarantee limited to the amount of up to $30 million and limited to 34.7% of the debt and to 78.32% of the interest and the hedging transactions. As at December 31, 2006, the balance of loans of Hof Hacarmel totals NIS 373 million.

4. Delek Real Estate provided guarantees to apartment buyers in the amount of approximately NIS 312 million in accordance with the Sales Law (Apartments) (Securing the Investments of Apartment Buyers) - 1974, as well as other guarantees in the amount of approximately NIS 82 million.

5. Including guarantees of approximately NIS 12 million granted in relation to a hedging transaction on gas prices, see Note 37e.

6. Including guarantees amounting to NIS 551 million provided in favor of the CEO of Delek Automotive, see also Note 9j(d)(1).

NOTE 25: -CONTINGENT LIABILITIES, GUARANTEES AND COMMITMENTS (CONT'D)

C. Commitments

1. As at December 31, 2006, Delek Petroleum entered into the following engagements with third parties for the rent and lease of stations, facilities and buildings:

	NIS Millions, Reported
2007	178
2008	152
2009	140
2010	122
2011	114
2012 and thereafter	1,023
	1,729

Moreover, Delek Petroleum and its subsidiaries possess commitments to acquire fuel products (delivery in January-December 2007) at an overall sum of NIS 3,494 million.

2. A foreign investee company owns a real estate property overseas that includes office space in the UK, that is leased under long-term lease contracts as well as investments through affiliates in additional commercial properties. The lease contracts of the properties are, in general, full repair and insurance ("FRI") lease contracts, consisting of the lessees' obligation to perform repairs and improvements in the leased property over the term of the lease and to repay expenses relating to current maintenance of the properties. Generally, the annual lease fees are updated each five years in such a manner that the lessee pays the higher of the annual payment paid until the day of update or the appropriate lease fees in the free market (as determined by an approved appraiser), under the assumption that the property is leased when it is vacated and the agreement is for a period of 15 years.

3. As for commitments of subsidiaries in connection with building a power station in Ashkelon and commitments in connection with oil and gas exploration, see Notes 9j(h)(1) and Note 13.

4. As for additional commitments of the Group in connection with investments in investees, see Note 9j.

D. Indemnification and insurance of officers

1. The Group has undertaken to indemnify all authorized officers of the Group due to an action taken by virtue of serving as an officer of the Group in the past, present or future. The obligation to indemnify is limited to the type of events, conditions and amounts as specified in the indemnification letter that was approved by the general meeting of shareholders.

2. The Group has decided to exempt officers of the Group from their responsibility under the duty of prudence toward the Group as set in the third chapter of the sixth part of the Companies Law, 1999.

3. Accordingly, the Company insured the liability of the officers with a total liability limit of $40 million.

NOTE 26: - LIENS

A. As collateral for loans from banks and others whose balance as of December 31, 2006 amounts to approximately NIS 7,971 million, the following securities were provided:

- The Company and its subsidiaries recorded fixed and floating liens on fixed and current assets, including inventories, specific liens on certain shares of investees and mortgages on all of the Company's rights to properties for which loans were received.

- Subsidiaries have undertaken to fulfill certain conditions, among which refraining from recording a charge in favor of others, without the advanced consent of the lending corporations.

- Loans amounting to NIS 2,059 million taken by a subsidiary in order to finance real estate properties overseas are non-recourse loans whose repayment is secured only by the pledged property.

- As for undertakings made in connection with the compliance with financial covenants, see Note 19c.

B. As for liens on issued debentures, see Note 22c.

C. As for liens in connection with investments in oil and gas assets, see Note 13.

NOTE 27: - SHARE CAPITAL

A. Composition:

	December 31, 2006		December 31, 2005	
	Registered	Issued and Outstanding	Registered	Issued and Outstanding
	No. of Shares			
Ordinary shares of NIS 1 Par value, each	15,000,000	11,635,932	15,000,000	10,930,304

The shares are registered for trade on the Tel-Aviv Stock Exchange.

B. In 2006, 33,707,290 debentures (Series A2), whose carrying amount totaled approximately NIS 36 million, were converted into 91,897 Ordinary shares of NIS 1 par value each of the Company; 714,286 debentures (series B2) whose carrying amount totaled approximately NIS 1 million, were converted into 1,949 Ordinary shares of NIS 1 par value each of the Company and 217,949,887 debentures (series E) whose carrying amount totaled approximately NIS 220 million, were converted into 583,782 Ordinary shares of NIS 1 par value each of the Company.

C. In March 2005, the Company issued (as part of the private placement of debentures) 400 thousand option warrants (five series of 80 thousand options each), each option warrant is exercisable into one Ordinary share of NIS 1 par value of the Company. The debentures were issued at their full price and the stock options were issued without consideration.

In 2006, a quantity of 8,000 stock options (series 1) was exercised into 8,000 ordinary shares of NIS 1 par value each of the Company for a total consideration of NIS 3 million. A quantity of 20,000 stock options (series 3) was exercised into 20,000 ordinary shares of NIS 1 par value each of the Company for a total consideration of NIS 10 million.

NOTE 27: - SHARE CAPITAL (CONTD.)

D. Subsequent to the balance sheet date, 3,749,559 debentures (series E) whose carrying amount totaled approximately NIS 4 million, were converted into 11,040 ordinary shares of NIS 1 par value each of the Company. Furthermore, subsequent to the balance sheet date, 13,560 stock options (Series 2) were exercised into 13,560 ordinary shares of NIS 1 par value each of the Company for a total consideration of NIS 6 million.

Subsequent to the conversions and exercises detailed above, the Company's issued and outstanding share capital is composed of 11,660,532 ordinary shares of NIS 1 par value each.

E. The following are details regarding the option warrants yet to be exercised, as at the balance sheet date:

Option warrants	Outstanding option warrants as at December 31, 2006	Exercise price as at December 31, 2006.*) (NIS)	Exercisable
Series 2	13,560	430.2	By March 2007
Series 3	13,560	470.3	By March 2008
Series 4	33,560	507.3	By March 2009
Series 5	33,560	539.2	By March 2010
	94,240		

*) The exercise increment is linked to the Israeli CPI (subject to adjustments).

F. Dividends

1. In 2006, the Company declared the distribution of dividend to its shareholders in the sum of approximately NIS 547 million. Approximately NIS 461 million were distributed in 2006, while NIS 86 million were distributed in January 2007.

2. Subsequent to the balance sheet date, on March 28, 2007, the Company declared the distribution of dividend in the amount of approximately NIS 100 million to its shareholders.

G. As to debentures convertible into company shares, see Note 20.

NOTE 28: -COST OF REVENUES

	Consolidated		
	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
Purchase of petroleum, fuel, vehicles, products and raw materials	19,784	14,755	9,550
Salaries and related	168	152	95
Depreciation, depletion and amortization	152	141	131
Manufacturing expenses and other costs	742	501	267
Transportation	63	74	56
Cost of real estate sold	270	152	110
Oil and gas exploration expenses	38	27	25
	21,217	15,802	10,234

NOTE 29: -SELLING, MARKETING AND GAS STATION OPERATING EXPENSES

	Consolidated		
	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
Salaries and related	314	281	273
Filling station maintenance	338	299	296
Advertising and Sales Promotion	29	39	33
Depreciation and Amortization	88	86	74
Agent commissions	10	9	11
Credit card commissions	68	52	37
Other	83	95	90
	930	861	814

NOTE 30: -GENERAL & ADMINISTRATIVE EXPENSES

	Consolidated		
	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
Salaries and related	*) 229	136	123
Depreciation and Amortization	16	36	40
Doubtful and lost debts	33	40	46
Professional services	40	19	22
Others	123	106	65
	441	337	296

*) Including an amount of NIS 59 million associated with share-based payment expenses. For details of share-based payment plans, see Note 9j.

NOTE 31: -FINANCIAL EXPENSES (REVENUES), NET

	Consolidated			The Company		
	For the year ended December 31			For the year ended December 31		
	2006	2005	2004	2006	2005	2004
	NIS Millions, Reported					
Expenses (revenues) on account of:						
Loans from banks	370	434	315	-	-	-
Debentures	152	286	93	83	89	56
Loss (profit) from marketable securities	(5)	3	(31)	(5)	(4)	(12)
Forward Transactions	43	(18)	(9)	-	-	-
Consolidated Subsidiaries	-	-	-	(80)	(91)	(39)
Others (primarily on account of deposits and rate differentials)	2	(108)	(14)	(7)	(9)	(7)
	554	597	354	(9)	(15)	(2)
Less – Expenses capitalized to qualified assets	8	3	12	-	-	-
	554	594	342	(9)	(15)	(2)

NOTE 32: -OTHER INCOME (EXPENSES), NET

	Consolidated		
	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
Gains from sale of companies holding real estate assets	6	92	-
Provision for impairment of assets	(5)	(9)	(25)
Loss from impairment of loans and other investments	(18)	(5)	(13)
Gains from sale of fixed assets, net	4	11	1
Management fees from affiliates	1	1	1
Other income, net	15	23	8
	3	113	(28)

NOTE 33: -TAXES ON INCOME

A. Tax laws applicable to the Group companies

1. The Income Tax Law (Inflationary Adjustments) -1985

In accordance with this law, expenses are measured for tax purposes after adjustment to changes in the Consumer Price Index.

2. Capital gains/losses

According to the provisions of the Law for Amendment of the Income Tax Ordinance (No. 132), 2003, ("the reform law"), tax at a reduced rate of 25% will apply to capital gains accrued after January 1, 2003, instead of the regular tax rate. In the sale of assets that were acquired before the launch of the Reform Law, the reduced tax rate will apply only to the profit component that was generated subsequent to the law, and will be calculated in accordance with the law. The Reform Law also stipulates that carryover capital losses for tax purposes may be used to offset capital gains, with no time limits. The Reform Law further regulates the possibility of offsetting capital losses from the sale of assets outside Israel, against capital gains in Israel.

3. Foreign subsidiaries

The foreign subsidiaries are subject to the law in their respective country of operations.

B. Tax rates applicable to the income of the Group companies

1. Companies in Israel

In June 2004, an amendment to the Income Tax Ordinance (No. 140 and Temporary Provision), 2004 was passed by the "Knesset" (Israeli parliament). On July 25, 2005, the Knesset passed the Law for the Amendment of the Income Tax Ordinance (No. 147), 2005, which prescribes, among other things, a gradual decrease in the corporate tax rate in Israel to the following tax rates: In 2006 - 31%, in 2007 - 29%, in 2008 - 27%, in 2009 - 26% and in 2010 and thereafter - 25%.

As to the effects of the said amendment, see Section F, below.

The statutory tax applicable to the consolidated insurance companies in Israel is composed of corporate taxes and gains tax; the weighted tax rates applicable to the consolidated insurance companies in Israel are: 2006 – 40.65%, 2007 – 38.53%, 2008 – 36.80%, 2009 – 35.93% and from 2010 onwards the applicable tax rate would be 35.06%.

2. Subsidiaries outside of Israel

- Leasing revenues from real estate properties in the UK, owned by foreign investees is subject to income tax at the rate of 22%. Sale of real estate in the UK which constitutes long-term investment is not liable to tax on capital gains.
- The leasing of properties in Canada is made by companies whose assets are held in trust for a subsidiary. Rental income from real estate properties of these companies is subject to income tax at a rate between 39% and 46%, according to the physical location of the property and/or the place where the trust was registered. Revenues from the lease and sale of assets located in Germany and Finland are subject to 26% taxes.
- The Federal corporate tax rate applicable to income of subsidiaries in the U.S. is 35%. Similarly, these companies are also liable for state tax at a rate of 3%.

NOTE 33: -TAXES ON INCOME (CONTD.)

C. Tax assessments

The Company received final tax assessments, or assessments deemed final, through 2002. Most of the subsidiaries received final tax assessments or assessments deemed final, through the years 2001-2002, inclusive.

D. Carry-forward losses for tax purposes

Carry-forward tax losses of the Company total approximately NIS 6 million as of December 31, 2006. Carry-forward tax losses of subsidiaries total approximately NIS ___ million as of that same date. A subsidiary in the US has federal operating loss carry-forward of approximately $1 million. Deferred tax assets of approximately NIS 128 million relating to part of the losses of subsidiaries were recorded in the financial statements. The Company does not record tax assets in respect of the above losses.

E. Deferred Taxes

1. Composition:

	Consolidated	
	December 31	
	2006	2005
	NIS Millions, Reported	
On account of non-monetary assets and inventories	(387)	(319)
Differences in timing of expenses and revenues	(61)	38
Carryover losses	127	177
	(321)	(104)

The deferred taxes are computed at tax rates that are expected to apply in the countries in which the Group companies operate (between 22% to 46%) and are presented in the balance sheet as follows:

	Consolidated	
	December 31	
	2006	2005
	NIS Millions, Reported	
In accounts receivable	21	33
In other assets	57	77
In long-term liabilities	(399)	(214)
	(321)	(104)

NOTE 33: -TAXES ON INCOME (CONT'D)

2. Changes in deferred taxes:

	Consolidated	
	For the year ended December 31	
	2006	2005
	NIS Millions, Reported	
Balance at beginning of year	(104)	(50)
Sums allocated to taxes on income	(162)	(43)
Sums allocated to equity in investee companies	(67)	(6)
Differences arising from financial statements of investee companies adjusted to foreign currency	12	(5)
Balance at end of year	(321)	(104)

F. Taxes on income included in the statements of income

	Consolidated		
	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
Current taxes	244	299	190
Transfer of current taxes to capital reserve from translation differences	-	-	(5)
Deferred taxes (see also E, above)	162	39	2
Update of deferred taxes balances following changes in tax rates	-	4	6
Taxes in respect of preceding years	(2)	(3)	(4)
	(404)	339	189

NOTE 33:- TAXES ON INCOME (CONTD.)

G. Adjustment of theoretical taxes

Below is a reconciliation between the tax expense assuming that all the income was taxed at the statutory tax rates applicable to the companies in Israel and the actual tax expense as reported in the statements of income:

	Consolidated		
	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
Income before taxes on income	1,681	991	635
Statutory tax rate	31%	34%	35%
Taxes calculated according to statutory tax rate:	521	337	222
Increase (decrease) in tax liability due to:			
Utilization of carry-forward losses	(5)	(5)	(60)
Losses on account of which no tax benefit was recorded	100	37	37
Influence of change in tax rates	-	4	6
Share in partnership profits	(16)	(4)	(7)
Taxes in respect of preceding years	(2)	(3)	(4)
Permanent differences for which no deferred taxes were calculated	-	-	(4)
Differences in tax rates between Israel and overseas	6	7	(15)
Exempt revenues, unrecognized expenses and other adjustments, net (primarily gains from issue of shares to minority at consolidated subsidiaries)	(200)	(34)	14
	404	339	189

H. The Company and certain subsidiaries are registered with the VAT authorities as a combined licensed trader (consolidation of traders).

NOTE 34: - EARNINGS PER SHARE

A. Detailed number of shares and earnings used in computing basic earnings per share:

	For the Year Ended December 31					
	2006		2005		2004	
	Weighted number of shares	Net Income	Weighted number of shares	Net Income	Weighted number of shares	Net Income
	thousands	NIS in Millions, Reported	thousands	NIS in Millions, Reported	thousands	NIS in Millions, Reported
For calculation of basic income, before cumulative influence of change in accounting principles, net	11,345	1,513	10,064	622	9,733	423
Cumulative influence of change in accounting principles, net	-	-	-	-	-	(20)
For calculation of basic net income	11,345	1,513	10,064	622	9,733	403
Less - Company's share in basic earnings per share of investees	-	(1,351)	-	(498)	-	(382)
Company's share in diluted earnings per share of investees	-	1,332	-	497	-	398
Influence of potential diluting ordinary shares	345	11	1,404	45	1,613	48
For calculation of diluted income, before cumulative influence of change in accounting principles, net	11,690	1,505	11,468	666	11,346	467
Cumulative impact per share due to change in accounting principles, net	-	-	-	-	-	(19)
For calculation of diluted net income	11,690	1,505	11,468	666	11,346	448

NOTE 35: -SEGMENTS OF OPERATION

A. General

The Group companies operate in several primary business segments:

- Fuel products in Israel - The main activity is marketing and selling of fuel products in gas stations and elsewhere.

- Fuel products in the U.S. - The main activity is maintenance and operation of gas stations and convenience stores in the US.

- Oil Refineries and marketing in the U.S. – These operations began in 2005 and relates to the operation of an oil refinery in the USA and a pipeline for the transportation of crude oil, as well as to the marketing of fuel to various customers.

NOTE 35: -SEGMENTS OF OPERATION (CONT'D)

- Vehicles and spare parts - The primary activity consists of the import and marketing of Mazda and Ford vehicles and spare parts.

- Real estate - The main activity is investing and managing investment properties in Israel and overseas and the construction of residential and commercial projects designated for sale.

- Insurance sector in Israel – Most of the operations in this sector are conducted via Phoenix, which was consolidated in these financial statements starting on December 31, 2006 (see Note 9j(g)(2).

- Insurance sector overseas (outside Israel) – Most of the operations in this sector are conducted via Republic, which was first consolidated in the financial statements starting on December 31, 2006 (see Note 9j(g)(4).

- Oil and gas exploration - The main activity is preformed through a joint venture "Yam Tethys", acting to find oil and gas on Israel's continental shelf.

- Biochemistry - The main activity consists of the manufacturing and marketing of fructose, citric acid and salt for the food, pharmaceutical and detergents industries.

- Other - The main activity concerns investments in infrastructure including primarily the field of seawater desalination and the establishment of a power station for the production of electricity.

The Group holds several affiliates that operate in part of the above segments (primarily real estate) as well as in other sectors (primarily in the field of telecommunications through its holdings in HOT.

The Company's segments of operation are carried out in several major geographic areas worldwide. In Israel, the residency of the Company and most of the subsidiaries, the activities of marketing vehicles and parts are performed as well as oil and gas explorations, insurance, part of the manufacturing and marketing of fuel products and investment and management of investment properties. In the U.S., the activities performed relate to the fuel products sector, as well as the refinery sector and insurance sector. In the UK, Canada and Western Europe, the activity relates to the real-estate sector. Products of the biochemistry segment are marketed in Europe, the US and in Israel.

NOTE 35: -SEGMENTS OF OPERATION (CONT'D)

B. Primary reporting on business segments

1. Revenues, net of excise and royalties:

	Consolidated		
	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
Revenues from externals (1)			
Israeli Fuel Sector Operations	4,455	4,050	3,273
Gas stations and convenience stores in the USA	6,181	4,951	3,846
Refinery operations & marketing in the USA	8,072	4,239	-
Automotive sector	4,060	3,868	3,923
Real Estate Sector	439	484	503
Biochemicals sector	366	375	343
Oil and gas exploration and production	268	184	141
Other sectors	277	182	220
Total in statements of income	24,118	18,333	12,249

2. Sector results and reconciliation to net income

	Consolidated		
	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
Israeli Fuel Sector Operations	94	46	56
Gas stations and convenience stores in the USA	143	144	70
Refinery operations & marketing in the USA	632	501	-
Automotive sector	440	380	405
Real Estate Sector	81	155	242
Biochemicals sector	55	68	66
Oil and gas exploration and production	154	95	79
Other sectors	35	9	-
	1,634	1,398	918
Expenses not attributed to sectors	(104)	(65)	(13)
Operating Income	1,530	1,333	905
Financial Expenses, net	(554)	(594)	(342)
Gains from realization of investments in investee and other companies, net	702	139	100
Other Income (Expenses), Net	3	113	(28)
Taxes on Income	(404)	(339)	(189)
Group's share in profits of affiliates and partnerships, net (1)	591	146	136
Minority Interest in subsidiary earnings, net	(355)	(176)	(159)
Income before cumulative effect of change in accounting principle, net	1,513	622	423
Cumulative effect of change in accounting principle, as of the beginning of the year, net	-	-	(20)
Net Income	1,513	622	403

NOTE 35: -SEGMENTS OF OPERATION (CONT'D)

3. Assets used by the sector

	Consolidated	
	December 31	
	2006	2005
	NIS Millions, Reported	
Insurance overseas (outside Israel)	4,202	-
Insurance - Israel	29,938	-
Israeli fuel sector operations	2,275	2,121
Gas stations and convenience stores in the USA	1,778	1,516
Refinery operations & marketing in the USA	1,358	896
Automotive sector	1,678	1,722
Real estate sector	4,004	3,460
Biochemicals sector	399	417
Oil and gas exploration and production	1,244	1,065
Other sectors	735	777
	47,611	11,974
Investments in Associated Companies		
Fuel products sector - Israel	170	134
Automotive sector	-	34
Real Estate Sector	1,549	615
Biochemicals	10	-
Oil and gas exploration sector	331	326
Others *)	733	1,298
	2,793	2,407
Assets not attributed to sectors	2,030	1,609
Total consolidated assets	52,434	15,990

*) Including investment in Matav whose balance totals approximately NIS 305 million as at December 31, 2006 (NIS 348 million as at December 31, 2005). As at December 31, 2005, also includes the investment in Phoenix in the amount of NIS 658 million.

NOTE 35: -SEGMENTS OF OPERATION (CONT'D)

4. Sector liabilities

	December 31	
	2005	2005
	NIS Millions, Reported	
Insurance overseas (outside Israel)	3,805	-
Insurance - Israel	27,311	-
Israeli fuel sector operations	285	492
Gas stations and convenience stores in the USA	512	268
Refinery operations & marketing in the USA	684	530
Automotive sector	224	654
Real estate sector	271	191
Biochemicals sector	71	69
Oil and gas exploration and production	145	25
Other sectors	170	151
	33,478	2,380
Liabilities not attributed to sectors	15,509	11,334
Total consolidated liabilities	48,987	13,714

5. Acquisition costs of long-term assets

	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
Israeli fuel sector operations	51	53	80
Gas stations and convenience stores in the USA	449	225	135
Refinery operations & marketing in the USA	471	398	-
Automotive sector	26	23	49
Real estate sector	1,020	595	478
Biochemicals sector	13	17	25
Oil and gas exploration and production	121	6	29
Other sectors	142	992	649
	2,293	2,309	1,445

NOTE 35: -SEGMENTS OF OPERATION (CONT'D)

6. Depreciation and Amortization

	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
Israeli Fuel Sector Operations	61	69	68
Gas stations and convenience stores in the USA	95	111	72
Refinery operations & marketing in the USA	27	6	-
Automotive sector	8	9	6
Real Estate Sector	45	71	48
Biochemicals sector	19	14	14
Oil and gas exploration and production	73	52	37
Other sectors	12	18	50
	340	350	295

C. Secondary reporting on geographic areas

1. Revenues by geographic markets (based on the location of the customer)

	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
Israel	9,334	8,506	7,880
USA	14,340	9,297	3,808
UK	45	98	153
Canada	211	199	195
Western Europe	188	233	213
	24,118	18,333	12,249

2. Carrying amounts for assets used by the segment and acquisition cost of long-term assets by geographic areas (based on the location of the asset)

	Sector assets		Acquisition costs of long-term assets		
	December 31		For the Year Ended December 31		
	2006	2005	2006	2005	2004
	NIS Millions, Reported				
Israel	37,479	7,590	309	1,389	1,298
USA	7,463	2,412	920	623	135
UK	494	602	-	117	6
Canada	1,240	1,359	17	64	6
Western Europe	844	-	849	116	-
Other	91	11	80	-	-
	47,611	11,974	2,293	2,309	1,445

NOTE 36: -RELATED PARTIES

A. In May 2004, Delek Investments completed the purchase of the remaining shares of Commutech which were held by parties related to the controlling shareholder (ultimate concatenation) of Commutech and the Company for the same price as paid to the shareholders of Commutech out of the public (as part of a tender offer from December 2003) and in return for a total of NIS 9 million. According to the Securities Regulations (Presentation of Transactions Between a Corporation and a Controlling Shareholder Therein in the Financial Statements), 1996, the difference of approximately NIS 6 million between the payment made for the purchase and the carrying amount of the shares in the books of the controlling shareholders is recorded in shareholders' equity.

B. On May 10, 2004, the general meetings of the Company and of Delek Automotive Systems Ltd. ("DAS") approved an agreement whereby the subsidiaries entered into an agreement for the sale of their share in the executive jet to Elad Group Ltd. (a company owned and controlled by the controlling shareholder in the Company). The price of the transaction totaled approximately $13.4 million (NIS 59 million), based on a valuation made to the airplane in January 2004. The payment approximates the value of the airplane in the Group's books.

C. A foreign investee of Delek Real Estate and a 50% owned investee of the Group's controlling shareholder entered into management agreements for the management of three buildings in Canada. The agreements are for a period of two years and they are renewed for additional periods unless one of the parties notifies the other as to the termination of the commitment. The annual volume of the engagement totals NIS 2 million.

   Additionally, a company owned by the Group's controlling shareholder leases, at arm's length terms, offices in Canada from a foreign investee of Delek Real Estate. The annual volume of the engagement totals NIS 0.5 million.

D. Regarding a liability for a special bonus to a company owned by the son-in-law of the Group's controlling shareholder – see Note 9j(a)(7).

E. Companies owned by the controlling shareholder of the Company provided limited-sum guarantees in order to secure the liabilities of subsidiaries of Delek Real Estate to banks. As of the balance sheet date, the guarantee amounts to NIS 21 million. The guarantee was provided against loans in the amount of approximately NIS 70 million. A subsidiary has undertaken to indemnify companies owned by the controlling shareholder in connection with any damage caused to them as a result of providing said guarantee. The guarantee of the controlling shareholder was cancelled in 2006 due to the refinancing of the said assets.

F. The Group's CEO was granted loans whose balance, as at December 31, 2006, amounts to NIS 8.4 million. The loans are scheduled for repayment in the years 2007-2008. The terms of the loans specify that the loans shall be linked to the Israeli CPI with the addition of annual interest at the rate of 4%. The loan funds serve for the acquisition of shares in Delek Group companies. The acquired shares serve as collateral for the repayment of the loans and any sum obtained from the sale of the shares shall be used initially to repay the loans.

NOTE 36: -RELATED PARTIES (CONTD.)

G. The chairman of the Company's board of directors was granted a facility for obtaining loans in the maximum amount of NIS 6.9 million, scheduled for repayment in the years 2007-2008. The terms of the loans specify that the loans shall be linked to the Israeli CPI with the addition of annual interest at a rate of 4%. The loans will serve to purchase shares of Delek Group companies, at the discretion of the chairman of the board of directors. The acquired shares serve as collateral for the repayment of the loans and any sum obtained from the sale of the shares shall be used initially to repay the loans. As at December 31, 2006, the outstanding loans total NIS 7.6 million.

H. As to a stock option plan at subsidiaries, that was granted to the Group CEO and to the Chairman of the Board of Directors, see Note 9j(b)(1) and 9j(a)(7).

I. Benefits to related parties

	Consolidated		
	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
Fees of directors who are not employed (1)	0.3	0.2	0.2
Number of directors and interested party who are not employed (2)	5	4	4
Fees of employed directors and interested parties (3) (4)	10.2	5	4
Number of employed directors and interested parties	3	3	3

(1) Including payments to three directors who ceased being directors in 2006.
(2) Represents the number of directors at the end of the year.
(3) In 2006 – Including labor expenses allocated on account of benefit originating from granting of options to investee companies.
(4) Including payments made by a subsidiary to a Group director on account of management services, in the sum of NIS 0.7 million (NIS 0.6 million in 2005 and NIS 0.2 million in 2004).

NOTE 36: -RELATED PARTIES (CONT'D)

J. Balances and Transactions with Related Parties

1. Balances

	Consolidated	
	December 31	
	2006	2005
	NIS Millions, Reported	
Long-term loans and debts	13	13
Short-term loans and debts	3	-
Highest balance of loans to interested parties in the course of the year	16	13

2. Transactions

	Consolidated		
	For the year ended December 31		
	2006	2005	2004
	NIS Millions, Reported		
Financial Revenues	1	1	1

K. The Group companies conduct transactions with entities that are related parties in the ordinary course of business – at arm's length terms – and under regular credit terms, at volumes that are immaterial.

NOTE 37: -FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

A. Credit Risks

The Group companies derive revenues from a large number of customers. The management of the companies perform ongoing credit evaluations of their customers and the financial statements include provisions which, in managements' estimates, are adequate to cover potential losses from doubtful debts.

B. Interest Risks

The Company and its investee companies possess NIS-denominated loans with variable interest rates, exposing the Company to changes in bank interest rates in Israel. Some of the Group companies have assumed variable rate loans overseas, thereby exposing them to changes in interest rates in those countries. Furthermore, interest rate fluctuations can potentially impact the financial results of the Company and its investee companies. Changes in interest rates in Israel and in the USA may negatively impact the returns of the marketable bond portfolio of insurance companies held by the consolidated subsidiaries, which serve to cover their insurance obligations.

NOTE 37: -FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONT'D)

C. Currency Risks

As at December 31, 2006, the excess of monetary liabilities denominated in foreign currency (primarily US dollars and Canadian dollar) in the Company's consolidated balance sheets, over monetary assets in foreign currency, in the approximate sum of NIS 3,205 million, originating primarily from a surplus of long-term liabilities denominated in foreign currency. The surplus of CPI-linked monetary liabilities over CPI-linked monetary assets totaled approximately NIS 5,252 million, including approximately NIS 668 million in surplus of CPI-linked current monetary liabilities.

D. Derivative Financial Instruments

From time to time, the Group companies enter into transactions with certain derivative financial instruments which are, in part, designated to hedge the exposure to fluctuations in the exchange rates of foreign currencies, to changes in the value of inventories and of selling prices of gas and to changes in interest rates.

As of the balance sheet date, the subsidiaries have open commitments as detailed below:

(1) Group companies have commitments for currency swap contracts and option contracts for the purchase and sale of various currencies (including USD, euro, yen and others). Most of the transactions are for a period of up to 1 year, and are not recognized as hedging transactions for accounting purposes.

(2) A consolidated subsidiary in the USA entered into Cap-type interest rate swap transactions, whereby the consolidated subsidiary is conferred the right to exchange variable interest (Eurodollar 1.25%-1.5%) on loans of $129 million for fixed interest ranging between 3.5% and 4%, subject to the maximum interest rates determined in the agreements.

The transactions are for various terms terminating between 2007 - 2010.

(3) Other consolidated subsidiaries have entered into Swaption and IRS-type interest rate swap transactions, whereby the companies are conferred the right to exchange variable interest for fixed interest and vice versa. Furthermore, the consolidated subsidiary has entered into Cap-type transactions for hedging against an increase in variable interest.

The net fair value of all the derivative transactions, as at December 31, 2006, represents a liability of NIS 36 million.

E. In 2004, Delek Investments, Delek Drilling and Avner entered into an agreement with a company related to a foreign investment bank for pegging the price for gas. According to the agreement, the price of gas for the years 2005 to 2013 was set at a fixed dollar value (the total sum of the transaction amounted to $ 630 million). The balance of the pegging transaction as at December 31, 2006, totals $471 million.

NOTE 37: -FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONT'D)

According to the above transaction, if the quarterly price for gas is lower than the fixed price ($ 2.47 per million BTU), the performing company shall pay Delek Investments and the limited partnerships the difference between the actual price and the fixed price with respect to the predetermined quantity. In the event that the actual price is higher than the fixed price, the Delek Investments limited partnerships will pay the difference with respect to the predetermined quantity.
Bank Hapoalim Ltd. and Bank Leumi LeIsrael Ltd. provided guarantees in the aggregate of approximately $ 37 million, as at the date of the formulation of the financial statements, to secure the liabilities of Delek Investments, Delek Drilling and Avner. Concurrently, a guarantee to secure the liability of the foreign investment bank has been obtained.

In 2005, in the context of agreements entered into in connection with the issuance of debentures (Note 22c(1) above), the above hedging arrangement and guarantees were assigned to SPC (the issuing company). Concurrency, a back-to-back agreement was signed between Delek Investments, Delek Drilling and Avner, with SPC, according to which profit and loss from the hedging arrangement shall be transferred from SPC to Delek Investments, Delek Drilling and to Avner.

The fair value of the transaction as at December 31, 2006 reflects a liability of NIS 97 million. Moreover, a consolidated partnership of DES US has entered into gas and oil pegging transactions. These transactions are not recognized as hedging for accounting purposes. Their fair value as at December 31, 2006 reflects a liability of NIS 72 million.

F. Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, short-term investments, trade receivables, other accounts receivable, short-term credit from banks and others, trade payables, other accounts payable and convertible and other debentures approximate their fair value. As to the value of convertible debentures, convertible into shares of investee companies and other debentures, see Notes 21 and 22.

The fair value of long-term loans with a carrying value of NIS 286 million is NIS 2,950 million.

The fair value of outstanding debentures and long and short-term loans from banks and others, as well as long-term receivables and and deposits is close to their carrying value, sinc emost of these balances carry interest rate no different from standard market interest for similar assets and liabilities.

The fair value of investments in other companies at as December 31, 2006 is NIS 1,152 million, while the carrying amount as at that date is NIS 790 million.

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED)

A. Investments

	As at December 31 2006
	NIS in Millions
Securities (1)	20,049
Loans (2)	1,932
Bank deposits (3)	3,225
Associated Insurance Agencies (4)	82
Other associated companies (5)	585
Rental properties (6)	50
Buildings under construction	13
Works of art	82
	26,018

1. Securities

a) Composition:

	December 31, 2006		
	Negotiable	Others	Total
	NIS in Millions, Reported		
Securities issued in Israel			
Debentures	5,210	6,762	11,972
Convertible debentures	94	-	94
Shares	2,445	3	2,448
Mutual fund units	114	-	114
Venture capital and equity funds	-	61	61
Hedge funds	13	60	73
Equity and real estate funds	-	212	212
Option warrants	63	62	125
Derivative Financial Instruments	2	-	2
Total securities issued in Israel	7,941	7,160	15,101
Securities issued abroad			
Debentures	1,811	272	2,083
Shares	573	116	689
Mutual fund units	1,035	-	1,035
Venture capital and equity funds	-	15	15
Hedge funds	620	-	620
Equity and real estate funds	401	84	485
Option warrants	(1)	20	19
Derivative Financial Instruments	2	-	2
Total securities issued abroad	4,441	507	4,948
Total securities	12,382	7,667	20,049

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

	December 31, 2006
	NIS in Millions, Reported
Including:	
Non-transferable securities	4,549
Including non-negotiable securities held against liabilities on account of profit sharing policies included in the financial statements at fair value:	
The value under contracting terms	2,147
Adjustment for fair value	208
	2,357
Net exposure (hedging) for base asset presented in delta terms of financial transactions executed as at the balance sheet date	(869)
Of which, for assets matching liabilities for profit sharing policies	(782)
	(87)

b) Details of debenture linkage basis:

	December 31, 2006			
	CPI Linked	USD Denominated or Linked	Non-linked	Total
	NIS in Millions, Reported			
Government bonds or government-secured bonds	6,446	-	1,606	8,052
Other debentures:				
Issued in Israel	3,539	319	62	3,920
Issued abroad (outside Israel)	-	2,083	-	2,083
Other convertible debentures issued in Israel	94	-	-	94
Total debenture investments	10,079	2,402	1,668	14,149

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

2. Loans

a) Details by collateral:

	December 31, 2006
	NIS in Millions, Reported
Loans secured by life insurance policies	277
Secured by mortgages and liabilities to issue mortgages	207
Secured by liens on vehicles	3
Secured by shares	760
Secured by other collateral and to employees (1) (3) (4)	584
To agents (2)	101
	1,932
Provision for doubtful debts deducted from above loan amounts	19
Including loans held against profit sharing life insurance policies included in financial statements at fair value	675

(1) Other collateral including post-dated checks, credit cards, third party guarantee etc. Loans to employees are not secured by collateral, other than lawful rights to offset.

(2) Loans to agents are mostly secured by liens on commissions and by collateral notes.

(3) Some of the loans have internal ratings. For loans granted in conjunction with the profit-sharing life insurance portfolio, the internal rating is used to determine the discount rates according to guidelines of Shaarey Ribit Inc.

(4) Some loans include an option to participate in loan or project profits under certain terms.

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

b) Below are further details pursuant to reporting regulations for loans to a single borrower exceeding NIS 12 million:

December 2006					
Entity	Company and Consolidated Balance	Indicated Interest Rate	Linkage	Average Term to Maturity	Collateral
	NIS in millions, Reported	%			
1	134	5.25	CPI-linked	5.51	Other collateral
2	128	6.52	CPI-linked	9.60	Other collateral
3	131	7.00	CPI-linked	2.34	Shares
4	80	6.59	CPI-linked	3.49	Shares
5	115	6.60	CPI-linked	2.56	Shares
6	103	5.18	CPI-linked	5.18	Other collateral
7	85	LIBOR +2%	CPI-linked	0.44	Shares
8	37	7.00	USD	0.72	Shares
9	43	6.00	Euro	0.50	Other collateral
10	40	6.59	Sterling	3.59	Shares
11	26	7.00	CPI-linked	3.36	Shares
12	36	7.85	CPI-linked	5.33	Shares
13	35	11.00	CPI-linked	6.52	Other collateral
14	27	6.00	CPI-linked	4.05	Other collateral
15	6	5.37	CPI-linked	2.01	Other collateral
15	20	6.40	CPI-linked	2.12	Other collateral
Total 15	26		Non-linked		
16	26	6.50		3.90	Mortgage
17	18	8.00	CPI-linked	0.55	Mortgage
18	15	6.75	CPI-linked	7.78	Shares
19	12	7.50	CPI-linked	4.53	Other collateral
20	15	7.25	CPI-linked	0.20	Other collateral
21	13	4.00	CPI-linked	1.76	Shares
22	29	9.00	CPI-linked	3.88	Shares + Mortgage
22	28	7.50	USD	3.88	Shares + Mortgage
Total 22	57		CPI-linked		
23	15	12.00		1.63	Shares
24	56	LIBOR +2.4%	Euro	2.36	Other collateral
25	15	4.00	USD	1.10	Other collateral
	1,288		CPI-linked		

Some loans include an option to participate in profits under certain terms.

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

c) Breakdown by linkage terms, average interest rate and average term to maturity:

	Average Indicated Interest Rate (%)	Average Term to Maturity (years)	NIS in Millions, Reported
As at December 31, 2006:			
CPI Linked	6.1	3.83	1,568
GBP linked	5.1	8.41	71
Euro linked	9.8	1.14	59
USD linked	8.0	1.64	171
CAD linked	18.1	4.30	6
Non-linked	2.6	0.62	57
			1,932

3. Bank deposits

a) Breakdown by linkage terms, average interest rate and average term to maturity:

	Average Indicated Interest Rate (%)	Average Term to Maturity (years)	NIS in Millions, Reported
As at December 31, 2006:			
CPI Linked	5.7	5.0	3,047
USD linked	6.5	4.8	158
Non-linked	6.4	3.9	20
			3,225

1. Including NIS 1,694 million in deposits held against profit sharing life insurance policies included in financial statements at fair value.

4. Associated Insurance Agencies

	December 31, 2006
	NIS in Millions, Reported
Cost of shares	4
Accumulated losses, net	(2)
Total book value	2
Goodwill balance	80
	82

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

5. Other associated companies

a) Composition:

	December 31, 2006
	NIS in Millions, Reported
Accumulated cost and profits through Dec-31-91	3
Cost of shares since Jan-01-92	180
Undistributed profits and reserves accumulated since Jan-01-92, net (1)	25
Transfer in conjunction with structural changes	108
Total book value	316
Goodwill balance and attributed original difference (2)	236
Loans	34
	586
Less provision for impairment	(1)
Total associated companies	585
(1) Dividend received in accounting year	14

b) Major changes during 2006:

On April 9, 2006 pursuant to agreements reached between Phoenix Investments and Finance Ltd., a fully-owned subsidiary of Phoenix (hereinafter: "Phoenix Investments") and controlling shareholders of Excellence Investments Ltd. (hereinafter: "Excellence") and Mizrahi Bank, the contingent terms have been met and the legally required approvals for signing contracts have been obtained, for acquisition of a total of 40% of Excellence shares in exchange for NIS 322.5 million in cash (including legal and other direct expenses associated with this acquisition, amounting to NIS 365 thousand).

Following this acquisition, Phoenix Investments and the controlling shareholders in Excellence are co-controlling shareholders of Excellence.

As at the acquisition date, Excellence's shareholders' equity was NIS 211 million. The acquisition cost was attributed to Excellence assets and liabilities based on their fair value as at the acquisition date. In conjunction with this, Phoenix Investments recognized investments in named non-tangible assets: Company name, client portfolios and management of provident, severance and pension funds amounting to NIS 12.9, 8.1 and 13.9 million, respectively. The balance of NIS 201 million was attributed to goodwill.

The company name, client portfolios and management of provident, severance and pension funds are amortized over financial life spans of 30, 3 and 8 years, respectively. The estimated value of non-tangible assets and their amortization periods were based on the opinion of a qualified external assessor.

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

Starting on January 1, 2009 Phoenix Investments would have a Call option and starting on February 1, 2009 the controlling shareholders of Excellence will have a Put option resulting in acquisition of full control of Excellence by the Company in exchange for price formulas agreed in advance and derived from future performance of Excellence.

On October 31, 2006 the board of directors of Excellence approved the acquisition of the provident fund management operations of United Mizrahi Bank Ltd. in exchange for NIS 347 million. The consideration was based on volume of assets under management by the provident funds as at September 30, 2006.

On December 31, 2006 Phoenix Investments granted a loan to Excellence of NIS 30 million, bearing interest at Bank of Israel rate + 0.5% per annum. The loan is for a 5 year term.

c) On March 9, 2007 a memorandum of understanding was signed between Phoenix and Bank Hapoalim Ltd. (hereinafter: "Bank Hapoalim"), by which the Company would acquire 25% of all source shares of Isracard Ltd. and Europay (Eurocard) Israel Ltd. (hereinafter: "the Companies"), both of which are wholly controlled by Bank Hapoalim, would be purchased, and it would be entitled to appoint directors on its behalf, as agreed under the memorandum of understanding.
The consideration for the shares shall be calculated on the basis of an attached value of NIS 2.55 billion, with adjustments for the payment of dividends, if and to the extent paid as at the date of conclusion of the transaction. In the event that the Companies make a public offering within 15 months, the basis for the Companies' value shall be adjusted upwards for the purpose of the transaction to 90% of the Companies' value for the purpose of the public offering, but not above the aggregate value of the Companies of NIS 2.7 billion.
Performance of the transaction is subject to due diligence, to conditions (including the consent of the Company as to arrangements between Isracard Ltd. and Bank Hapoalim), regulatory approvals, to the extent necessary, to the approvals of management and the board of directors of Bank Hapoalim, and to the approval of the board of directors of The Phoenix.

6. Rental Properties

The balance includes NIS 20 million for assets held against profit-sharing policies.

B. Fixed Assets

	December 2006					
	Office Buildings	Improvements to Rental Property	Vehicles	Computers and Software	Office furniture & equipment	Total
Cost	274	25	12	491	85	887
Accumulated depreciation	(42)	(8)	(3)	(212)	(40)	(305)
Provision for impairment	(2)	-	-	-	-	(2)
Depreciated cost	230	17	9	279	45	580
Depreciation rates	4%-5%	8%-28%	15%-33%	10%-33%	6%-33%	

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

C. Sums to collect

	As at December 31
	2006
	NIS in Millions
Insurance companies and insurance agencies (1)	2,785
Premiums to be collected (2)	819
Other accounts receivable (3)	276
	3,880
(1) Composition:	
Share of reinsurers -	
Of insurance reserves	937
Of pending claims	1,753
Other accounts	95
	2,785
Including:	
In life insurance	232
In general insurance	2,553
	2,785

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

a) Balances of reinsurers in general insurance as at December 31, 2006

In books of insurance companies in Israel:

	Total Premiums For Reinsurance for 2006	Current Debit(Credit) Balances, Net (b)	Reserve for Unexpired Risks	Pending Claims		Deposits of Reinsurers	Total Exposure (a)	Current Post-Due Debts Included in Open Balances	
				Property	Liability			6 to 12 Months	Over 12 Months
	NIS millions, reported								
Rating Group: (d)									
AA or higher									
Kölnische Rückversicherungs-Gesellschaft AG	31	2	40	9	-	5	47	-	-
Others	42	(2)	25	28	71	10	112	-	-
	73	-	65	37	71	15	159	-	-
AA- to BBB									
Munich Reinsurance Co AG	78	20	47	55	291	16	398	-	-
Swiss Reinsurance Co	47	8	14	49	62	11	121	-	-
Others	203	4	78	127	181	47	343	4	1
	328	32	139	231	534	74	862	4	1
BBB and lower									
Non-rated	14	(4)	4	46	65	-	110	1	1
Total	415	28	208	314	670	89	1,131	5	2

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

a. Total exposure to a re-insurer is the share of all re-insurers in insurance reserves and pending claims, net of deposits and net of the amount of the letters of credit received from the re-insurer as a guarantee for its liabilities, plus (less) the net current debit (credit) balance.

b. After deduction of provision for doubtful debts amounting to NIS 3 million.

c. Total provisions for doubtful debt, plus reduced share of re-insurers in pending claims amount to NIS 6 million, or 0.49% of total exposure.

d. The rating group was primarily determined by S&P rating company. In cases where no rating is available from this company, the rating is usually determined based on Moody's rating company, with the rating converted based on a key prescribed by investment regulations.

e. The share of re-insurers in the Company's insurance risk amount for earthquakes amount to NIS 12 million. The share of the most significant re-insurer in this exposure is 32.77%.

f. The non-rated group includes balances for pending claims by business brokers received through 2003, for which the exposure amounts to NIS 51 million.

g. The company did not receive letters of credit from re-insurers to guarantee their liabilities.

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

In books of insurance companies abroad:

	Total Premiums For Reinsurance for 2006	Current Debit(Credit) Balances, Net	Reserve for Unexpired Risks	Pending Claims		Deposits of Reinsurers	Total Exposure (a)	Current Post-Due Debts Included in Open Balances
				Property	Liability			6 to 12 Months
	NIS in Millions, Reported							
Rating Group: (c)								
A- or higher								
Hartford Fire Insurance Co.	38	-	195	17	114	-	326	-
American Hallmark Insurance Co.	20	(3)	108	3	48	-	156	-
Northland Insurance Co.	15	(3)	85	4	149	-	235	-
Others	24	70	112	81	309	132	440	2
	97	64	500	105	620	132	1,157	2
B to A	13	-	11	7	18	-	37	-
Non-rated	-	-	-	-	3	-	3	-
Total	110	64	511	112	642	132	1,197	2

a) Total exposure to a re-insurer is the share of all re-insurers in insurance reserves and pending claims, net of deposits and net of the amount of the letters of credit received from the re-insurer as a guarantee for its liabilities, plus (less) the net current debit (credit) balance.
b) There are no material balances post-due over 12 months, and no provisions have been made for doubtful debts.
c) The rating group was determined according to A.M. Best rating company.

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

b) Balances of reinsurers in life insurance as at December 31, 2006

	Total premiums for re-insurance in 2006	Current Credit Balance, Net (b) *)	Insurance reserves	Pending Claims	Deposits of Reinsurers	Total Exposure (a)
	NIS in Millions, Reported					
Rating Group: (c)						
AA or higher						
Kölnische Rückversicherungs-Gesellschaft AG	26	(3)	83	2	14	68
Others	20	(15)	15	4	13	(9)
	46	(18)	98	6	27	59
AA- to BBB	17	(4)	120	7	107	16
Non-rated	3	(1)	-	-	-	(1)
Total	66	(23)	218	13	134	74

a. Total exposure to a re-insurer is the share of all re-insurers in insurance reserves and pending claims, net of deposits plus (less) the net current debit (credit) balance.

b. There are no material balances post-due over 12 months, and no provisions have been made for doubtful debts.

c. The rating group was primarily determined by S&P Rating Company. In cases where no rating is available from this company, the rating is usually determined based on Moody's rating company, with the rating converted based on a key prescribed by investment regulations.

3. The share of the re-insurers set forth in sections b1 and b2 above exceeds 10%of the total exposure to re-insurers as defined above, or their share of the total premium delivered to re-insurers (in life insurance or in general insurance) exceeds 10%.

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

2. Premiums to be collected

In Israel

	December 31 2006 NIS in Millions, Reported
General insurance	
CPI-linked	298
USD-denominated or linked	80
Total general insurance	378
Life insurance	
CPI-linked	109
Total life insurance	109
Total	487
Including post-dated checks and standing orders to banks	247

Abroad

	December 31 2006 NIS in Millions, Reported
Open accounts	334
Less - provision for doubtful debts	2
	332

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

3. Other Accounts Receivable

Composition:

	December 31 2006 NIS in Millions, Reported
Employees	17
Government organizations and authorities	12
Deferred Taxes	25
Held Companies	3
Advance payment of insurance agent commissions	9
Agent debts	8
Unearned revenues	17
Pre-paid expenses	35
For sale of rental properties and building under construction	125
Unearned insurance commissions	12
Others	13
	276

D. Deferred acquisition costs and other assets

	December 31 2006 NIS in Millions, Reported
Deferred acquisition costs (1)	893
Other assets (2)	1,654
	2,547

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

1. Deferred acquisition costs

	December 31 2006 NIS in Millions, Reported
In life insurance (1)	730
In general insurance and in medical insurance	163
	893

(1) Composition:	
Deferred acquisition costs D.A.C	657
Zillmer deduction	73
	730

2. Other assets

a) Composition:

	December 31 2006 NIS in Millions, Reported
Goodwill	924
Original difference attributed to value of insurance portfolios	683
Deferred Taxes	22
Acquisition costs of life insurance portfolios from Noga Insurance Company Ltd. (dissolved)	9
Other	16
	1,654

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

E. Insurance reserves and pending claims

	December 31 2006 NIS in Millions
Life insurance:	
Insurance reserves (see 1, below)	20,842
Reserve for extraordinary risks	178
Pending Claims	69
Total life insurance	21,089
General insurance:	
Reserve for Unexpired Risks	1,923
Pending claims (see 2, below)	4,829
Total general insurance	6,752
Total reserves and pending claims	27,841

E1. Life insurance reserves

a) Composition:

1) Insurance reserves by linkage basis
:

	December 31 2006 NIS in Millions, Reported
CPI Linked	13,832
For profit sharing policies, including policies in personal investment tracks	6,473
Non-linked or denominated in foreign currency	537
	20,842

2) Major reserve types

Reserves for ADIF type policies	13,442
Reserves for MEORAV type and other policies	7,400
	20,842

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

b) Details of insurance reserve types and methods for their determination

1) ADIF type policies:

In these policies the savings component is identified. The major basic reserve is in the amount of accumulated savings plus returns subject to policy terms as follows:

(a) Reserve linked to asset principal (profit sharing policies).

(b) Principle linked to CPI plus fixed, guaranteed interest or credited by guaranteed return against adjusted assets (non profit sharing policies) For insurance components attached to ADIF policies (disability, death, nursing care etc.) the reserve is calculated as set forth in section (2) below.

2) MEORAV (legacy) type and other policies:

In MEORAV type policies, the savings component is combined with an insurance component for death risk. Other policies include pure savings components or pure risk components (disability, death, nursing care etc.) as well as risk factors attached to ADIF type policies, as mentioned above. For these policies the reserve is calculated mathematically. In addition, reserves for claims paid over an extended period of time are calculated in disability and nursing care type policies.

The insurance reserves also include provisions for IBNR claims and profit sharing in group insurance.

c) Below are details of calculation methods for reserves for MEORAV type and other policies, by reserve and product type:

1) Some 35.5% of the mathematical reserve is for legacy products with a savings component (predominantly the MEORAV product), and pure risk products with a fixed premium (predominantly disability and nursing care). This reserve is calculated for each coverage as a discounted cash flow of expected claims, less expected future premiums. This calculation is based on the assumptions used to price the products, including the interest rate (hereinafter: "base interest") and mortality or morbidity charts. The calculation is done using a theoretical calculation known as “Net Premium reserve”, where instead of accounting for expenses and commissions directly, the calculation is based on "net premium" which includes the expected cost for the claim component alone, and excludes the commission and expenses rate under the calculation assumptions.

The discount rates are from 3.5% to 5% for CPI-linked policies (reserves for these policies are primarily invested in designated government debentures); and 2.5% for profit sharing policies (sold since 1991).

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

2) In addition to this reserve, for legacy, investment profit sharing products a reserve is calculated at the actual amount of accumulated bonus. The bonus reflects the difference between actual returns and the base interest.

3) For extended-payment claims, including for nursing care and disability insurance, a reserve is calculated according to the expected payment period of claims and a discount rate appropriate for the policy type as set forth in section 1 above.

4) For paid pensions and policies including a pension liability, a reserve is calculated for each policy based on mortality rates including future enhancements to life expectancy and using discount rates appropriate for each policy type, as per Commissioner Memorandum 2007-1-3, published on Feb-20-07.

5) IBNR reserve (claims incurred but not yet reported) is calculated based on past experience.

6) The reserve for group life insurance is composed of reserve for unearned premiums, provision for profit sharing, IBNR reserve, reserve for standard deviations and provision for future losses if required; it is calculated based on commonly used actuarial practices.

d) The assumptions used for actuarial reserve calculations

1) For legacy products with a savings component, and pure risk products with fixed premiums, as set forth in section b2, the discount rate used is the base interest.

2) Furthermore, for reserves set forth in section b2, in most cases the mortality and morbidity rates are equal to the rates used to determine the rate approved by the Supervisor. In disability and pension sectors, based on company experience and/or general research or research by re-insurers indicating that mortality or morbidity rates used in calculations should be updated. Phoenix Insurance increases the reserve accordingly.

3) For other reserves, the actuary determines the assumptions based on guidelines of the Insurance Commissioner, if any; based on past experience (which is reviewed from time to time); and/or by research of re-insurers or standard charts where the Company has insufficient history to use past experience.

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

e) Liability Adequacy

A Phoenix Insurance actuary verifies annually that the total reserve amount, less deferred acquisition costs, is sufficient to cover the expected future flow: Claims, commissions and expenses less premiums and investment revenues. The flows are checked after discounting expected cancellations and are discounted using real, risk-free interest for existing policies, under reasonable assumptions. This check is conducted at several levels, as follows:

1) Check recoverability of DAC (as per Insurance Commissioner memorandum). For this calculation, a check is performed that the reserve less DAC for the policies sold since 1999 is sufficient, and that the policies are expected to generate future revenues which cover the DAC reduction and the insurance liabilities, operating expenses and commissions for these policies. The check is performed in aggregate for all underwriting years combined.

   Even a 200% worsening in cancellation rate should not impact the recoverability of DAC.

2) Phoenix Insurance conducts checks of reserve adequacy. If this check indicates that the premiums received are insufficient to cover the expected claims, a special provision for this shortfall is recorded. The check is performed separately for individual policies and for collective policies. In case of individual policies, the check is performed at the product level.

   The assumptions used for the above checks, including assumptions with regard to cancellations, operating expenses, return on assets, mortality and morbidity are determined by the actuary annually based on tests, past experience and other relevant research.

2. Pending claims in general insurance

a) Below is the composition by segment:

	December 31
	2006
	NIS in Millions, Reported
In Israel	
Mandatory auto insurance segment	1,704
Third party insurance segment	446
Other liability segments	764
Total liability segments	2,914
Other segments	652
Total provisions for pending claims	3,566

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

a) Below is the composition by segment: (Contd.)

	December 31 2006 NIS in Millions, Reported
Abroad (outside Israel)	
Auto segments (1)	717
Property segments	145
Liability segments (2)	401
Total provisions for pending claims	1,263
Total	4,829

b) Below is the composition by provision type:

	December 31 2006 NIS in Millions, Reported
Actuarial estimates	3,837
Other estimates	840
Excess revenue over expenses (accumulation)	152
Total provisions for pending claims	4,829

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

c) Further details on calculation method of actuarial estimate.

1) Gross pending claims, and pending claims less the share of re-insurers in them were calculated by the external actuary, Mr. Stuart Cotts of "International Actuarial Consultants" based on actuarial calculations for the following segments: Casco auto, homeowners, business, mandatory auto and the liability segments (third party, employer's liability, professional liability and product liability); for the medical expenses, severe illness and dental insurance segments they were calculated by Ms. Dafna Vairuch, a Company employee; and for the personal accident and travel insurance segments they were calculated by the actuary Mr. Moti Mor, a Company employee. These actuaries have stated, *inter alia*, that the estimates were prepared in accordance with common actuarial practices and that the assumptions and methods for estimating the provisions were determined by them to the best of their professional knowledge and in accordance with instructions, rules and regulations (see actuary statements attached to financial statements).

(a) Liability and mandatory auto segments:

(1) The basic calculation models (for further details see section d1):

(a) Chain ladder.

(b) Link Ratio.

(c) Bornhuetter-Ferguson.

(2) Individual estimates of claim departments is accounted for in the following cases:

(a) Old pending claims.

(b) Especially large claims.

(3) Assessment of pending claims was made at gross level and at re-insurance level separately.

(4) Estimation of the re-insurer's share for claims due to excess contracts for the past three underwriting years was calculated based on percentage of premium for re-insurance. For claims which occurred in a previous period, the estimate is based on actual claims.

(5) The estimates for facultative re-insurance were made under a model separate from other claims (at gross level and at residual level).

(6) Individual estimates account for the share of deductible payable by the customer.

(7) Subrogation is accounted for, since the actuarial model accounts for development of all payments (positive and negative).

(8) No provision was calculated for indirect expenses for claim settlement. Calculated for policies issued starting in 2006.

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

(9) Estimates of pending claims for the companies' share of the Israeli auto insurance pool affiliated with the Israeli Insurance Company Association (hereinafter: "the pool"), and for re-insurance and co-insurance received from other insurance companies (lead insurers) are based on calculation made by the pool or by the lead insurers.

(b) Property and medical segments (automotive property, business comprehensive, homeowners comprehensive, personal accidents and travel):

(1) The basic calculation models:

(a) Chain ladder.

(b) Link Ratio.

(c) Averages.

(2) Individual estimates of claim departments is accounted for in the following cases:

(a) Old claims.

(b) Claims due to car theft and damage by natural elements.

(3) Assessment of pending claims was made at gross level and at re-insurance level separately.

(4) Estimation of the re-insurer's share for claims due to excess contracts was based on actual claims.

(5) The estimates for facultative re-insurance were made under a model separate from other claims in segments where the re-insurer's share is material.

(6) Individual estimates account for the share of deductible payable by the customer.

(7) Subrogation is accounted for, since the actuarial model accounts for development of all payments (positive and negative).

(8) No provision was calculated for indirect expenses for claim settlement. According to the Ministry of Finance memorandum, insurance companies are required to make this provision starting in 2006 for policies issued after this date.

(c) Medical expenses, severe illness and dental insurance:

(1) The basic calculation model: Link Ratio.

(2) Individual estimates of claim departments is accounted for in claims due to implants.

(3) A provision was calculated for indirect expenses for claim settlement for policies issued starting in 2006.

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

2) Estimation of non-statistical insurance segments:

Phoenix Insurance has reviewed actuarial calculation for pending claims in the remaining general insurance segments. Due to absence of statistical significance, no actuarial model was implemented for the following segments: Engineering insurance, loss of property, cargo, airplanes and sea vessels, overseas business and other risks. Therefore, pending claims in these segments were included as follows:

a) Known pending claims which include appropriate provision for settlement and processing expenses through the end of the period, and which are as yet unpaid as at the date of the financial statements. This provision is primarily based on individual estimate of each claim according to opinion obtained from legal counsel and company experts who handle the claims.

b) Provision for claims incurred but not yet reported to the company (IBNR).

d) The assumptions and material models for determining insurance liabilities in general insurance

1) Pending Claims:

In estimating pending claims, the following actuarial models were used, along with different assumptions. Choice of the actuarial method appropriate for each insurance segment and each event/underwriting year was based on discretion, according to how appropriate the method was for the case and sometimes a combination of different methods was used. In some cases the actuary updates the models for trends, court rulings, changes in legislation or other factors which may influence future claims differently than in the past.

(a) Chain Ladder/Link Ratio:

These methods are based on historical claim development (development of payments and/or development of total claims, as well as development of number of claims) in order to estimate the expected development for current and future claims. Use of this method is primarily appropriate after a sufficient time period has elapsed since the event or policy underwriting, when there is sufficient information from past claims to estimate the total expected claims. The two methods differ in how the average development is calculated (simple average vs. weighted average). In segments with high claim variance, in addition to the average development factor, the standard deviation of development factors is also calculated.

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(b) Bornhuetter-Ferguson:

This method combines an a-priori estimate known within the company or the sector, and an additional estimate based on the claims themselves. The a-priori estimate used premiums and damage rate to estimate the total claims. The second estimate uses the actual claim experience, based on other methods (such as: chain ladder). The combined claim estimation weights both estimates, with a greater weight assigned to the estimate based on claim experience the longer the time which elapsed and with more claim information accumulated. Use of this method is primarily suitable where not enough claim information is available, or for a new business or one with insufficient historical information.

(c) Averages:

Sometimes, similar to the Bornhuetter-Ferguson method, when the claim experience over recent periods is insufficient, use is made of the historical average method. With this method the cost of claims is determined based on cost of claims for the policy in earlier years and the number of policies in later years. Similarly, the cost of claims is calculated based on the forecast number of claims (chain ladder method) and the average historical claim.

2) Major assumptions used for actuarial estimates

(a) Reserves in mandatory auto and liability segments were discounted based on a 3% real interest rate; the total reduction made is NIS 260 million gross, and NIS 220 million in residual.

(b) When calculating the reserves, the tail of claim development was accounted for.

(c) The basic assumption for each calculation method is that past claim behavior reflects their future behavior.

3) Changes to assumptions, facts (case law and legislation) and actuarial models made in the report year to material assumptions and their impact on the provisions:

The precedent of the “lost years” verdict has increased provisions by NIS 24.5 million gross and NIS 22 million in residual for death claims in mandatory and third party auto segments.

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

4) Sensitivity of provisions to changes in assumptions:

The actuarial estimate is based on statistical estimates which include an uncertainty factor. The statistical estimate is based on various assumptions, which may not necessarily materialize. Assumptions used for the actuarial forecast influence the end result for the provision. Therefore, the actual cost of claims may be higher or lower than the statistical estimate.

Assumptions set in the past may change with new information obtained in the future. In such case the provision would change based on changes to assumptions and actual results, and the differences created in the report year would be included in the general insurance business report.

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e) Check of estimation of pending claims, gross

In Israel	Underwriting year						
	2001	2002	2003	2004	2005	2006	Total
In mandatory automobile segment	NIS Millions adjusted for November 2006 CPI *)						
At end of year	7	6	8	11	13	18	
After 1 year	-	50	47	68	74	76	
After 2 years	-	-	102	119	136	133	
After 3 years	-	-	-	192	183	181	
After 4 years	-	-	-	-	234	227	
After 5 years	-	-	-	-	-	268	
Accumulated claim estimate (including payments)							
At end of year *)	277	363	384	447	431	415	
After 1 year	-	378	398	469	455	429	
After 2 years	-	-	411	481	472	437	
After 3 years	-	-	-	449	457	408	
After 4 years	-	-	-	-	445	425	
After 5 years	-	-	-	-	-	413	
Excess (shortfall) after release of accumulation					12	(4)	8
Deviation rate after release of accumulation (%)					2.7%	(1.06%)	(0.9%)
Accumulated claim estimate (including payments) as at December 31, 2006 *)	278	378	411	449	445	413	2,374
Accumulated payments through December 31, 2006	7	51	103	192	235	268	856
Pending claims at end of period	271	327	308	257	210	145	1,518
For years through 2000							277
Total insurance liabilities as at December 31, 2006							1,795
Less - reserve for unexpired risks							
Less - deferred acquisition costs							91
Total pending claims as at December 31, 2006							1,704

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

e) Check of estimation of pending claims, gross (Contd.)

*) Including reserve for unexpired risks less deferred acquisition costs.
**) The above amounts are adjusted to the CPI as per instructions of the Insurance Commissioner, in order to allow review of their development based on real values.
***) The source of deviation is late reporting of claims for policies insured under re-insurance at 100% which are not administered by the Company. This deviation does not exist in the Company's residual.

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

In third party sector:	Underwriting year						
	2001	2002	2003	2004	2005	2006	Total
	NIS Millions adjusted for November 2006 CPI *)						
At end of year	16	1	1	1	1	1	
After 1 year	-	61	7	5	4	5	
After 2 years	-	-	11	10	7	11	
After 3 years	-	-	-	18	15	19	
After 4 years	-	-	-	-	23	28	
After 5 years	-	-	-	-	-	31	
Accumulated claim estimate (including payments)							
At end of year *)	76	74	72	86	83	72	
After 1 year		79	71	87	87	74	
After 2 years		-	73	88	89	79	
After 3 years		-	-	67	71	62	
After 4 years		-	-	-	67	73	
After 5 years		-	-	-	-	71	
Excess (shortfall) after release of accumulation					4	(9)	(5)
Deviation rate after release of accumulation (%)					(5.2%)	14.79%	4.2%
Accumulated claim estimate (including payments) as at December 31, 2006 *)	76	79	73	67	67	71	433
Accumulated payments through December 31, 2006	1	6	11	18	23	31	90
Pending claims at end of period	75	73	62	49	44	40	343
For years through 2000, inclusive							131
Total insurance liabilities as at December 31, 2006							474
Less - reserve for unexpired risks							
Less - deferred acquisition costs							28
Total pending claims as at December 31, 2006							446

*) Including reserve for unexpired risks less deferred acquisition costs.

**) The above amounts are adjusted to the CPI as per instructions of the Insurance Commissioner, in order to allow review of their development based on real values.

***) The source of deviation is late reporting of claims for policies insured under re-insurance at 100% which are not administered by the Company. This deviation does not exist in the Company's residual.

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

Abroad (outside Israel)
In liability sectors:

	Underwriting year 2006 NIS millions, reported
Paid claims (accumulated)	98
Estimated accumulated claims (including payments)	100
Estimated accumulated claims (including payments), as at December 31, 2006 *)	100
Total insurance liabilities as at December 31, 2006	98
Total pending claims as at December 31, 2006	2

*) Including reserve for unexpired risks less deferred acquisition costs.

f) Long-Term Liabilities

Composition:

	Weighted interest rate as at December 31, 2006 %	As at December 31, 2006 NIS in Millions, Reported
Deferred notes (1 below)	5.2	1,648
Deferred taxes (2 below)		412
Loan from banking corporation (3 below)	4.9	177
Others		16
Total long term liabilities		2,253

1. Deferred notes:

(1) Repayment years – from balance sheet date

First year (current maturities)	29
Second year	132
Third year	315
Fourth year	315
Fifth year and later	886
	1,648
	1,677

Under capital regulations, the share of deferred notes payable after two years from the date of the financial statements are considered secondary capital

As at December 31, 2006, some NIS 475 million of all notes are considered to be secondary capital

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

2. Deferred Taxes

	As at December 31 2006 NIS in Millions, Reported
Composition:	
For deferred acquisition costs	174
For other assets	228
Other items (primarily fixed assets)	10
	412

Deferred taxes are created due to the difference between the adjusted value of non-monetary assets and the value deductible for tax purposes.

3. Loans from bank

Maturities subsequent to balance sheet date

	As at December 31 2006 NIS in Millions, Reported
First year (current maturities)	27
Second year	56
Third year	59
Fourth year	62
	177
	204

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

g) Other Liabilities

	As at December 31
	2006
	NIS in Millions, Reported
Insurance companies and insurance brokers	
Deposits of Reinsurers (1)	306
Other accounts (1)	52
	358
Credit from banking corporations and others (2)	57
Other accounts payable and credit balances (3)	607
	1,022
(1) Including:	
In life insurance	157
In general insurance	201
	358

	Weighted interest rate as at December 31, 2006	As at December 31
		2006
	%	NIS in Millions, Reported
(2) Including:		
Current maturities for deferred notes	5.9	29
Current maturities for long term loans		27
Overdraft	7.7	1
		57

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	As at December 31 2006 NIS in Millions, Reported
(3) Including:	
Accounts payable, trade	52
Liabilities to institutions	63
Liabilities to employees and other liabilities for wages and salary	81
Liabilities to insurance agents	213
Liabilities to policyholders	75
Advanced revenues	4
Expenses payable	68
Liabilities to held companies and interested parties	2
Deferred Taxes	6
Other Liabilities	43
	607

h) Guarantees, contracts and contingent liabilities

(a) Guarantees and contracts

1. Phoenix Insurance is guarantor for members of Phoenix Central Severance fund and members of Phoenix Provident and Severance fund, such that amounts reimbursed to them would in no case be less than amounts deposited by them into the funds.
The value of assets in said funds as at the balance sheet date considerably exceeds the amounts which the company guarantees.

2. The subsidiary, Phoenix Insurance, has liabilities for future investments in venture capital and equity funds which as at Dec-31-06 amount to NIS 511 million, of which NIS 4870 million out of profit sharing policy monies.

3. Phoenix Insurance has extended credit facilities to several entities which may instruct the company to grant them loans under these credit facilities as per agreements with then. The balance of credit facilities extended by Phoenix Insurance which are untapped as at Dec-31-06 is NIS 267 million.

   Subsequent to the balance sheet date, Phoenix Insurance provided a guarantee to an associated company of the Company (Excellence Investments Ltd. – hereinafter: "the associated company") amounting to NIS 170 million for obligation to increase the associated company's shareholders' equity so that it may be appointed as market maker. The guarantee will be effective in 2007 and may be extended for further terms.

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4. On September 10 an agreement was signed with the Chairman of the Phoenix Board of Directors, by which the Chairman would be eligible for a bonus of 0.5% of the difference between the Company value derived from the average price of Company shares traded on the Tel Aviv Stock Exchange on the final 20 trading days of the relevant year, less all amounts invested in the company as share capital, including amounts received in issues of affiliated companies from the date of signing the agreement, plus 75% of all dividends declared by the Company from the date of signing the agreement, and a base amount of $650 million plus the difference in valuation for which the chairman of the board had received, via the management company, bonuses for previous years.

(b) Requests for approval of class action lawsuits

1. In the District Court in Tel Aviv on Jun-19-00 a claim was filed against Discount Mortgage Bank Ltd. (hereinafter: "the bank") and against Phoenix Israel Insurance Company Ltd. (hereinafter: "Phoenix Insurance") by two couples.

   The claim states that the plaintiffs have obtained loans from the bank for purchase of a residential apartment secured by a mortgage, and in conjunction with this loan the bank required them to insure their residential apartment under homeowner's insurance policies with Phoenix Insurance. The plaintiffs claim that the initial insurance amount set for their apartments was higher than the proper reinstatement value of the apartments, and furthermore, they claim, in December 1993 and December 1994 the insurance amounts for their apartments were increased, with no justification or reasonable cause. Therefore, the plaintiffs claim, they paid exorbitant insurance premiums over the years, and have accordingly petitioned for reimbursement of the excess insurance premiums paid by them under their claim.

   The plaintiffs have applied for approval of their lawsuit as a class action suit. The plaintiffs estimated the class action lawsuit amount at NIS 105 million. In December 2000 the District Court decided to delay proceedings against the bank alone. Following this decision, Phoenix Insurance filed a motion with the District Court to delay proceedings against it, under claims of pending proceedings as well as under the claim that the proceedings cannot be further explored in the absence of the bank, which is a necessary and required party to the proceedings. The District Court rejected the motion to delay proceedings by Phoenix Insurance, and therefore Phoenix Insurance filed in May 2001 a motion to appeal to the Supreme Court the rejection by the District Court of the motion to delay proceedings against it. The motion was approved and in January 2002 an injunction was granted to delay proceedings against Phoenix Insurance. After several continuations, a further reminder meeting was scheduled for Jun-28-07.

   Management of Phoenix Insurance and Company management estimate, based on legal counsel, that chances are slim for approval of the lawsuit as a class action suit, therefore no provision was made for this lawsuit in the financial statements.

2. In April 2003 a claim was filed against Phoenix Israel Insurance Company Ltd. (hereinafter: "Phoenix Insurance") and other insurance companies, with attached application for approval of the lawsuit as a class action suit (Case no. 1498/03 under 8673/03).
   The cause for the claim is collection of stamp duty payable for insurance agreements under the Stamp Duty on Documents Law, 1961 unlawfully for a period of years.

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The plaintiff claims that by collecting stamp duty from him, Phoenix Insurance made unlawful profits at his expense, and is therefore liable to refund the amounts it collected and transferred to the Ministry of Finance. The total claim amount is NIS 95 million. Phoenix Insurance filed its response on Sep-15-03. On Dec-01-05 a pre-trial hearing was held, in which the plaintiff asked to consider a motion to amend the affidavit supporting his request to approve the lawsuit as a class action suit. At his request, the court allowed him 21 days in which to do so. On Dec-20-05 the plaintiff's attorney informed the court that the plaintiff intends to file a motion to amend the affidavit in case no. 1497/03 only (i.e. not the affidavit in support of the request subject of the claim against Phoenix Insurance). As for the discussion of the request to approve filing of a class action suit against Phoenix Insurance, the above pre-trial hearing determined that this would be postponed until following a decision is handed down on the requests to approve class action suits filed against the other insurance companies, on matters similar to the subject of this request. On May-01-06 a joint notice was submitted by the other insurance companies, in which they agree there is a need to interrogate the affidavit providers, and therefore they see no point in separating the hearings on the four cases, and the court was therefore asked to schedule a single hearing date for them.

The court's decision on May-04-06 was that the cases (including the one concerning Phoenix Insurance) would be brought up for decision on Jul-12-06. Prior to handing down a decision on this matter, on Sep-04-06 the judge handed down a decision to transfer the case for selection of a different judge to hear it. As at the report date no such selection was made yet.

Management of Phoenix Insurance and Company management, based on legal counsel, opine that Phoenix Insurance has good defense claims which stand a good chance to reject the claim and its status as a class action suit, therefore no provision was made for it in the financial statements.

3. On Jun-04-03 a claim was filed against Phoenix Israel Insurance Company Ltd. and against Hadar Insurance Company Ltd. (hereinafter: "Phoenix Insurance") accompanied by a motion to approve the lawsuit as a class action suit.

   The lawsuit involves the claim that policyholders under the "KAV HA-BRIUT" insurance programs were allegedly insured under two policies having overlapping insurance coverage which apparently present "double insurance" due to deception and/or exploitation and/or distress by Phoenix Insurance. The total claim amount is NIS 12 million. The response of Phoenix Insurance to the motion to approve the lawsuit as a class action suit has been filed with the court.

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On March 9, 2004 a pre-trial hearing was held on the request to approve the aforementioned lawsuit as a class action suit, in which it was decided to eliminate the cause under the Consumer Protection Law from the lawsuit and from the request to approve it as a class action suit, as well as reduction of the application for a class action suit so that it would only apply to policyholders who purchased policies as set forth in the motion from Jan-01-98 onwards. After many delays caused by the plaintiff, on Sep-21-05 a motion was filed to amend the motion to approve the lawsuit as a class action suit, accompanied by an expert opinion. Phoenix Insurance, as advised by the court, did not object to the motion and on Jun-06-06 Phoenix Insurance filed an amended response, also accompanied by an expert opinion on its behalf. On Jan-16-07 an evidentiary hearing was held in this lawsuit. In this hearing, the person who filed for a class action suit which allegedly had cause against Phoenix Insurance, retracted her case and motion, and the court ordered the claim against Phoenix Insurance to be expunged. Following the evidentiary hearing, the court instructed that the Attorney General should be approached for his position on the claims made in the motion, and after his position is obtained, the responses of plaintiffs and defendants to his position should be sought. Only after this would the case be scheduled for summation.

Management of Phoenix Insurance and Company management, based on legal counsel, opine that Phoenix Insurance has good defense claims which stand a good chance to reject the claim and in particular its status as a class action suit, therefore no provision was made for it in the financial statements.

4. On Jan-09-05 a claim was filed against Phoenix Israel Insurance Company Ltd. (hereinafter: “Phoenix Insurance”) accompanied by a motion to approve the lawsuit as a class action suit. This lawsuit claims that Phoenix Insurance allegedly deceives its business customers when contracting comprehensive auto insurance, since collection of insurance premiums is based, according to the plaintiff, on Levi Yitzhak’s pricelist, while when making insurance payouts subsequently to an insurance event, the company deducts the VAT component from the car value. The plaintiff filed a motion to award its lawsuit class action status for all business customers who have comprehensive auto insurance, setting the claim amount at NIS 223.3 million. Phoenix Insurance filed its response on May-11-05. The lawsuit was thrown out by decision of the court in March 2006.

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5. On Oct-19-04 a claim was filed against Hadar Insurance Company Ltd. (hereinafter: "Phoenix Insurance") accompanied by a motion to approve the lawsuit as a class action suit. The lawsuit involves payment of motor vehicle insurance payout in cases of total loss. The plaintiffs claim that in cases of total loss, Phoenix Insurance does not pay the full insurance payout, which amount, according to them, to the car's full pricelist value, but rather deduct from its value various sums for special variables associated with the car pricelist and which may affect its value. The plaintiffs claim that in so doing, without notifying the policyholders in the insurance proposal stage or when contracting the insurance contract, Phoenix Insurance allegedly misleads all policyholders and is in breach of a duty legislated in view of instructions by the Insurance Commissioner on this matter. The plaintiffs have set the claim amount at NIS 41 million. Phoenix Insurance filed its response with the District Court on Jan-09-05.

   In its decision dated Jun-06-05 the court instructed that the Commissioner of Capital Market, Insurance and Savings should inform the court if he wishes to join the proceedings, and further instructed the parties to announce their position on conducting the proceedings with no inquiries. On Jul-25-05 Phoenix Insurance informed the court that it would be willing to conduct the proceedings with no inquiries, provided that the plaintiffs so consent. Phoenix Insurance informed the court that should the plaintiffs insist on conducting proceedings with inquiries, it would also reserve the right to do so.

   On May-29-06 the Insurance Commissioner informed the court of his position via the Attorney General, whereby he joins the proceedings and states his position on the applicability of the Insurance Commissioner's memorandum and its status, without expressing a position on the proceedings per se. The plaintiffs' response to the Attorney General's position was filed on Jun-19-06 and Phoenix Insurance's response to the Attorney General's position was filed on Jul-10-06. On Jul-30-06 the plaintiffs filed a motion to erase Phoenix Insurance's response to the Attorney General's position, and Phoenix Insurance filed its response to this motion on Aug-07-06. On Nov-06-06 a pre-trial hearing was held on this matter, where the plaintiff's attorney repeated their request to erase Phoenix Insurance's response to the Attorney General's position. On Dec-18-06 the judge handed down his decision wherein he rejects the claim that Phoenix Insurance's response expands the case, but instructed Phoenix Insurance to file a summary response within 45 days within the limit on page numbers set in the proceedings arrangement, and granted the plaintiff and the Attorney General the right to respond to Phoenix Insurance's response within a further 45 days. Phoenix Insurance filed its summary response to the Attorney General's position on Feb-01-07.

   Management of Phoenix Insurance and Company management, based on legal counsel, opine that it is currently impossible to assess the chances of this claim; therefore no provision was made for it in the financial statements.

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6. On Apr-25-06 a motion to approve class action status was filed by Emek Zevulun Metal Coatings Company Ltd. and others against Migdal Insurance Company Ltd. and other insurance companies, including Phoenix Insurance Company Ltd. (hereinafter: "Phoenix Insurance"), concerning disability insurance policies (case no. 1519/06 at Tel Aviv District Court).

   To summarize, the plaintiffs claim that the defendants charge under these policies monthly premiums for the "waiting period", i.e. the period from the date on which the event occurs by which the policyholder is disabled, and until the period specified in the policies – three months – has elapsed. Only after the waiting period is over, and provided that the policyholder is still disabled, would the insurance company start paying the insurance fees from this time onwards. The plaintiffs claim that the policies subject to the lawsuit, which are issued by different insurance companies including Phoenix Insurance, there is another condition for making insurance payouts, which is the time at which the insurance company stops payment of the insurance fees, i.e. the end of the period set forth in the policy. In all policies subject to the lawsuit, the end of the period is the date set as the end of the policy term, the end of the year in which the policyholder turned 65 or cancellation of a life insurance policy to which a disability policy has been attached, or the death of the policyholder. The plaintiffs claim that should the insurance event occur in the period starting three months prior to the end of the disability policy term, the situation arises where the policyholder would not be eligible for insurance payout in any case. The plaintiffs claim that in such case, by the date on which eligibility for insurance payout is created, following the waiting period, the policy term would have expired and the insurer would no longer be liable to make insurance payouts.

   The damage claimed by the plaintiffs is the insurance fees paid for the non-covered period. According to an expert opinion obtained by the plaintiffs, the initial estimation of the damage for the years 1998-2004 for the five insurance companies being sued is NIS 47.6 million, and with regard to Phoenix Insurance, the estimated damage is NIS 8.12 million. Phoenix Insurance filed its response On Oct-03-06 objecting to the motion to award class action status. A preliminary hearing on the motion has been scheduled for Mar-19-07.

   Management of Phoenix Insurance and Company management, based on legal counsel, opine that it is currently impossible to assess the chances of this claim; therefore no provision was made for it in the financial statements.

7. On Jun-19-06 a claim was filed with the Tel Aviv District Court against Phoenix Insurance, other insurance companies, banks, and provident funds, accompanied by a motion to approve the lawsuit as a class action suit. The lawsuit and the motion are concerned with payment collection under Collection Regulations (Fees, Wages and Expenses), 1968 ("the Fee Regulations") in conjunction with "Request to impose third party foreclosure" via electronic media, on accounts and rights of debtors which are held by third parties listed under the Fee Regulations. Phoenix Insurance is a third party listed under the Fee Regulations.

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The plaintiffs claim that Phoenix Insurance (as all other defendants which are insurance companies and banks) does not provide to those requesting to impose third party foreclosures via electronic media, information on monies or rights of debtors held by it at the time, or only provides partial information to the requestor, or provides misleading information to the requestor. This is although, pursuant to the Fees Regulations, it charges a fee for this service. The plaintiffs further claim that Phoenix Insurance has not informed the requestors that it is unable to provide real, true answers to questions directed to it in conjunction with requests to impose third party foreclosures.

By so doing, the plaintiffs claim, Phoenix Insurance is in blatant breach of the prohibition on deception and the duty of disclosure imposed on it by the Insurance Supervision Law, the Consumer Protection Law, the Debt Collection Law and regulations pursuant thereto. The plaintiffs also claim that in doing so, Phoenix Insurance is making unlawful gains at their expense. The plaintiffs have set the aggregate damage to the claimed class, and thus the amount of the class action suit, at NIS 233 million.

On Oct-18-06 Phoenix Insurance filed, together with the other insurance companies, a preliminary motion to reject the motion prior to filing their response ("the preliminary motion") and also filed a request for extension of time to submit their response to the motion to award class action status, pending a decision on the preliminary motion, inasmuch as such a response would at all be necessary. On Oct-31-06 the court accepted the motion for extension, and determined that the response to the motion to award class action status will be due 30 days after a decision is made on the preliminary motion. On Nov-20-06 the plaintiffs filed a request for extension, unopposed, to submit their response to the preliminary motion. On Nov-29-06 the court granted their request. On Dec-19-06, the final date to submit the plaintiffs' response to the preliminary motion, the plaintiffs requested, without seeking consent of the defendants, a further 45 day extension for submitting their response. The plaintiffs have yet to file their response to the preliminary motion. In their preliminary motion, the companies raised valid claims concerning the appropriateness of the lawsuit to be debated as a class action suit, yet because we are dealing with a new class action suit law, which has not yet been elaborated by the courts, it is difficult to assess if the preliminary motion would be accepted. Note that the defense statement in the lawsuit would only be submitted by the companies, if at all, after a decision is handed down on the request to award class action status. Should the preliminary motion not be accepted, the companies have good defense claims against both the motion to award status and against the lawsuit itself.

Management of Phoenix Insurance and Company management, based on legal counsel, opine that it is currently impossible to assess the chances of this claim; therefore no provision was made for it in the financial statements.

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8. On Dec-19-06 a claim was filed with the Tel Aviv District Court against Phoenix Insurance accompanied by a motion to approve the lawsuit as a class action suit, which Phoenix Insurance received on Dec-25-06.

   The lawsuit and motion to award class action suit status concerns a "disability by accident" appendix added, at the policyholder's request, to the life insurance policy (hereinafter: "the appendix").
   This appendix includes a table listing the rate of monetary compensation to be paid out of the full insurance amount for various bodily injuries, such as: Loss of leg, arm etc. The company pays compensation based on the disability grade determined relative to the organ injured, and thereby the company restricts its liability under the policy.

   The lawsuit claim is based, *inter alia*, on breach of disclosure duty set forth in insurance laws, including in the Supervision of Financial Services (Insurance) Law, 1981 and regulations pertaining thereto, provision of misleading description, breach of contract, imposing a restriction not in good faith, breach of fiduciary duty and making unlawful gains.
   The plaintiff claims, on his behalf and on behalf of the class, that he is entitled to receive appropriate compensation out of the full insurance amount set forth in the policy, based on the disability rating determined or to be determined, as opposed to the amount paid by the relatively lower disability rating as calculated by the company.

   The plaintiff asks that the company be found liable to pay the difference between the compensation due, under the plaintiff's claim, pursuant to the policy and the actual compensation paid – for the entire class. The plaintiff's personal damage was set at NIS 77 thousand, whereas for the entire class the plaintiff has no information allowing the total damage to be estimated. A defense statement has yet to be filed, since an extension has been granted.
   Phoenix Insurance management, based on legal counsel, opine that it is currently impossible to assess the chances of this claim to be accepted and the financial exposure inherent to it should the claim be approved, therefore no provision was made for it in the financial statements.

9. On Feb-25-07 a claim was filed with the Tel Aviv District Court against Phoenix Insurance accompanied by a motion to approve the lawsuit as a class action suit; similar claims and motions were filed against 4 other insurance companies.

   The claim was filed by the defendant on her own behalf and on behalf of all Phoenix Insurance customers who have purchased from Phoenix Insurance a comprehensive auto insurance policy including additional coverage (riders) such as: Towing services, courtesy car services, glass breakage and radio insurance and for whom an insurance event had occurred.

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The plaintiff claims that in case of total loss, the policy is cancelled (after compensating the policyholder) but she did not receive from Phoenix Insurance, as did not all class members, the pro-rated refund of premium paid for the riders. The plaintiff estimated the class action lawsuit amount at NIS 6.5 million.

From initial analysis of this lawsuit it would appear hat its chances to prevail are slim, and therefore no provision was made for it in the financial statements.

10. One of Republic's subsidiaries is a defendant at Louisiana Federal Court in a class action suit filed in April 2006 in the aftermath of Hurricane Katrina. The lawsuit claims that the subsidiary – and other unrelated insurance companies – are in breach of their insurance policies by not paying the policy amount to policyholders who have lost their homes, since the policies did not include coverage for losses. The plaintiffs ask to receive the amount set forth in the policies, regardless of caveats in the policies or the fact that the subsidiary has paid for losses covered under the terms of the policies. The remedies sought by the plaintiffs are declarative remedies, unspecified amount in damages, legal damages and attorney fees. The proceedings are in the preliminary stages and the lawsuit had not yet been awarded class action status.

    In addition, two Republic subsidiaries are defendants at Louisiana Federal Court in a class action suit filed in August 2006 in the aftermath of Hurricane Katrina. The lawsuit claims that the subsidiaries, as well as other unrelated insurance companies, are in breach of their insurance policies by not properly applying the law on various matters. The remedies sought by the plaintiffs are declarative remedies, unspecified amount in damages, legal damages and attorney fees. The proceedings are in the preliminary stages and the lawsuit had not yet been awarded class action status.

    Furthermore, one of Republic's subsidiaries is defendant at Louisiana Federal Court in a class action suit filed in July 2006 in the aftermath of Hurricane Rita. The lawsuit claims that the subsidiary, Republic Fire, is in breach of its insurance policies by not properly adjusting and paying insurance claims over the past 10 years. The remedies sought by the plaintiffs are declarative remedies, unspecified amount in damages, legal damages and attorney fees. The proceedings are in the preliminary stages and the lawsuit had not yet been awarded class action status.

    Republic management is unable to estimate at this time the outcome of the said proceedings, the range of potential losses arising therefrom, if any, and is unable to estimate whether any of the lawsuits would have material negative impact on its business, results or operations. No provision was therefore made for the aforementioned proceedings in the financial statements.

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

I) Information on equity of Phoenix Insurance under the capital regulations

	Shareholders' equity	Primary capital
	NIS millions	
1. As at December 31, 2006		
The amount extant as at December 31, 2006 pursuant to the capital regulations (a)	1,580	1,105
The amount required as at December 31, 2006 pursuant to the capital regulations (b)	1,144	75
	436	1,030

(a) The amount required as of December 31, 2006 includes an addition of NIS 659 million for deferred acquisition costs in life insurance and in medical insurance, as well as NIS 96 million for "unrecognized assets" as defined in the capital regulations (primarily loans and expenses for acquisition of life insurance portfolios).

(b) Including "secondary capital" of NIS 475 million, as defined in the capital regulations.

2. Dividend distribution from capital surplus is also subject to liquidity requirements and compliance with the provisions of the investment regulations.

3. Pursuant to permit to control and hold means of control in Phoenix, awarded to Delek Group on November 16, 2006, no more than 50% of Phoenix Holdings' annual profits may be distributed as dividend over a 3 year period. This restriction would apply only should Phoenix Insurance's shareholders' equity drop below 120% of the shareholders' equity required under the shareholders' equity regulations.

4. In January 2007 the Insurance Commissioner published a draft amendment of the capital regulations, including a capital requirement for extraordinary risks in life insurance, amounting to 0.17% of the amount at risk in life insurance in Company's residual as of December 31, 2006, or 0.17% of the amount at risk in Company's residual as of the report date. This amount should be a capital requirement in addition to the capital currently required under existing regulations; the requirement is concurrent with classification of an identical share of reserve for extraordinary risks as shareholders' equity.

J) Fair Value of Financial Instruments

Fair value of financial assets and liabilities owned by subsidiaries which are not insurance companies approximately matched their book value.

NOTE 38: -INSURANCE BUSINESS (CONSOLIDATED) (CONTD.)

K) Proposal by Capital Market, Insurance and Savings Division concerning transfer of monies between mutual funds

In July 2006, the Insurance Supervisor published draft regulations for the supervision of financial services (provident funds) (transfer of funds between funds) – 2006 and a draft memo regarding the transfer of savings (including insurance coverage for disability and death) between provident funds. The drafts are aimed at allowing consumers to move their pension savings at any time between entities managing pension savings, thereby increasing competition and market sophistication. Under the proposed amendments, it would be possible, *inter alia*, to move the accumulated savings from a pension insurance policy to a comprehensive pension fund and vice versa, without any regulatory, legal or other restrictions, as well as from lump-sum programs (insurance policy, provident fund, continuing education fund), which provide a lump-sum payment, to a pension fund or a pension insurance policy. Furthermore, new regulations were set forth to support the proposed processes, including specific binding times to transfer information and accumulated monies for a customer who has asked to move, and setting means of communications between the different vendors to transfer information and content with regard to the transferring customer.

Moving savings monies from an insurance company, due to implementation of the above regulations, may impact future operations and/or results of Phoenix.

Since it is unclear whether the draft regulations would be accepted as-is or with changes, and since it is impossible to assess the policyholder behavior upon publication of the aforementioned regulations, it is therefore not possible at this time to anticipate the impact of said regulations.

The insurance companies are in discussions with the Insurance Commissioner on this matter.

NOTE 39: -CONSOLIDATED PROFORMA STATEMENTS OF INCOME

A. General

As specified in Note 9 J (g)(2), in November 2006 a transaction was completed to purchase a further 28.5% of the issued and outstanding share capital of the Phoenix (hereinafter: "the Additional Transaction"). As a result of completion of the transaction, the group held 61.5% of the issued and outstanding share capital of the Phoenix (prior to decrease in holding percentage as a result of issue of Phoenix shares) and therefore, pursuant to the instructions of the Securities Authority, the group included proforma data in the financial statements.

The proforma financial statements include the proforma consolidated statements of income for each of the years ended December 31, 2006, 2005 and 2004.

The proforma consolidated statements of income were formulated in order to reflect the results of the Group's operation under the assumption that the Group acquired 61.5% of the issued and outstanding share capital of the Phoenix as at 1 January 2004 (hereinafter: "the Acquisition Date"), rather than on the dates described in Note 9 J (g)(2).

NOTE 39: -CONSOLIDATED PROFORMA STATEMENTS OF INCOME (CONTD.)

B. Assumptions employed in preparation of the proforma financial statements

Proforma financial statements were formulated on the basis of the Group's and the Phoenix's financial statements for the periods specified in Section A, above. The accounting policy implemented when preparing the proforma financial statements is described in Note 2 above of the financial statements. Moreover, the proforma financial statements were formulated under the following assumptions:

1. On the acquisition date, the Group paid the entire consideration for acquisition of the Phoenix shares, a payment totaling NIS 1,873 million, financed by theoretical loans assumed by the Group. These theoretical loans are linked to the CPI and carry interest at a rate of 5.5% per annum. The financial expenses ensuing from these theoretical loans were recorded in the proforma statements of income starting from the Acquisition Date.

2. The excess cost created on account of the acquisition amounted to NIS 962 million. This excess cost will be allocated to the Phoenix's assets and liabilities and goodwill as outlined in Note 9 J (g)(2).

   The consolidated proforma statements of income include amortization of excess costs allocated to the insurance assets starting from the acquisition date (in accordance with the rates outlined in Note 9 J (g)(2). Goodwill from these acquisitions was not amortized.

3. The financial statements of an investee company, of which the Group acquired control following the Phoenix acquisition, were included in the consolidated proforma financial statements.

NOTE 39: -CONSOLIDATED PROFORMA STATEMENTS OF INCOME (CONTD.)

C. Consolidated Proforma Statements of income

	For the year ended December 31		
	2006	2005	2004
	NIS millions, reported		
General business:			
Revenues	26,330	20,365	14,380
Less excise and royalties	2,211	2,014	2,026
	24,119	18,351	12,354
Cost of revenues	21,217	15,814	10,304
Gross profit	2,902	2,537	2,050
Selling, marketing and gas station operating expenses	930	861	816
General & administrative expenses	442	340	304
Operating income	1,530	1,336	930
Financial expenses, net	650	734	461
	880	602	469
Gains from realization of investments in investee and other companies, net	702	139	100
Other income (expenses), net	2	245	(26)
Earnings before taxes	1,584	986	543
Taxes on income	404	342	199
Earnings after taxes on income, from general operations	1,180	644	344
Equity in earnings of affiliates and partnerships, net	597	104	133
Minority interest in subsidiary earnings, net	(355)	(221)	(165)
Net income from general business	1,422	527	312
Insurance business:			
Profit from insurance business	500	394	282
Revenue (losses) from investments and other revenue not included in insurance operations	46	27	(8)
Administrative and general expenses not included in insurance and other operations	42	52	38
Equity in earnings of affiliated companies	23	9	4
Earnings before taxes	527	378	240
Taxes on income	182	158	110
Earnings after taxes on income, from insurance business	345	220	130
Minority interest in earnings	(150)	(118)	(68)
Net income from insurance business	195	102	62
Overall net income	1,617	629	374

NOTE 39: -CONSOLIDATED PROFORMA STATEMENTS OF INCOME (CONTD.)

D. Principal Details Regarding Insurance Operations

1. Profit from insurance operations

	For the year ended December 31		
	2006	2005	2004
	NIS millions, Reported		
Profit from life insurance operations (A1)	336	367	327
Profit (loss) from general insurance operations (A2)	164	27	(45)
	500	394	282
(a1) Life insurance operations			
Premiums (1)	2,535	2,403	2,320
Less reinsurance	66	108	133
Retained premium	2,469	2,295	2,187
Revenues from investments, net	1,580	1,964	1,220
Total revenues for the year	4,049	4,259	3,407
Paid and pending claims	459	426	384
Less reinsurance	93	94	110
	366	332	274
Surrendered policies	719	645	665
Expired policies	119	131	112
Pensions	17	15	12
	1,221	1,123	1,063
Participation in income from group life insurance	5	4	3
Total claims for year	1,226	1,127	1,066
Excess of revenues over claims for year	2,823	3,132	2,341
Growth in insurance reserve (less reinsurance)	2,185	2,496	1,683
Less management fees for participating policies	237	222	155
Growth in reserve, net	1,948	2,274	1,528
Growth in reserve for extraordinary risks	12	10	5
	1,960	2,284	1,533
Paid commission	240	214	235
Administration and general expenses (A3)	254	231	215
	494	445	450
Decrease (increase) in deferred acquisition expenses	28	30	29
	522	475	479
Less commission from reinsurance	12	16	15
Expenses for year, net	510	459	464
Amortization of insurance portfolio purchasing expenses	9	8	8
Earnings for the year from life insurance operations before modified reinsurance results	344	381	336
Modified reinsurance results	(8)	(14)	(9)
Profit for statements of income	336	367	327

*) Reclassified

NOTE 39: -CONSOLIDATED PROFORMA STATEMENTS OF INCOME (CONTD.)

(A1) Life insurance operations (cont'd)

(1) Income from life insurance premiums

	For the year ended December 31		
	2006	2005	2004
	NIS millions, Reported		
Personal insurance			
Traditional	231	139	166
ADIF	184	205	330
Policies issued since 1 January 2004	50	27	8
Managers insurances			
Traditional	149	151	150
Preference	1,035	1,015	987
Policies issued since 1 January 2004	368	253	82
Group life insurance	99	87	98
Disability insurance	194	172	175
Nursing insurance	193	177	152
Other	32	177	172
Total	2,535	2,403	2,320

(2) Nominal rate of return on assets

Average return on assets at the Phoenix in participating investment policies issued from 1992 through to 2003 (J Fund) and for policies issued from 2004 onwards (general investment)

NOTE 39: -CONSOLIDATED PROFORMA STATEMENTS OF INCOME (CONTD.)

(A1) Life insurance operations (cont'd)

(2) Returns for 2003-2006 (in percentage) for participating policies of the associated company

	Gross annual nominal yield				Average annual nominal yield 5 years ***			
	2003	2004	2005	2006	Before management fees	After management fees	Standard deviation 5 years	Management fees for the year ended December 31, 2006
								NIS MIllions
Fund I	13.38	13.38	12.35	6.83	8.36	6.77	3.59	8
Fund J	18.09	18.09	15.00	9.7	10.59	8.61	4.24	222
Share tracks	-	-	24.60	12.4	19.38	18.04	12.49	*)
Debentures (50%)	-	-	15.54	14.45	14.31	13.27	7.06	*)
Debentures (60%)	-	-	9.37	7.50	8.20	7.01	2.17	*)
Foreign currency	-	-	10.44	4.28	5.18	4.01	3.43	*)
Index linked debentures	-	-	5.64	4.93	4.97	3.97	3.09	*)
General	-	-	11.43	7.55	10.06	8.69	1.58	6
Gamla	-	-	4.66	5.78	5.22	4.33	1.19	*)
Excellence - debentures	-	-	-	2.41**	-	-	-	*)
Excellence perpetual shares 15%	-	-	-	6.13**	-	-	-	*)
Excellence perpetual shares 30%	-	-	-	7.95**	-	-	-	*)
Excellence perpetual shares 50%	-	-	-	8.44**	-	-	-	*)
Excellence overseas	-	-	-	1.06**	-	-	-	*)
Excellence ETFs	-	-	-	2.06**	-	-	-	*)
Excellence perpetual shares 100%	-	-	-	3.12**	-	-	-	*)
Total								236

The sums in the clause relating to management fees for participating policies in life insurance operations were calculated in accordance with the Insurance Supervisor's directives, based on the quarterly yield and balance of the insurance reserves.

*) Represents sum lower than NIS 1 million
**) Excellence Invest products were introduced in October 2006
***) For products less than five years, average yield is from the day the product was launched.

NOTE 39: -CONSOLIDATED PROFORMA STATEMENTS OF INCOME (CONTD.)

A1) Life insurance operations (cont'd)

(3) For the year ended December 31, 2006:

	Policy with risk factor (including appendixes) According to policy issue date				Policy without risk factor				
			From 2004		Risk sold as single policy		Health		
	Up to 1990	Up to 2003	Participating in profits	Guaranteed yield	Private	Group	Private	Group	Total
	NIS thousands, reported								
A. Gross premiums:									
Traditional/mixed	161	105	1	-	143	-	39	-	449
Saving factor	55	1,001	456	-	21	-	-	-	1,533
Other	6	288	5	-	1	99	36	118	553
Total	222	1,394	462	-	165	99	75	118	2,535
B. Premiums for direct investment contracts for insurance reserves	-	-	164	5	-	-	-	-	169
C. Financial margin including management fees (3)	175	230	6	1	-	-	-	-	412
D. Profit (loss) from life insurance operations	178	184	(37)	1	42	(20)	2	(14)	336

NOTE 39: -CONSOLIDATED PROFORMA STATEMENTS OF INCOME (CONTD.)

Remarks:

1. The products issued in this period (including the growth in their respect) were mainly to guarantee yield and they are backed mainly by designated debentures.

2. The products issued in this period were mainly part of participating policies.

3. The financial margin does not include the company's further income earned as a percentage of the premium and it is calculated according to deduction of management expenses for investments. It also does not include the investments against reserves for exceptional risks.

   In the participating policies, the financial margin is the total fixed and variable management fees calculated on the basis of the average yield and balance of the insurance reserves.

NOTE 39: -CONSOLIDATED PROFORMA STATEMENTS OF INCOME (CONTD.)

A1) Life insurance operations (cont'd)

(4) As at 31 December 2006

	Policy with risk factor (including appendixes) According to policy date				Policy without risk factor				
			From 2004		Risk sold as single policy		Health		
	Up to 1990	Up to 2003	Participating in profits	Guarantees yields	Private	Group	Private	Group	Total
	NIS thousands, reported								
A. Insurance reserves (gross)									
1. According to insurance exposure									
Deferred pension payment until May 2001	1,862	7,026	-	-	-	-	-	-	8,888
Deferred pension payment from June 2001 onwards	-	289	112	-	-	-	-	-	401
Paid pension payment	165	39	1	-	-	-	-	-	205
Capital	4,232	4,896	687	41	-	-	-	-	9,856
Other	158	455	107	-	219	63	233	257	1,492
	6,417	12,705	907	41	219	63	233	257	20,482
2. According to financial exposure									
Guaranteed return	6,350	-	-	41	16	-	97	-	6,504
Participating	67	12,705	907	-	121	-	-	-	13,800
	-	-	-	-	82	63	136	257	538
	6,417	12,705	907	41	219	63	233	257	20,482
B. Contingent claims	7	30	1	-	23	8	-	-	69

NOTE 39: -CONSOLIDATED PROFORMA STATEMENTS OF INCOME (CONTD.)

A1) Life insurance operations (cont'd)

(5) Management fees for profit-participating policies

(a) For uncharged management fees consolidated in the net yield, calculations are based on estimations. The calculation relates to investment in mutual, hedge and investment funds.

(b) Management fees are calculated in accordance with the Supervisor's directives based on yield and accumulated saving of policyholders in the participating portfolio.

(c) Management fees include the following components:

For policies sold up to 31 December 2003 – fixed and variable management fees

For policies sold as at 1 January 2004 – fixed management fees only

(6) The consolidated financial statements include further reserve for covering future losses in collective health policies for the balance of the insurance period, for a sum of NIS 5.3 million (as at 31 December 2005, a sum of NIS 4.9 million).

NOTE 39: -CONSOLIDATED PROFORMA STATEMENTS OF INCOME (CONTD.)

A2) General insurance operations

	For the year ended December 31		
	2006	2005	2004
	NIS millions, Reported		
Premiums	1,733	1,691	1,728
fees	415	414	433
Total insurance fees	2,148	2,105	2,161
Less reinsurance	415	395	402
	1,733	1,710	1,759
Increase (decrease) in reserve for unexpired risks (less reinsurance)	(38)	(57)	33
Insurance fees earned	1,771	1,767	1,726
Revenue from investments, net	167	193	160
Total revenues for year	1,938	1,960	1,886
Paid and pending claims	1,462	1,743	1,599
Less reinsurance	230	357	244
Total claims for year	1,232	1,386	1,355
Excess revenues over claims for year	706	574	531
Paid commission	337	352	385
Less commission from reinsurance	70	72	73
	267	280	312
General and administrative expenses	270	282	255
Increase (decrease) in deferred acquisition expenses	5	(15)	9
Expenses for year, net	542	547	576
Profit (loss) carried to statements of income	164	27	(45)

NOTE 39: -CONSOLIDATED PROFORMA STATEMENTS OF INCOME (CONTD.)

(1) Results of general insurance operations by main insurance sectors:

	For the year ended December 31 2006				
	Assets (1)	Liabilities (2)	Health (3)	Others	Total
	NIS millions				
Insurance fees	1,124	537	466	21	2,148
Retained insurance fees	861	476	378	18	1,733
Change in reserve for unexpired risks, net	(14)	(47)	24	(1)	(38)
Paid and pending claims, gross	678	508	267	9	1,462
Claims for	553	465	205	9	1,232
income year	40	53	66	5	164

(1) including loss of property, vehicle property, comprehensive apartment and others.
(2) Including employer liability, third party, professional liability, and compulsory vehicle and other
(3) Including personal accident, disease and hospitalization

(2) General insurance operations

(a) The consolidated financial statements include further reserve for covering future losses in collective health policies for the balance of the insurance period, for a sum of NIS 5.3 million (as at 31 December 2005, a sum of NIS 9.4 million).

(b) The company did not receive more than 5% of its insurance fees from any other party. has no income from insurance fees received from any other party that exceed 5% of the insurance fees

A3) General and administrative expenses

(a) Composition:

	For the year ended December 31		
	2006	2005	2004
	NIS millions, reported		
Salaries and related expenses	297	273	237
Rental and office upkeep	37	35	34
Software and hardware depreciation and amortization	39	32	26
Other depreciation and amortization	19	22	21
Communication, mail, dispatches and other office expenses	23	22	25
Computer services	23	21	17
Auditing, consulting and other legal expenses	15	21	16
including amortization of surplus cost	113	139	132
	566	565	508

NOTE 39: -CONSOLIDATED PROFORMA STATEMENTS OF INCOME (CONTD.)

(b) The above mentioned expenses were included in the consolidated financial statements as follows:

	For the year ended December 31		
	2006	2005	2004
	NIS millions, reported		
Life insurance operations	254	231	215
General insurance operations	270	282	255
Profit and loss	42	52	38
	566	565	508

(c) Taxes on income

(1) Composition:

	For the year ended December 31		
	2006	2005	2004
	NIS thousands, reported		
Current taxes			
For the accounting year	189	140	97
In respect of preceding years	4	2	4
	193	142	101
Deferred taxes, net	(11)	16	9
	182	158	110

NOTE 39: -CONSOLIDATED PROFORMA STATEMENTS OF INCOME (CONTD.)

A3) General and administrative expenses

(c) Taxes on income (Contd.)

(2) Theoretical tax adjustments assuming the business results were subject to tax using the statutory tax rate for the company, compared to the actual tax sums:

	For the year ended December 31		
	2006	2005	2004
	NIS thousands, reported		
Earnings before taxes on income	527	378	240
Statutory tax on insurance companies	40.65%	43.59%	44.52%
Tax amounts based on statutory tax rate	214	165	107
Increase (decrease) in tax liability on account of:			
Amounts for which deferred taxes were not recorded	(13)	2	6
Unrecognized expenses less exempt income and other differences, net	(8)	1	-
Preferred income	(2)	(1)	(2)
Differences in defining assets and liabilities for tax and financial statement purposes	(1)	(7)	(1)
Income tax on payroll tax	4	3	3
Taxes in respect of preceding years	4	2	4
Erosion of prepaid tax			
Adjustments for different tax rate in consolidated companies	(2)	1	2
Amortization of original difference		5	5
Adjustments for change in tax rate (see clauses A2 and B above)	(14)	(13)	(14)
Provisions for income taxes in the statement of income	182	158	110

(d) Final assessments

(1) Phoenix has final assessments up to and including the 2003 tax year

(2) Other consolidated subsidiaries have final assessments up to and including tax years 1999-2002.

NOTE 39: -CONSOLIDATED PROFORMA STATEMENTS OF INCOME (CONTD.)

(e) Information Regarding Business Sectors - Proforma

(1) Revenues, net of excise and royalties, pro forma

	For the year ended December 31		
	2006	2005	2004
	NIS thousands, reported		
Israeli fuel sector operations	4,455	4,050	3,273
Gas stations and convenience stores in the USA	6,181	4,951	3,846
Refinery operations & marketing in the USA	8,072	4,239	-
Automotive sector	4,060	3,868	3,923
Insurance sector operations in Israel *)	4,240	4,063	3,945
Real estate sector	439	484	503
Biochemical sector	366	375	343
Oil and gas exploration and production	268	182	141
Other sectors	278	202	325
	28,359	22,414	16,299

*) Represents insurance premiums earned with in residual life insurance and general insurance.

(2) Sector results *:

	For the year ended December 31		
	2006	2005	2004
	NIS thousands, reported		
Israeli fuel sector operations	89	46	56
Gas stations and convenience stores in the USA	143	144	70
Refinery operations & marketing in the USA	632	501	-
Automotive sector	440	380	405
Insurance sector operations in Israel ***)	504	369	236
Real estate sector	81	155	242
Biochemical sector	55	68	66
Oil and gas exploration and production	154	95	79
Other sectors	35	9	-
Adjustments **)	(99)	(65)	(13)
Total in statements of income	2,034	1,702	1,141

*) Represents operating income of the sector
**) Including expenses not attributed to sectors.
***) Including earnings from insurance operations, as well as administrative, general and other expenses and other income of the Phoenix, which were not included in insurance operations.

NOTE 39: -CONSOLIDATED PROFORMA STATEMENTS OF INCOME (CONTD.)

(3) Pro forma revenues by geographical markets (based on customer location):

	For the year ended December 31		
	2006	2005	2004
	NIS thousands, reported		
Israel	13,575	12,587	11,930
USA	14,340	9,297	3,808
UK	45	98	153
Canada	211	199	195
Western Europe	188	233	213
	28,359	22,414	16,299

NOTE 40: - CONDENSED FINANCIAL DATA IN NOMINAL HISTORICAL VALUES FOR TAX PURPOSES

A. The Company provides nominal historical data for income tax purposes only.

B. The financial statements have been prepared in accordance with generally accepted accounting principles based on the historical cost convention, without taking into consideration the changes in the general purchasing power of the Israeli currency.

C. Company Balance Sheets

	As at December 31	
	2006	2005
	NIS Millions	
Current assets	754	475
Investments in investee companies	1,713	1,768
Long-term loans	3,004	1,251
Deferred charges	-	4
	4,771	3,498
Current liabilities	480	244
Long-term liabilities	2,629	1,316
Shareholders' equity	1,662	1,938
	4,771	3,498

D. Company Statements of Income

	For the year ended December 31		
	2006	2005	2004
	NIS Millions		
Revenues, net			
Equity in earnings of investees, net *)	-	533	419
Gains from issue of shares to third party	-	128	-
Management fees from investees	4	5	5
		666	424
Expenditures			
General & administrative expenses	8	7	5
Financial expenses (revenues), net	(9)	(15)	(2)
	(1)	(8)	3
Income, before taxes on income	5	674	421
Taxes on income	2	-	-
Net income	3	674	421

*) Starting in 2006, the Company is not recording its equity in investee earnings in its nominal financial statements for tax purposes.

NOTE 40: - CONDENSED FINANCIAL DATA IN NOMINAL HISTORICAL VALUES FOR TAX PURPOSES (CONT'D)

E. Statements of Changes in Shareholders' Equity

	Share Capital	Capital Reserves	Retained earnings	Dividend declared subsequent to balance sheet date	Company shares held by subsidiary	Total
	NIS Millions					
Balance as at January 1, 2004	10	626	221	54	-	911
Conversion of debentures into shares	-	1	-	-	-	1
Losses yet to be realized in interest swap at affiliate	-	(2)	-	-	-	(2)
Capital reserve from transaction with a controlling shareholder	-	(52)	-	-	-	(52)
Differences arising from financial statements of investee companies adjusted to foreign currency	-	32	-	-	-	32
Dividend	-	-	(97)	(54)	-	(151)
Net Income	-	-	421	-	-	421
Dividend declared subsequent to balance sheet date	-	-	(104)	104	-	-
Balance as at December 31, 2004	10	605	441	104	-	1,160
Conversion of debentures into shares	1	357	-	-	-	358
Realization of interest-swap transaction at foreign associated company	-	11	-	-	-	11
Differences arising from financial statements of investee companies adjusted to foreign currency	-	(21)	-	-	-	(21)
Exercise of option warrants into company shares	-	140	-	-	-	140
Dividend	-	-	(280)	(104)	-	(384)
Net Income	-	-	674	-	-	674
Dividend declared subsequent to balance sheet date	-	-	(61)	61	-	-
Balance as at December 31, 2005	11	1,092	774	61	-	1,938
Conversion of debentures into shares	1	262	-	-	-	263
Realization of interest-swap transaction at foreign associated company	-	-	-	-	-	-
Differences arising from financial statements of investee companies adjusted to foreign currency	-	(8)	-	-	-	(8)
Exercise of option warrants into company shares	-	13	-	-	-	13
Dividend	-	-	(486)	(61)	-	(547)
Net Income	-	-	3	-	-	3
Dividend declared subsequent to balance sheet date	-	-	(100)	100	-	-
Balance as at December 31, 2006	12	1,359	191	100	-	1,662

LIST OF PRINCIPAL INVESTEES AND PARTNERSHIPS

Holding Company	Company Name	Ownership & control by holding company As at December 31, 2006.(1)	Presentation method
		%	
Delek Group Ltd. -	Delek Petroleum Ltd.	100	Subsidiary
	Delek Real Estate Ltd.	67.9	Subsidiary
	Delek Investments and Properties Ltd.	100	Subsidiary
Delek Petroleum Ltd. -	Delek The Israeli Fuel Corporation, Ltd.	100	Subsidiary
	Delek Hungary Holding Ltd.	96.7	Subsidiary
	Held by Delek – The Israel Fuel Corporation, Ltd.:		
	Delkol Ltd.	100	Subsidiary
	Gal-Shoham Fuel Corporation Ltd.	100	Subsidiary
	Bitum Petrochemical Industries Ltd.	60	Subsidiary
	Delek Heating Ltd.	51	Subsidiary
	Shall-Dal Fuel Transportation Services Ltd.	100	Subsidiary
	Shaarei Delek Development and Management registered partnership	100	Subsidiary
	Delek Belski Registered Partnership for Marketing of fuel and oil	100	Subsidiary
	Delek Menta Roads Ltd.	100	Subsidiary
	United Petroleum Industries Ltd.	75	Subsidiary
	Tanker Services Ltd.	75	Subsidiary
	Delek Retail Areas Ltd. (2)	50	Subsidiary
	American Israeli Gas Corporation Ltd.	39	Affiliate
	Orpak Industries Ltd.	7.9	Cost
	P. Glilot Oil Terminals and Pipes Ltd.	15.3	Cost
	Basic Oils Haifa Ltd.	11.5	Cost
	Delek Hungary Holding Ltd.	3.3	Affiliate
	Held by Delek Hungary Holding Ltd.		
	Delek US Holdings Inc.	77	Subsidiary
	Held by Delek US Holdings Ltd.		
	MAPCO Express, Inc.	100	Subsidiary
	MAPCO Family Centers	100	Subsidiary
	MAPCO Fleet, Inc.	100	Subsidiary
	Delek Refining Inc.	100	Subsidiary
	Delek Marketing and Supply Inc.	100	Subsidiary

(1) Ownership and control held directly and indirectly.

(2) 50% held by Delek – The Israel Fuel Corporation Ltd. and 50% by Delek Real Estate Ltd.

Holding Company	Company Name	Ownership & control by holding company as at December 31, 2006 (1)	Presentation method
		%	
Delek Real Estate Ltd. -	Delek Poleg	100	Subsidiary
	Delek Real Estate – Income-Generating Properties Ltd.	100	Subsidiary
	Dankner Investments Ltd.	100	Subsidiary
	Delek Belron International, Ltd.	100	Subsidiary
	Ein Yahav – Delek Ltd.	50	Jointly controlled
	Orhan Megido Waters Ltd.	50	Jointly controlled
	Delson Investments and Property (1994) Ltd.	50	Jointly controlled
	Trading Center Delek Corporation – BLG Ltd.	50	Jointly controlled
	Delek Saadon – Initiation Corporation	50.1 (2)	Affiliate
	Biranit Galil Tahton Tveria Ltd.	45	Affiliate
	Hof Carmel Recreation and Tourism 89 Ltd.	17.3	Affiliate
	Hof Carmel 88 Ltd.	17.3	Affiliate
	Delek Retail Areas Ltd. (3)	50	Subsidiary
	Held by Delek Belron International Ltd.		
	Delek Global Real Estate	100	Subsidiary
	Delek Belron Luxembourg S.A.	99.9	Subsidiary
	Right Angle Limited	100	Subsidiary
	West Meath Limited	100	Subsidiary
	Property Investment Holdings Limited	100	Subsidiary
	Frenchay Holdings Limited	75	Subsidiary
	Botley Properties Limited	70	Subsidiary
	Dalriada Holding S.A.	90	Subsidiary
	Anchor Falls Limited	80	Subsidiary
	Daleham Holdings Limited	100	Subsidiary
	Carnwood Holdings Limited	40	Affiliate
	Kristwood Holdings Limited	49	Affiliate
	Roundwood Properties Limited	40	Affiliate
	Rosmore Limited.	40	Affiliate
	Romesfielled Properties	45	Affiliate
	Linchfield Limited	40	Affiliate
	North Ring Limited	49	Affiliate
	Quarry Town Limited	21.25	Affiliate
	Padwick Properties Sarl	45	Affiliate
	Stevemary Holding Ltd.	47.5	Affiliate

(1) Ownership and control held directly and indirectly.

(2) Ownership percentage in Company.

(3) 50% held by Delek – The Israel Fuel Corporation Ltd. and 50% by Delek Real Estate Ltd.

Holding Company	Company Name	Ownership & control by holding company as at December 31, 2006 (1)	Presentation method
		%	
Delek Investments and Properties Ltd. -	Delek Capital Ltd.	94	Subsidiary
	Delek Infrastructure Ltd.	100	Subsidiary
	Delek Ecology - Limited Partnership	100	Subsidiary
	Delek Automotive Systems Ltd.	55.4	Subsidiary
	Gadot Biochemical Industries Ltd.	64.1	Subsidiary
	Delek Energy Systems Ltd. (DES)	88.9	Subsidiary
	Delek Drilling – Limited Partnership	6.5	Subsidiary
	Yam Tethys Joint Venture	4.4	Jointly controlled
	Delek & Avner Yam Tethys Ltd. (SPC)	9.1	Jointly controlled
	Avner Oil Exploration – Limited Partnership	12.6	Affiliate
	HOT – Cable Communication Systems Ltd. (formerly – Matav Cable Communication Systems Ltd.)	15.9	Affiliate
	Phoenix Holdings Ltd. (2)	29.8	Subsidiary
	Menora Holdings Ltd.	14	Cost
	Held by Delek Capital Ltd.		
	Phoenix Holdings Ltd. (2)	29.8	Subsidiary
	Menora Holdings Ltd.	14	Cost
	Held by Phoenix Holdings Ltd.		
	Phoenix Insurance Company Ltd.	100	Subsidiary
	Phoenix Investments & Finance Ltd.	100	Subsidiary
	Held by Phoenix Insurance Company Ltd.		
	Salit Investment & Holding Co. Ltd.	100	Subsidiary
	Hadar Yarok Properties & Investments Ltd.	100	Subsidiary
	Held by Phoenix Investment & Finance Ltd.		
	ADC Holdings Ltd.	33.3	Subsidiary
	Atara Technology Ventures Ltd.	100	Subsidiary
	Atara Partnership Management Ltd.	100	Subsidiary
	Excellence Investments Ltd.	40	Affiliate
	Mehadrin Ltd.	41.42	Affiliate
	Held by Delek Capital Ltd.		
	Phoenix Holdings Ltd. (2)	25.7	Subsidiary
	Delek Finance US Inc.	100	Subsidiary
	Held by Delek Finance US Inc.		
	Republic Companies Group Inc.	100	Subsidiary
	Held by Delek Infrastructures Ltd.		
	IDE Technologies Ltd.	50	Jointly controlled
	Held by Delek Ecology – Limited Partnership		
	I.P.P. Delek Ashkelon Ltd.	100	Subsidiary

Holding Company	Company Name	Ownership & control by holding company as at December 31, 2006 (1)	Presentation method
		%	
	Held by Delek Automotive Systems Ltd.		
	Delek Motors Ltd.	100	Subsidiary
	Delek Motors Spare Parts (1987) Ltd.	100	Subsidiary
	DMR Properties (1985) Ltd.	100	Subsidiary
	DSR – Delek Automobile Agencies 1994 – Registered Partnership	75	Subsidiary
	ADC Holdings Ltd. (3)	33.3	Subsidiary
	Held by DES		
	Delek Drilling Management (1993) Ltd.	100	Subsidiary
	Delek Drilling Trusts Ltd.	100	Subsidiary
	Delek Energy (Vietnam) LLC.	100	Subsidiary
	Delek Energy Debentures Ltd.	100	Subsidiary
	Delek Drilling – Limited Partnership	62.32	Subsidiary
	Avner Oil and Gas Ltd.	50	Jointly controlled
	Avner Oil Exploration – Limited Partnership (1)	39.02	Affiliate
	Avner Trusts Ltd.	50	Affiliate
	Delek International Energy Ltd.	100	Subsidiary
	Delek Energy Systems US Inc.	100	Subsidiary
	Held by Delek Drilling – Limited Partnership		
	Yam Tethys Joint Venture	25.5	Jointly controlled
	Delek & Avner Yam Tethys Ltd. (SPC)	48.7	Jointly controlled
	Held by Avner Oil Exploration – Limited Partnership		
	Yam Tethys Joint Venture	23	Jointly controlled
	Delek & Avner Yam Tethys Ltd. (SPC)	43.7	Jointly controlled
	Held by IDE Technologies Ltd.		
	VID Desalination Company Ltd.	50	Affiliate
	OTID Desalination Partnership	50	Jointly controlled

(1) Ownership and control held directly and indirectly.

(2) Held by Delek Investments and Properties Ltd. and Delek Capital Ltd. The total controlling percentage in Phoenix is 53%.

(3) Held by Delek Automotive Systems Ltd. (33.3%) and by Phoenix Holdings Ltd. (33.3%).

Chapter 4 Additional Details Regarding the Corporation

Company Name: Delek Group, Ltd. **Registrar of Companies' number**: 52-004432-2

Date of Balance Sheet: December 31, 2006
(Regulation 9)

Date of report: March 28, 2007
Regulation 1 and 7

(Regulation 9) **Financial Statements**
Audited Financial Statements for December 31, 2006 along with a CPA review are attached here.

Regulation 10: **The Board of Directors report on the corporation's status**
The Board of Directors's report on the corporation's status as of December 31, 2006, is attached here.

Regulation 10A: **A synopsis of the quarterly statements of income**
Attached herein (in the Board of Directors's report) is a synopsis of the quarterly statements of income

Regulation 10C **Utilization of proceeds from securities in consideration of the use of proceeds according to the prospectus**
The Company did not raise any funds through the issue of securities to the public.

Regulation 11: List of investments in subsidiaries and essential associated companies on the balance sheet date

Companies directly held by the Corporation

Company Name	Share No. on Stock Exchange	Type of security	Par value of the security	Amount par value/units held by the Group	% of capital held	% of voting rights	Total investment at balance sheet date (NIS million)	Market price of Security on balance sheet date	Loan balance in Investments item (NIS million)
Delek Investments and Properties Ltd.	-	Ordinary shares	NIS 0.01	5,586,407	100.00%	100.00%	1,094	-	2,738
Delek Petroleum Ltd.	-	Ordinary shares	NIS 0.01	1,100,000	100.00%	100.00%	1,487	-	-
Delek Real Estate Ltd.	1093293	Ordinary shares	NIS 0.01	81,000,000	67.91%	67.91%	985	3,021	41

Subsidiaries and Key Associated Companies of Delek Investments & Properties Ltd.

Company Name	Share No. on Stock Exchange	Type of security	Par value of the security	Amount par value/units held by the Group	% of capital held	% of voting rights	Total investment at balance sheet date (NIS million)	Market price of Security on balance sheet date	Loan balance in Investments item (NIS million)
Delek Automotive Systems Ltd.	829010	Ordinary shares	NIS 0.01	50,166,456	55.37%	55.37%	266	2,928	-
Delek Energy Systems Ltd.	565010	Ordinary shares	NIS 0.01	4,098,452	88.87%	88.87%	21	36,600	579
Delek Drilling – Limited Partnership	475020	Participating units		5,730,446	6.53%	6.53%	47	227	12
Avner Oil Exploration – Limited Partnership	268011	Participating units		420,011,874	12.59%	12.59%	41	33	-

Subsidiaries and Key Associated Companies of Delek Investments & Properties Ltd.

Company Name	Share No. on Stock Exchange	Type of security	Par value of the security	Amount par value/units held by the Group	% of capital held	% of voting rights	Total investment at balance sheet date (NIS million)	Market price of Security on balance sheet date	Loan balance in Investments item (NIS million)
Gadot Biochemical Industries Ltd.	1093004	Ordinary shares	NIS 0.01	7,200,000	64.11%	64.11%	164	2,493	-
Phoenix Holdings Ltd.	767012	Ordinary shares	NIS 1	50,691,000	29.81%	27.95%	967	2,280	-
	767038	Ordinary shares	NIS 5	2,356,000				9,549	-
I.P.P. Delek Ashkelon Ltd.	0	Ordinary shares		1,001,000	100.00%	100.00%	28	-	66
IDE Technologies Ltd.	0	Ordinary shares		635,256	50.00%	50.00%	99	-	59
Delek Capital Ltd.		Ordinary shares	NIS 0.01	940	94.00%	94.00%	13	-	1,335
HOT – Cable Communication Systems Ltd. (formerly Matav)	510016	Ordinary shares	NIS 1	12,088,618	15.93%	15.93%	305	3,494	-

Subsidiaries and Key Associated Companies held by Delek Energy Systems, Ltd.

Company Name	Share No. on Stock Exchange	Type of security	Par value of the security	Amount par value/units held by the Group	% of capital held	% of voting rights	Total investment at balance sheet date (NIS million)	Market price of Security on balance sheet date	Loan balance in Investments item (NIS million)
Delek Drilling – Limited Partnership(*)	475020	Participating units		340,855,709	62.32%	62.32%	222	227.60	-
Avner Oil Exploration – Limited Partnership(*)	268011	Participating units		1,271,098,536	39.02%	39.02%	224	33.00	-

Subsidiaries and Key Associated Companies held by Delek Capital, Ltd.

Company Name	Share No. on Stock Exchange	Type of security	Par value of the security	Amount par value/units held by the Group	% of capital held	% of voting rights	Total investment at balance sheet date (NIS million)	Market price of Security on balance sheet date	Loan balance in Investments item (NIS million)
Phoenix Holdings Ltd.	767012	Ordinary shares	NIS 1	46,847,324	25.71%	25.42%	952	2,280.00	-
	767038	Ordinary shares	NIS 5	1,405,419				9,549.00	-
Delek US Holdings Inc.(**)			$0.01	1,000,000	100.0%	100.0%	344	-	41

Subsidiaries and Key Associated Companies held by Delek Petroleum, Ltd.

Company Name	Share No. on Stock Exchange	Type of security	Par value of the security	Amount par value/units held by the Group	% of capital held	% of voting rights	Total investment at balance sheet date (NIS million)	Market price of Security on balance sheet date	Loan balance in Investments item (NIS million)
Delek US Holding Ltd(***)	USA stock exchange	Ordinary shares	$ 0.01	39,389,869	77.04%	77.04%	1,246	16.35	-
”Delek” The Israeli Fuel Corporation, Ltd.		Ordinary shares	NIS 1	9,731,771	100.00%	100.00%	440	-	580
Delkol Ltd.		Ordinary shares		13,586	100.00%	100.00%	50	-	-
Orpak Industries Ltd.	London Stock Exchange	Ordinary shares		52,483	7.89%	7.89%	10	39	-
Amisragas - the American Israeli Gas Corporation Ltd.		Ordinary shares A+ B		33,500,000	39.00%	39.00%	137	-	-

Subsidiaries and Key Associated Companies held by Delek Investments and Properties Ltd.

Company Name	Share No. on Stock Exchange	Type of security	Par value of the security	Amount par value/units held by the Group	% of capital held	% of voting rights	Total investment at balance sheet date (NIS million)	Market price of Security on balance sheet date	Loan balance in Investments item (NIS million)
Delek Belron International, Ltd.		Ordinary shares	NIS 1	495,385	100.00%	100.00%	1,155	-	497
Dankner Investments Ltd.		Ordinary shares	NIS 1	21,396,384	100.00%	100.00%	209	-	75

(*) Including holdings via wholly-owned company.
(**) Holds 100% of Republic company's shares.
(***) Indirectly held through a wholly-owned subsidiary, Delek Hungary.

Regulation 12: Changes in the investments in subsidiaries and key associated companies during the period covered by the report

Key Changes at Delek Investments & Properties Ltd.

Date of change	Nature of change	Company Name	No. of Security on Stock Exchange	Type of share	Total par value	Cost NIS millions
18.6.2006	Acquisition	Phoenix Holdings Ltd.	0767012	Ordinary shares NIS 1	9,119,991	224
18.6.2006	Acquisition	Phoenix Holdings Ltd.	0767038	Ordinary shares NIS 5	6,066,725	

Key Changes at Delek Capital, Ltd.

Date of change	Nature of change	Company Name	No. of Security on Stock Exchange	Type of share	Total par value	Cost NIS millions
17.11.2006	Acquisition	Phoenix Holdings Ltd.	0767012	Ordinary shares NIS 1	46,847,324	940
17.11.2006	Acquisition	Phoenix Holdings Ltd.	0767038	Ordinary shares NIS 5	7,027,095	
7.12.2006	Acquisition	Delek US Holdings Inc.		Ordinary shares $0.01	1,000,000	334 (*)

(*) During the year, Delek Finance purchased the American insurance company, Republic Companies Group, Inc., at a cost of $298 million (including transaction costs).

Changes in the rate of holdings as a result of a stock issue at an investee to a third party - such as Delek USA, Phoenix Properties, DAS

Regulation 13: **Income from subsidiaries and key related companies and Corporate revenues therefrom as of the report date.**

Companies directly held by the Corporation

	2006		2005		Dividends and Distributable Earnings Received (NIS Million)		Interest received (NIS Million)		Management fees received (NIS Million)	
Company Name	**Pre-tax Income (Loss) (NIS million)**	**Income (Loss) after taxes (NIS million)**	**Pre-tax Income (Loss) (NIS million)**	**Income (Loss) after taxes (NIS million)**	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**
Delek Investments and Properties Ltd.	562	400	411	261	-	-	80	49	1	1
Delek Petroleum Ltd.	1,082	855	447	265	-	-	-	-	-	-
Delek Real Estate Ltd.	401	329	140	125	47	27	13	16	1	1

(*) The income before taxes data are taken from the Delek Real Estate report that is presented as a single stage approach.

Subsidiaries and Key Related Companies of Delek Investments & Properties Ltd.

	2006		2005		Dividends and Distributable Earnings Received (NIS Million)		Interest received (NIS Million)		Management fees received (NIS Million)	
Company Name	**Pre-tax Income (Loss) (NIS million)**	**Income (Loss) after taxes (NIS million)**	**Pre-tax Income (Loss) (NIS million)**	**Income (Loss) after taxes (NIS million)**	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**
Delek Automotive Systems Ltd.	399	274	397	264	150	223	-	-	1	2
Delek Energy Systems Ltd.	96	90	-7	-10	-	-	30	30	-	-
Delek Drilling – Limited Partnership	113	113	45	45	7	1	-	-	-	-
Avner Oil Exploration – Limited Partnership	113	113	52	52	9	6	-	-	-	-

Subsidiaries and Key Related Companies held by Delek Investments & Properties Ltd. (continued)

	2006		2005		Dividends and Distributable Earnings Received (NIS Million)		Interest received (NIS Million)		Management fees received (NIS Million)	
Company Name	Pre-tax Income (Loss) (NIS million)	Income (Loss) after taxes (NIS million)	Pre-tax Income (Loss) (NIS million)	Income (Loss) after taxes (NIS million)	2006	2005	2006	2005	2006	2005
Gadot Biochemical Industries Ltd.	46	32	62	47	-	13	-	-	-	-
Phoenix Holdings Ltd.	567	361	432	251	-	63	-	-	-	-
I.P.P. Delek Ashkelon Ltd.	-16	-16	-13	-13	-	-	2	2	1	1
IDE Technologies Ltd.	60	40	31	24	-	-	2	2	2	1
Delek Capital Ltd. (**)	-11	-11	-	-	-	-	8	-	-	-
HOT – Cable Communication Systems Ltd. (formerly Matav)	-57	-51	69	75	-	-	-	-	-	-

(**) Established during 2006.

Subsidiaries and Key Related Companies held by Delek Energy Systems, Ltd.

	2006		2005		Dividends and Distributable Earnings Received (NIS Million)		Interest received (NIS Million)		Management fees received (NIS Million)	
Company Name	Pre-tax Income (Loss) (NIS million)	Income (Loss) after taxes (NIS million)	Pre-tax Income (Loss) (NIS million)	Income (Loss) after taxes (NIS million)	2006	2005	2006	2005	2006	2005
Delek Drilling – Limited Partnership	113	113	45	45	55	12	-	-	-	-
Avner Oil Exploration – Limited Partnership	113	113	52	52	27	20	-	-	-	-

Subsidiaries and Key Associated Companies held by Delek Capital, Ltd.

	2006		2005		Dividends and Distributable Earnings Received (NIS Million)		Interest received (NIS Million)		Management fees received (NIS Million)	
Company Name	Pre-tax Income (Loss) (NIS million)	Income (Loss) after taxes (NIS million)	Pre-tax Income (Loss) (NIS million)	Income (Loss) after taxes (NIS million)	2006	2005	2006	2005	2006	2005
Phoenix Holdings Ltd.	567	361	432	251	-	-	-	-	-	-
Delek US Holdings Inc. (***)	15	10	-	-	-	-	-	-	-	-

(**) Established during 2006.

Subsidiaries and Key Related Companies held by Delek Petroleum, Ltd.

	2006		2005		Dividends and Distributable Earnings Received (NIS Million)		Interest received (NIS Million)		Management fees received (NIS Million)	
Company Name	Pre-tax Income (Loss) (NIS million)	Income (Loss) after taxes (NIS million)	Pre-tax Income (Loss) (NIS million)	Income (Loss) after taxes (NIS million)	2006	2005	2006	2005	2006	2005
Delek US Holdings Ltd.(***)	1059	859	475	311	5	-	-	22	2	0
Delek The Israeli Fuel Corporation, Ltd.	42	21	-19	-30	-	-	48	1	0	3
Delkol Ltd.	3	2	5	3	-	-	-	-		-
Amisragas - the American Israeli Gas Corporation Ltd.	82	12	68	47	4	3	-	-	-	-

Subsidiaries and Key Related Companies held by Delek Real Estate

	2006		2005		Dividends and Distributable Earnings Received (NIS Million)		Interest received (NIS Million)		Management fees received (NIS Million)	
Company Name	Pre-tax Income (Loss) (NIS million)	Income (Loss) after taxes (NIS million)	Pre-tax Income (Loss) (NIS million)	Income (Loss) after taxes (NIS million)	2006	2005	2006	2005	2006	2005
Delek Belron International, Ltd.	527	455	238	222	-	-	15	38	5	5
Dankner Investments Ltd.	27-	26-	-44	-43	-	-	3	3	-	-

Regulation 14: **A list of groups of loan balances that were extended at the balance sheet date, if extending loans was one of the main functions of the corporation.**

None

Regulation 20: **Trade on the stock exchange – securities that were listed for trade – times and reasons trading was suspended**

During 2006, 28,000 ordinary shares of NIS 1 par value each, were registered for trade as a result of the exercise of option warrants for the purchase of company shares.

During the first quarter of 2007, an additional 13,560 ordinary shares of NIS 1 par value each were registered for trade as a result of the exercise of option warrants for the purchase of company shares.

During 2006, 677,628 ordinary shares of NIS 1 par value each were registered for trade as a result of the conversion of the company's debentures.

During the first quarter of 2007, an additional 11,040 ordinary shares of NIS 1 par value each were registered for trade as a result of the conversion of the company's debentures.

To best of the Company's knowledge, trading was not suspended, other than on the date of publication of the Financial Statements, and on the date of publication of immediate reports on the publication of the financial statements of a foreign subsidiary (Delek USA).

Regulation 21: **Payments to Senior Officers (in NIS million):**

	Wages	Other benefits	Notes
1. Chairman of the Board of Directors	2,339		
2. General Manager	2,483	4,607	Other benefits are for options in associated companies, according to expenses included in the Financial Statements.*
3. Deputy CEO			
A. Deputy CEO who ended his position in May 2006	1,427		
B. Deputy CEO who began his position in September 2006	413		
4. Director	737		
5. Internal Auditor	527		

* For additional details regarding option grants to interested parties, see Note ___ to the Financial Statements.

Regulation 22: **Wages and Benefits**

Directors fees, including participation in meetings (except payments to directors who are officers) for the reported year – NIS 250 thousand.

- Concerning the Chairman's and the Company CEO's wages, see Regulation 21 above.

Regulation 24: Convertible shares and securities held by interested parties in the Corporation as of March 28, 2007

Interested Party	Company No. at Companies Registrar/ID	Name of Security	No. of Security on Stock Exchange	Par value held on Mar-28-2007	Holding % in equity and voting	Holding % (fully diluted)
Yitzchak Sharon (Teshuva)*	043480003	Delek Group Ltd.	1084128	6,817,061	58.59	57.94
Gabriel Last	4787933	Delek Group Ltd.	1084128	6,919	0.06	0.05
Asi Bartfeld	65474108	Delek Group Ltd.	1084128	4,876	0.04	0.04

* The shares are held through Mr. Yitzchak Sharon's (Teshuva) wholly owned companies (100%).

Regulation 24A: Registered and issued capital and convertible securities

Below are the data as of March 28, 2007

Equity	Registered capital	Issued and outstanding capital
	Par Value	Par Value
Ordinary shares of NIS 1 par value each	15,000,000	11,660,532

Convertible Securities:	Par Value
Convertible bond – Series E	8,352,854
Options warrants – Series 2	13,560
Options warrants – Series 3	13,560
Options warrants – Series 4	33,560
Options warrants – Series 5	33,560

Below are the data for December 31, 2006:

Equity	Registered capital	Issued and outstanding capital
	Par Value	Par Value
Ordinary shares of NIS 1 par value each	15,000,000	11,635,932

Convertible Securities:	Par Value
Convertible bond – Series A1	21
Convertible bond – Series B2	714,286
Convertible bond – Series E	235,058,134
Options warrants – Series 1	13,560
Options warrants – Series 2	13,560
Options warrants – Series 3	33,560
Options warrants – Series 4	33,560
Options warrants – Series 5	33,560

Regulation 25: Registered address

Address:	7 Giborei Israel, Netanya
Telephone:	09-8638444
Facsimile:	09-8854955
Email address:	friedgoot_y@delek.co.il
Web site:	www.delek-group.com

Regulation 26: Directors of the Corporation

Attached herein are the details of the company's directors.

Regulation 26A: Additional senior officers in the Corporation.

Attached herein are details of the company's senior officers.

Regulation 27: The Corporation's accountants

Kost Forer Gabbay & Kasierer– 3 Aminadav St., Tel-Aviv 67067.

Regulation 28: Changes in the memorandum or articles

During the reported year, there were no changes to the Company's memorandum or articles.

Regulation 29: Recommendations and decisions by the Directors:

Regulation 29(a)(1) – The Board of Directors's decision concerning dividend distribution

On March 29, 2006, the Board of Directors made the following decision:

To distribute dividend, a total of NIS 60,953,936 (557% gross per share of par value NIS 1) to all the shareholders that were listed in the Company's books on April 16, 2006. The dividend will be distributed on May 1, 2006.

On May 30, 2006, the Board of Directors made the following decision:

To pay a dividend, a total of NIS 149,700,733 (435% gross per share of par value NIS 1) to all the shareholders listed in the Company's books on July 10, 2005.

On August 30, 2006, the Board of Directors made the following decision:

To distribute dividend, a total of NIS 249,742,538 (2,150% gross per share of par value NIS 1) to all the shareholders listed in the Company's books on October 4, 2006.

On November 11, 2006, the Board of Directors made the following decision:

To distribute dividend, a total of NIS 86,105,897 (740% gross per share of par value NIS 1) to all the shareholders listed in the Company's books on December 24, 2006. The dividend will be distributed on January 8, 2007.

Regulation 29C – Decisions by the extraordinary General Meeting

On May 29, 2006, the company's extraordinary general meeting made the following resolutions:

To appoint Prof. Gabrielle Shalev and Prof. Ben-Zion Zilberfarb as external Directors for a period of three (3) years.

Details concerning the above special decision are included in the Company's immediate reports of April 24, 2006 and May 29, 2006.

On December 14, 2006, the company's extraordinary general meeting made the following resolutions:

1. To approve payment of a bonus for the year 2005 to the Chairman of the Board, Mr. G. Last, in the sum of NIS 800,000.
2. To approve payment of a bonus for 2005 to the Chairman of the Board of sub-subsidiary, Delek - The Israel Fuel Company, Ltd. (hereinafter: "The Subsidiary"), Mr. M. Amit, who also serves as a director of the Company, a sum of NIS 200,000. The bonus will be paid by the subsidiary.
3. To approve rectification of the work agreement between Mr. M. Amit and the subsidiary whose main point is raising the consideration to which Mr. Amit will be entitled, to NIS 60,000 per month (instead of NIS 30,000 according to the original agreement). The rectification will be valid as of September 1, 2006.
4. To approve granting options to the Chairman of the Board, Mr. G. Last, in the Delek USA subsidiary, that is listed for trade on the New York Stock Exchange (hereinafter: "Delek USA") for a sum (exercise price) of up to US$500,000. The exercise price will be set according to Delek USA's share price on the New York Stock Exchange, on the date the options are allocated. The terms for the options will be according to those last approved by Delek USA when Delek USA was issued on the New York Stock Exchange. Mr. Last serves as the Director of Delek USA and the option grant by Delek USA to him is due to his position in Delek USA.

Details concerning the above special decision are included in the Company's immediate reports dated November 8, 2006, November 29, 2006 and December 14, 2006.

Regulation 29A (4): Exemption from insurance and indemnity for officers - valid at the date of the report:

1. Pursuant to the resolutions of the company's Board of Directors and the general meeting (that was ratified before 2006), the decision was accepted to rectify the letter of indemnity for the Company's officers. Amending the letter of indemnification, was done in order to bring it in line with amendment 3 of the Companies Law 5759 – 1999, and is in agreement with the company's articles of association, as also amended in 2006. Pursuant to the amended letter of indemnification, seeing as the articles of association of the company includes a suitable directive allowing the company to provide an advanced undertaking to indemnify an executive therein, provided that the said undertaking shall be limited to the types of events that the board of directors feels may be anticipated in view of the company's actual operations, at the time of granting the undertaking to indemnify and to a sum or standard that the board of directors has determined to be reasonable given the circumstances, all on account of any liability or expenditure that shall be authorized at that time according to the law and/or according to any law at the time of making such a resolution as aforesaid, the company also undertakes to indemnify the executive for reasonable litigation expenses, including attorneys' fees, such that he may incur as a result of an investigation or proceedings that shall take place against you by any authority certified to launch an investigation or proceeding and that has ended without filing charges against the executive and without a fine being imposed in lieu of criminal proceedings or that has ended without an indictment being filed against the

executive, yet while imposing a fine in lieu of criminal proceedings in a felony that does not warrant the proof of criminal intent.

2. Pursuant to previous resolutions of the company's institutions (made prior to 2006), the company resolved to grant an exemption to company executives from their liability for the duty of caution toward the company, as set in the third chapter of the sixth part of the Companies Law.

3. Furthermore, pursuant to previous resolutions of company institutions, made prior to 2006, the company insures its executives with officer's insurance.

DELEK GROUP LTD.

Date: **March 28, 2007**

Name of Signatories and their functions:

Gabriel Last, Chairman of the Board of Directors

Asi Bartfeld, CEO

Director's Name:	Main activities over the past 5 years
Gabriel Last, Chief Superintendent (Ret.) Address: 72 Kochav Hayam St., Hofit Year of birth: 1946 ID No.: 4787933 Appointment date: 2003 Citizenship: Israeli External director: No Education: LLB (TA Uni.) MA (Haifa Uni.), AMP (Harvard)	CEO of the insurance company union, 1998-2001. Chairman of the companies: Delek Group, Delek Petroleum, Delek The Israeli Fuel Company Ltd., Delek Motors, Delek Motor Systems, Delek Infrastructures, Delek Properties & Investments, ADC and the boards of the subsidiaries. Since 2000, service as external director at Synel Industries Ltd.
Elad Sharon (Teshuva) Address: 3 Menahem Begin, Ramat Gan Year of birth: 1980 ID No.: 37336997 Appointment date: Aug-13-2006 Citizenship: Israeli External director: Education: Bachelor of Law, LLB **The director is the son of the controlling shareholder**	Vice-Chairman of the Board of directors, Delek Group Serves as Director of Phoenix Holdings, Ltd. Managed the business of the Elad Group (USA) and Tashluz Investments and Holdings, Ltd. (both subsidiaries owned by the controlling shareholder).
Benjamin Davidai Address: Nehardea 9/7, Tel Aviv Year of birth: 1929 ID No.: 01640002 Appointment date: 2000 Citizenship: Israeli External director: No Education: BSc Eng. MBA (TA Uni.)	CEO + Director of ZLP-Gal Industries Ltd.; director of L.B. Davidai Ltd. **Ceased serving as a Director on Aug-30-06**
Shimon Vig Address: 18 Binyamini Zvi, Ramat Hasharon Year of birth: 1941 ID No.: 04258158 Appointment date: 2000 Citizenship: Israeli External director: Yes (member of audit committee) Education: MBA (TA Uni.)	Financial and Economic Consultant **Ceased serving as a Director on Apr-26-06**
Dr. Haim Parlok Address: 18 Arazi, Tel Aviv Year of birth: 1953 ID No.: 052028057 Appointment date: 2000 Citizenship: Israeli External director: Yes (member of audit committee) Education: Medicine, law, economics	Chairman of Mediton – chain of medical centers. Chairman of Parlok Medical Holdings. Chairman of Mediton Bezeq – collection of medical information. Chairman of Mediton Adam. Member of the Israeli opera management. Management member at Keshet. **Ceased serving as a Director on Apr-26-06**

Prof. G. Shalev Address: 9 Hardufim, Even Yehudah Year of birth: 1941 ID No.:07129158 Appointment date: May-29-06 Citizenship: Israeli External director: Yes Education: Professor of Law (Hebrew U., Jerusalem) **Member of the Audit Committee**	President of the Council for Higher Education, Rector of the Academic Center, Kiryat Ono Full fledged professor, lecturer, Hebrew U., Jerusalem Guest lecturer, assorted American universities Chief editor of the Supreme Court's decisions Member of Board of Directorss – Israel Electric Co., Koor Industries, Osem Investments, Teva Industries and Pharmaceuticals
Ben-Zion Zilberfarb Address: 10 Hatizmoret, Kiryat Ono Year of birth: 1949 ID No.:30134605 Appointment date: May-29-06 Citizenship: Israeli External director: Yes Education: PhD in Economics (Penn U., Philadelphia, USA) **Member of the Audit Committee**	Member of the board of directors, Discount Bank External director, Brimag Digital Age External director: Member Board of Directors, Clal Pension and Advanced Education Funds In the past: Member Board of Directors, Partner
Avi Harel Address: 4 Esther Hamalkah, Bnei Brak Year of birth: 1948 ID No.: 030108195 Appointment date: May-29-06 Citizenship: Israeli External director: No Education: Masters in Economics (Tel Aviv U.)	Assistant CEO, Manager of the Finance Division and Information Array and member of the board, Bank Poalim. Serves as director of Bank Poalim (Switzerland), Bank Poalim (Luxemburg) Poalim Capital Markets and the Excellence's Right Fund.
Mazal Bronshtein Address: 8 Haroov, Zichron Yaakov Year of birth: 1952 ID No.: 51245330 Appointment date: Apr-1-2003 Citizenship: Israeli External director: No Education: Academic **Member of the Audit Committee**	Marketing of real estate projects. Director of Bet Shacham Ltd. and partner (14.5%) in a retirement home.
Moshe Amit Address: 17 HaMeorer St., Givatayim Year of birth: 1935 ID No.: 1127885 Appointment date: Apr-1-2004 Citizenship: Israeli External director: No Education: Social Sciences graduate, Bar-Ian University	Serves as Joint-CEO of Bank Hapoalim, Acting CEO of Bank Hapoalim. Board member: Isracard, Bank Hapoalim Switzerland, St. Lawrence Bank Barbados, Israel Phoenix Insurance Company, Matav Cable Communication Systems, Poalim Capital Markets, Tempo Beer Industries, Blue Square Properties & investments, Global Factoring Ltd.

Additional Senior Executives	
Asi Bartfeld Address: 106 Rokach, Ramat Gan Year of birth: 1952 ID No.: 65474108 Appointment date: Sept-4-2003 Citizenship: Israeli Education: Academic	CEO of Delek Group Ltd., CEO of Delek Investments & Properties Ltd. and board member of various Delek Group companies. Previously served as CFO of Delek and other Group companies; In 2001-2003 served as Deputy CEO of Delek Group Ltd.
Alan Gelman Address: 34A Ahad Ha'am, Ra'anana Year of birth: 1955 ID No.: 15704307 Appointment date: Sept-1-06 Citizenship: Israeli Education: MBA, (Hofstra U.)	Deputy CEO of Delek Group Ltd., CFO of Delek Investments & Properties Ltd., board member of various Group companies. Before that served as CFO in Partner Communications, Ltd. (over 5 years)
Ronel Ben Dov Address: 13a Simtat Kinneret, Ganei Tikva Year of birth: 1968 ID No.: 023718836 Appointment date: May-1-2004 Citizenship: Israeli Education: Graduate of Accounting and Economics, Bar-Ilan University	Deputy CEO of Delek Group Ltd., CFO of Delek Investments & Properties Ltd., board member of various Group companies. Previously worked for 11 years at Luboshitz Kasierer/Kost Forer Gabbay & Kasierer CPAs, in various capacities. Partner during the years 2001-2004. **Ceased serving as a Company officer on 5-11-06officer on 5-11-06**
Michael Greenberg Address: 17 Klauzner St., Herzlia Year of birth: 1955 ID No.: 069108231 Citizenship: Israeli Appointment date: 2002 Position: Company Auditor Education: Academic	Internal Auditor of Delek Group Ltd. and various Group companies. Internal Auditor of the Israel Petroleum Institute.

* The senior officers (including the Board of Directors) are not family members of other senior officers in the Company, or of an interested party, except for Mr. Elad Sharon (Teshuva), Assistant Chairman of the Board of Directors, who is the son of the Company's controlling shareholder.

Jerusalem, February 28, 2007

Delek Group Ltd.
7 Giborei Israel St.
Netanya

An Accounting Opinion Concerning the Accounting Method of Handling the Excess Cost Generated in Transactions in Which Delek Group Ltd. Acquired Control of Phoenix Holdings Ltd.[1]

1. At the end of 2005 Delek Group Ltd. (hereafter: "Delek Group") acquired[2] a block of shares constituting 25.01% of the share capital of Phoenix Holdings Ltd. (hereafter: "the first acquisition"). In June 2006, Delek Group exercised a purchase option under which 8.03% more shares in Phoenix Holdings Ltd. were acquired (hereafter: "the second acquisition"). In November 2006, Delek Group acquired[3] a block of shares constituting 28.5% of the issued share capital of Phoenix Holdings Ltd. (hereafter: "Phoenix" or "the company") for NIS 939.6 million (including transaction costs).[4] Following the acquisition of 28.5% in November 2006 (hereafter: "the third acquisition"), Delek Group became the controlling shareholder in the company with 61.55% of the capital of Phoenix and 59.83% of the voting rights, as listed in Table 1 on page 2 below. In December 2006, Phoenix held a private placement for investment institutions, following which the holding of Delek Group fell to approximately 55.5% of the capital of Phoenix and 53.3% of the voting rights.
2. I have been asked to express my opinion on the proper accounting method of handling the NIS 962.1 million excess cost generated in these three transactions, as listed in Table 1 below.
3. A detailed description of how the excess cost was handled is given in three separate attached studies, one for each of the three acquisitions.

Table 1 - Excess Cost Generated in the Three Transactions (in millions of NIS)

	Acquisition I	Acquisition II	Acquisition III	Total
Proceeds paid	720.2	213.5	939.6	1,873.3
Minus/plus value of option	(10.0)	10.0	---	
	710.2	**223.5**	**939.6**	**1,873.3**
Balance sheet value acquired				

[1] Formerly Israel Phoenix Insurance Co. Ltd.
[2] Through Delek Investments and Properties Ltd.
[3] Through Delek Capital Ltd.
[4] NIS 924.3 million in proceeds were paid, and transactions costs (primarily costs of a hedging transaction) totaled NIS 15.3 million.

Equity as of the acquisition date	1,253.7	1,394.7	1,484.7	4,133.1
Dividend distributed	250.0	---	---	250.0
	1,503.7	1,394.7	1,484.7	4,383.1
Percentage acquired	25.01%	8.03%	28.5%	61.54%
	376.1	**112.0**	**423.1**	**911.2**
Excess cost	**334.1**	**111.5**	**516.5**	**962.1**

4. A summary of the handling of the excess acquisition cost for each of the elements of fair value and good will, and the depreciation and amortization period of each element, is presented in Appendix A below.

5. In accordance with Section 66 of Accounting Standard 19 of the Israel Accounting Standards Board, I have taken into account liability for deferred taxes in respect of expenditures that will not be regularly recognized for tax purposes. The liability for future taxes has been calculated at NIS 274 million.

Sincerely yours,

Prof. Yoram Eden

CPA

Appendix A: Attribution of surplus acquisition and future method of amortization - cumulative (NIS millions)

	Acquired I	Acquired II	Acquired III	Total	Amortization period
To existing life insurance portfolio I	41.4	13.7	49.3	104.4	Parallel to usage of reserve for special risks
Balance of existing life insurance portfolio	247.6	96.2	222.3	566.1	Acc. to portfolio retention (15 years average)
Reserve for deferred taxes	(90.9)	(34.5)	(80.3)	(205.7)	Acc. to portfolio retention (15 years average)
To existing general insurance portfolio I	16.4	7.7	18.3	42.4	Parallel to release of cumulative to P&L over 3 years
Reserve for deferred taxes	(6.5)	(2.9)	(6.8)	(16.2)	Parallel to release of cumulative to P&L over 3 years
Balance of existing general insurance portfolio	16.8	5.0	15.2	37.0	Acc. to portfolio retention (7.3 years average)
Obligation for deferred taxes	(6.7)	(1.8)	(5.5)	(14.0)	Acc. to portfolio retention (7.3 years average)
Investment in Linchfield	-	7.8	31.7	39.5	On realizing investment
Reserve for deferred taxes	-	(2.8)	(11.1)	(13.9)	On realizing investment
Profit latent in Givatayim Mall	8.3	-	-	8.3	Realized - June 2006
Reserve for deferred taxes	(3.4)	-	-	(3.4)	Realized - June 2006
Profit latent in Rothschild 1	8.7	-	-	8.7	Realized - June 2006
Reserve for deferred taxes	(3.6)	-	-	(3.6)	Realized - June 2006
Options in Arazim	10.4	2.3	7.5	20.2	On exercise of options
Reserve for deferred taxes	(4.0)	(0.8)	(2.7)	(7.5)	On exercise of options
Surplus value of Mehadrin	5.6	3.2	14.4	23.2	On realizing investment
Reserve for deferred taxes	(2.4)	(1.1)	(5.1)	(8.6)	On realizing investment
Nitzba Europe	-	-	2.6	2.6	On realizing investment
Reserve for deferred taxes	-	-	(0.9)	(0.9)	On realizing investment
Options in Am-Hal	-	-	1.0	1.0	On exercise of options
Reserve for deferred taxes	-	-	(0.3)	(0.3)	On exercise of options
Intermediate total	**237.7**	**92.0**	**249.6**	**579.3**	
Elements in goodwill:					
Future life insurance portfolio	21.7	8.4	21.5	51.6	
To future general insurance portfolio	13.1	5.2	14.1	32.4	
To surplus cost of control (goodwill)*	**61.6**	**5.9**	**231.3**	**298.8**	
Intermediate total	**96.4**	**19.5**	**266.9**	**382.8**	
Total	**334.1**	**111.5**	**516.5**	**962.1**	

Jerusalem, August 20, 2006

To
Ms Revital Deutscher, Accountant
The Delek Group
7, Giborei Israel St.
Netanya

Dear Ms Deutscher,

Accounting Opinion on the Accounting Handling of the Cost Surplus Established in the Transaction Involving the Purchase by Delek Investment & Properties Ltd. of Approximately 25.01% of the Share Capital of Israel Phoenix Insurance Co. Ltd.

1. I was requested to express my opinion on the proper accounting approach to the cost surplus engendered in the transaction where Delek Investment and Properties Ltd. ("Delak") acquired in early October 2005[1] a share package corresponding to 25.01% of the share capital of the Israel Phoenix Insurance Company Ltd. ("Phoenix", or "the Company")[2] for the sum of approximately NIS 720 million. My present opinion will deal both with the nature of the surplus cost and the question of the duration and manner of its amortization. It is based on information as presented by you to me according to art. 4 hereinbelow. Therefore my present opinion is to be construed strictly in connection with the said information.

2. Details on my education and experience can be found in Appendix A hereinbelow.

3. I used the following accounting standards, among others, for preparing my present opinion:

   3.1 Manifest No. 57 by the Israel Institute of Certified Public Accountants, on *Consolidated Financial Statements;*
   3.2 Accounting Standard No. 31 by the Israel Institute of Accounting Standardization, *Depreciation of Assets";*
   3.3 Accounting Standard No. 20 by the Israel Institute of Accounting Standardization (Revised), *"The Accounting Approach to Goodwill and Intangible Assets in the Acquisition of a Held Company";*
   3.4 International Accounting Standard (IAS) 38, Intangible Assets;
   3.5 FASB Statement No. 141, Business Combinations;
   3.6 FASB Statement No. 142 Goodwill and Other Intangible Assets;
   3.7 IFRS 3 "Business Combination";
   3.8 Accounting Standard No. 19 by the Israel Institute of Accounting Standardization: "Taxes on Income";

4. For preparing my present opinion I also estimated the economic value of the operations of Phoenix, including the use of data from the following sources:

---

[1] The transaction was conducted on October 12, 2005 and the closing date was December 4, 2005
[2] These shares grant 25.3% of the voting rights in the Company.

4.1 The consolidated audited financial statements of the company as of December 31, 2005, and the consolidated audited financial statements of the company for prior years;

4.2 The audited financial statements of the main subsidiaries of Phoenix (Hadar Insurance Co., Atara Investment Co. Ltd., Phoenix Pension Fund Management Ltd., and Gmulim Ltd., Silit Investment & Holding Co. Ltd., and Pheniclas Ltd.) as of December 31, 2005;

4.3 The report by Maalot, the Israeli rating company for securities ("Maalot"), of July 19, 2005, which sets out the main considerations for rating the issue of deferred obligation letters by the company at AA;

4.4 The Maalot report of March 7, 2006, concerning the validation of the AA rating to deferred obligation letters (Series A, B, and C) issued by Phoenix by way of private placements;

4.5 The Insurance Economy of Israel in 2005, published by Ernst & Young, May 2006;

4.6 The Insurance Economy of Israel in 2004, published by Ernst & Yound, May 2005;

4.7 Immediate Report by the company of May 18, 2006, on the sale of all of the company's rights to the Givatayim Mall.;

4.8 Immediate Report by the Company of June 5, 2006, on the sale of all of the company's rights to the Rotschild 1 Project, Tel-Aviv;

4.9 Immediate Report by the Company of June 7, 2006 on the realization of the option for acquisition of 8.03% of the company shares by Delek;

4.10 Data and forecasts on the company income from future insurance transactions, submitted to me by company employees.

I have not checked the above information except for a prima facie examination for reliability and reasonableness. I have accepted the data as given to me, and they formed the basis for my valuation.

In my present opinion I also dealt with future-oriented information submitted to me by the management of the company. Such information is uncertain as far as the future is concerned, being based on data existing in the company as of the valuation date, along with estimates by and intentions of the company management as of the valuation date. If these corporate assessment fail to materialize, the actual results may turn out to be substantially different from the results projected or arising from the said information.

In addition, my present opinion itself contains future-oriented information that reflects my own estimates of various parameters on the basis of information available to me. If these estimates of mine fail to materialize, the actual results may turn out to be substantially different.

5. Description of the Transaction

5.1 5.1An agreement was signed on October 12, 2005, between companies controlled by Mr Shlomo Eliahu ("the Eliahu group") and Delek for acquisition of a Phoenix share package amounting to ab out 25.01% of the share capital of the company, imparting approximately 25.3% of the voting rights in the company (see Table 1 below). The price actually paid

for the share package amounted to approximately NIS 720.2 million (including interest and linkage differentials from the time of signing the agreement up to the date of actual payment in December 2005).

The market value of the so acquired share package was as follows.

As of December 29, 2005	NIS 713.3 million (ex dividend)
As of March 30, 2006	NIS 756.4 million
As of June 29, 2006	NIS 743.4 million

5.2 Moreover, the companies controlled by Mr Shlomo Eliahu granted to Delek a call purchase option for a period of nine months from the date of signing the agreement. The option was for causing the Eliahu group to sell an additional share package of the company to Delek, corresponding to approximately 8.03% of the corporate capital and granting approximately 6.10% of the voting rights in the company (see Table 1 below), in consideration of the sum of NIS 222 million plus linkage differentials to the index, that amount being subject to increase at the annual rate of 5% starting from the date of signing the agreement and up to the time of actfual payment (subject to adjustments). That purchase option was exercised by Delek in June 2006 (see art. 4.9 above).

Table 1: Purchased Shares and Options

Corporate Capital			
	QUANTITY	N.V.	TOTAL
Ord. shares NIS 1 n.v.	164,376,576	1	164,376,576
Ord. shares NIS 5 n.v.	4,931,293	5	24,656,465
	169,307,869		189,033,041
PURCHASED SHARES:			
Ord. shares NIS 1 n.v.	41,570,721	1	41,570,721
Ord. shares NIS 5 n.v.	1,142,318	5	5,711,590
	42,713,039		47,282,311
Acquired Capital Rights			25.01%
Acquired Voting Rights	25.23%		
Option for further purchase			
Ord. shares NIS 1 n.v.	9,119,991	1	9,119,991
Ord. shares NIS 5 n.v.	1,213,345	5	6,066,725
	10,333,336		15,186,716
Additional rights in capital			8.03%
Additional voting rights	6.10%		

5.3 The largest shareholder in the Company is Meir Trucks Ltd., which holds 51.41% of the share capital and 57.40% of the voting rights.

5.4 The shareholders' equity reported in the consolidated balance sheet of Phoenix as of December 31, 2005 is approximately NIS 1,237.7 million (after declaring the payment of a cash dividend amounting to NIS 250 million, effected at the end of December 2005, following recognition of

the agreement)[3] On acquiring the package of shares, an excess of cost amounting to NIS 344 million [(1253.7 + 250) *25.01% - 720.2 = 344.1] was created.

6. Summary of the opinion

6.1 I estimated the fair value of the purchase option given to Delek at an amount of NIS 10 million.

6.1 I estimated the fair value of Phoenix at NIS 2,567.9 million. The value derived from the proceeds paid in the transaction, after offsetting the option component is NIS 2,839.7 million.
[(720 - 10)/25.01% = 2,840]. The transaction price therefore includes goodwill, which reflects the excess of the cost of acquisition over the fair value of Phoenix, totalling NIS 68 million, as set forth in Table 2 below:

Table 2 - Components of the fair value of Phoenix (NIS in millions)

	Valuation	Percentage acquired - 25.01%	See discussion in section:
Value of existing life assurance portfolio	2,040.9	510.4	8.3
Value of future life assurance portfolio	223.5	55.9	8.4
Value of existing general insurance portfolio	206.0	51.5	8.5
Value of future general insurance portfolio	135.0	33.8	8.5
Total value of insurance activity	**2,605.4**	**651.6**	
Surplus assets:			
Capital surpluses	588.0	147.0	8.6.2
Profit incorporated in the Givatayim Mall	19.7	4.9	8.6.4(a)
Profit incorporated in Rothschild 1	20.3	5.1	8.6.4(a)
Excess value of Mehadrin	13.0	3.3	8.6.4(c)
Total surplus assets	**641.0**	**160.3**	
Sub-total	**3,426.4**	**811.9**	
Net of:			
Monetary liabilities	(678.6)	(169.7)	8.7
Total valuation	**2,567.8**	**642.2**	
Value of option		10.0	9
Excess of cost of acquisition over fair value		**68.0**	10
Price paid (including transaction expenses)		**720.2**	

[3] The determining date for payment was December 28, 2005.

In accordance with these valuations, I first determined the method of allocating the excess of the cost arising on acquisition to the components of the fair value as set forth in Table 3 below:

	Amount paid (NIS in millions)
Amount paid	720.2
Less - value of options	10.0
	710.2
Equity acquired	
Shareholders' equity as of December 31, 2005	1253.7
Dividend paid	250.0
	1503.7
Percentage acquired	25.01%
	376.1
Excess cost of control	**334.1**
Of which:	
To the existing life assurance portfolio	198.1
To the future life assurance portfolio	21.7
To the existing general insurance portfolio	20.0
To the future general insurance portfolio	13.1
Total to insurance activities	**252.9**
Profit incorporated in the Givatayim Mall	4.9
Profit incorporated in Rothschild 1	5.1
Excess of value of Mehadrin	3.3
To excess of cost of control	68.0
Total	**334.1**

6.3 Pursuant to the provisions of Accounting Standard No. 20 (amended) of the Israeli Accounting Standards Board, I examined whether the abovementioned components of the fair value comply with the criterion of ability of identification as set forth in paragraph 6 or whether the components of the value do not comply with the criterion and are therefore goodwill.

6.4 I believe that that components of the value of the existing life assurance portfolio and the existing general insurance business meet the definition of intangible assets whose ability of identification meet the criterion. On the other hand, the future life assurance portfolio, as well as the future general insurance business portfolio, do not meet the ability of identification criterion, and therefore are not part of the Company's goodwill.

6.5 It is clear that the excess of the fair value over the equity of the investments in the Givatayim Mall and in the Rothschild 1 Project (which were sold in 2006) are identifiable assets to which may be attributed some of the excess cost of acquisition. This is the rule with regard to the excess of the fair value over the equity of the Company's investment in Mehadrin.

6.6 Pursuant to the provisions of paragraph 66 of Accounting Standard No. 19 of the Israeli Accounting Standards Board, I gave expression to the liability for deferred taxes in respect of the expenses of amortizing the insurance portfolios that will not be recognized, on a current basis, for tax purposes.

6.7 Table 4 sets forth a summary of the opinion in all matters related to the allocation of the excess cost, the period of its amortization and the calculation of the liability for deferred tax.

6.8 From time to time, it is necessary to carry out a check to see whether there has been no decline in the value of the insurance portfolios (including the amount added thereto in respect of deferred tax liability), and the investment in Mehadrin, in accordance with the provisions of Accounting Standards No. 15 -Decline in the Value Of Assets.

Table 4 - Allocation of the excess cost of acquisition and the method of amortization in the future

Table 11 - Allocation of the excess cost of acquisition and method of amortization in the future

Activity / Investment	Gross amount (NIS in millions)	Of which provision for deferred taxes (NIS in millions)	Net amount (NIS in millions)	Method of amortization	See discussion in paragraph:
Purchase option	10.0	-	10.0	On exercising the option	11.1
Existing life assurance portfolio	41.4	-	41.4	In accordance with utilization of the reserve for extraordinary risks	11.2
Balance of existing life assurance portfolio	247.6	90.9	156.7	According to the maintenance of the portfolio (on average 15 years)	11.3
Existing general insurance portfolio	31.9	11.9	20.0	According to the maintenance of the portfolio (on average 8 years)	11.5
Givatayim Mall	8.3	3.4	4.9	On the sale of the investment (June 2006)	11.7
Rothschild 1	8.7	3.6	5.1	On the sale of	11.8

Project				the investment (June 2006)	
Investment in Mehadrin	5.6	2.3	3.3	On the sale of the investment	11.9
Total identifiable assets	**353.5**	**112.1**	**241.4**		
Components of goodwill: *					
Future life assurance portfolio	21.7	-	21.7	Not amortized	11.4
Future general insurance portfolio	13.1	-	13.1	Not amortized	11.6
Excess cost of fair value	68.0	-	68.0	Not amortized	
Total goodwill	**102.8**	-	**102.8**		
Total	**456.3**	**112.1**	**344.2**		

7. Short description of the Company and its activity

7.1 The Company was incorporated as a private company in 1949. In 1978, the Company offered its securities to the public and all of its shares are listed for trading on the Tel Aviv Stock Exchange.

7.2 The Company is engaged in all areas of insurance: general insurance, life assurance, health and nursing insurance and pension insurance.

7.3 The Company markets its insurance policies through over 1,000 active agents and through its own insurance agencies.

7.4 From the data from the "Insurance Industry in Israel" (see paragraph 4.5 above), in 2005, the Company achieved approximately 15.8% of the total premiums in the life assurance industry in Israel, and approximately 11.9% of the total premiums in the general insurance industry. In total, it is estimated that Phoenix is currently the fourth largest insurance group in Israel.

7.5 Life assurance

7.5.1 The Phoenix is the third largest company in Israel in the life assurance industry (when rating of the companies is made according to the size of the insurance reserves)[4].

7.5.2 The Phoenix is the second oldest (in terms of seniority) company on Israel (after Migdal), and therefore, it still enjoys a relatively large component (33.4%) of life assurance reserves from the consolidated

[4] If we grade the companies according to the volume of revenues from premiums in the life assurance industry in 2005, Phoenix would fall to fourth place, after the Harel Group.

balance sheet originating in the policies including the component of savings that were issued up to and including 1990. This component contributes to the financial strength and future profitability of the Company. In 2005, policies issued up to 1990 contributed approximately 38.6% of the Company's profit in the area of life assurance (on a consolidated basis).

7.5.3 In the past two years (2004 and 2005), the Company presented a percentage of expenses (commission fees and general and administrative expenses as a fraction of the outstanding premiums), which was the lowest among the five large insurance groups.

7.5.4 In 2005, the Company achieved (on a consolidated basis) an income of NIS 404.7 million from life assurance business, compared to a profit of NIS 364.8 million in 2004 and a profit of NIS 376.4 million in 2003 (the aforesaid profits are before the tax applicable thereto.)

7.6 General insurance

7.6.1 The Phoenix is the third largest company in Israel in the general insurance field.

7.6.2 In 2005, Phoenix achieved (on a consolidated basis) a profit of approximately NIS 53 million from general insurance business compared to a loss of NIS 18.6 million in 2004 and a profit of NIS 98.2 million in 2003. In the field of general insurance, the Phoenix lags behind other insurance groups, which posted significant profits in this field.

7.6.3 The Company is currently the second largest company in the health insurance sector after Harel (with a market share of approximately 11%).

7.7 Additional investments

7.7.1 The Company operates through a subsidiary under full control. "Atara", and through other companies on the real estate market.. Its investment in this area as of December 31, 2005 amounted to approximately NIS 209 million.

7.7.2 The Company holds an art collection, which is included in the December 31, 2005 balance sheet, at a value of NIS 89 million.

7.7.3 Of the Company's holdings in non-consolidated affiliates, it is appropriate to note its holdings in "Mehadrin" (approximately 41.42%), which is included in the balance sheet as of December 31, 2005 on an equity basis in the amount of NIS 108.5 million. The market value of the investment at this date is NIS 128.8 million.

8. Method of calculation of fair value

8.1 I have assumed that the fair value of the Phoenix is comprised of the combination of the following four elements:

8.1.1 Value of the existing life insurance portfolio based on policies issued in the past.
8.1.2 Value for future life insurance portfolio, resulting from life insurance polices to be issued in the future.
8.1.3 Value of general insurance operations.
8.1.4 Surplus assets which can be withdrawn from the company.

8.2 The results of the valuation are shown in Table 2 above. The following is an explanation of the method of estimation of the fair value of each of the aforementioned four components.

8.3 Estimation of value of existing life insurance portfolio

8.3.1 The analysis is based on the existing reserve in the consolidated balance sheet as at 31.12.2005 - 18,976 million NIS.

8.3.2 The analysis horizon was through 2030 (the next 25 years).

8.3.3 The main assumptions forming the basis of the estimation for each of the coming years:

a. The income from premiums for each year will be 93% of the income from the previous year.
b. The re-insurance as a percentage of premiums will be 5.5% (similar to the average percentage for the past five years).
c. The income from investment of the life insurance reserve will be 3.75% of the reserve amount at the start of the year.
d. The percentage income from management fees from "with-profits" policies will be 0.7% of the reserve balance at the star of the year.
e. The rate of retention claims from the reserve will be 1.8%. The rate of re-insurance as a proportion of claims will be 27.5%).
f. The percentage of redeemed policies will be 4.8% of the reserve. Whilst this rate is higher than the redemption rate during the last two years, because of the assumption that as a result of the recent reforms and the intention of the Insurance Supervision to enable "mobility" of existing insured persons to other savings instruments, it is possible that insured persons could consider transferring to other savings instruments (mainly provident and pension).
g. The rate of policies removed from the reserve is 0.7%.
h. The rate of payment of pensions from the reserve is 0.1%.
i. The rate of commission paid to agents will be 9.0% of the income from premiums. This rate reflects the trend of improvement achieved in recent years: in 2005 the commission rate as a percentage of premium income was approximately 8.7% as compared with approximately 10.1% in 2004.

j. The percentage of administrative and general expenses will be 8.0% of premium income (similar to the percentage in 2005 - 7.9%).

k. The company will have benefit of re-insurance commission fees of 0.6%.

l. The tax rate expected to apply in coming years are as follows:

2006 -	41.03%
2007 -	39.32%
2008 -	37.61%
2009 -	36.75%
2010 and thereafter -	35.90%

8.3.4 The capitalization rate has been set at 6% per annum. Insofar as I have been informed this is the capitalization rate used by the company for the calculation of the embedded value of its life insurance portfolio.

8.3.5 Under these results, the estimated fair value of the existing insurance portfolio as at 31st December 2005 is approximately 2,040.9 million NIS.

8.4 <u>Estimation of value of the "new" life insurance portfolio to be achived from policies issued ion the future</u>

8.4.1 The analysis is based on an assumption of expected premiums of 225 million NIS from new business in respect of the 2006 underwriting year .

8.4.2 The analysis horizon was for the next 25 years (through 2030).

8.4.3 The main assumptions on which this forecast is based were:

a. Savings element - 95%.

b. <u>Cancellation and death rate</u>:

Year 1 -	25.3%
Year 2 -	18.1%
Year 3 -	18.6%
Year 4 -	16.2%
Year 5 -	15.5%
Year 6 and on	12.1%

c. Return on investment of the cumulative reserve - 2.75%

d. Company return - 3.75%

e. Commission rates:

In each of the first 10 years	- 8.0%
Thereafter	- 5.0%

8.4.4 The capitalization rate used by me was 8.0% (2% higher than the capitalization rate for the existing portfolio)

8.4.5 Under these assumptions the cumulative representative profit from new policies issued during one future underwriting year total 17.9 million NIS.

8.4.6 I capitalized the cumulative profit for the above underwriting years into "infinity" using a factor of 8%. The capitalization result obtained is an estimated value of approximately 223.5 million NIS.

8.5 Estimated value of elementary insurance business activity

8.5.1 The main assumptions on which the forecast is based appear in table 5 below (income and profit data are in million NIS).

Table 6 - Calculation of expected annual profit (before tax) from general insurance business (in million NIS)

	Vehicle property	Vehicle mandatory	Other property	Liabilities	Health	Other	Total
Income from premiums*	637	331	469	241	409	18	2,105
% of total	30.25%	15.71%	22.28%	11.47%	19.42%	0.87%	100.00%
Percentage profit:							
Sector 2003	5.06%	33.60%	6.00%	13.38%	7.97%	7.97%	
Phoenix 2003	(4.36%)	4.19%	3.43%	19.32%	0.15%	38.09%	
Sector 2004	5.06%	5.06%	5.06%	5.06%	5.06%	5.06%	
Phoenix 2004	(3.28%)	8.54%	4.04%	18.42%	(32.69%)	13.22%	
Sector 2005	5.57%	30.14%	3.36%	6.04%	4.22%	26.59%	
Phoenix 2005	0.08%	(3.06%)	3.24%	1.74%	9.39%	20.43%	
Average	1.36%	13.08%	4.19%	10.66%	(0.98%)	26.25%	
Estimate for coming years	1.50%	1.50%	3.50%	6.00%	5.00%	10.00%	
Expected pre-tax profit	**9.55**	**4.96**	**16.42**	**14.48**	**20.45**	**1.83**	**67.69**

8.5.2 Approximately 46% of premiums from general insurance businesses of the company are expected to come form the vehicle sector (property and mandatory) sector. The Phoenix has been trailing the sector average in recent years. I also estimate that the sector as a whole enjoyed high investment profits in recent years, which overcame the poor profitability situation. There is sever price competition in these sectors from then direct insurance companies, which succeed in drawing insured persons who are regarded as being relatively good. I estimate that the expected rate of profit from premiums in the vehicle sector (property and mandatory) in coming years will be approximately 1.5%.

8.5.3 In the liabilities insurance sector the company profits have been relatively high in recent years. However, attention is drawn to accounting distortions in the results reported in previous years as a result of the reporting method which recognizes profit only three years after the end of the underwriting year. In addition, this sector is characterized

by high insurance risks. Thus, I estimate the insurance profit rate for this sector in coming years at approximately 6% of insurance premiums.

8.5.4 I have assumed that the company can stabilize its health insurance business (after incurring relatively high losses in 2004) and achieve a profitability rate of 5% of insurance premiums.

8.5.5 The expected annual profit of the company form general insurance business is 67.69 million NIS. I have deducted the tax applying from this profit in accordance with the tax rates set forth in Section 8.3.3.12.

8.5.6 I have capitalized the annual after-tax profit expected from general insurance businesses according to an annual capitalization rate of 12.5%. This capitalization rate reflects the equity-intensity base required according to the regulations against premium income form general insurance operations. The result obtained is approximately 341 million NIS.

8.5.7 For the purpose of allocation of this amount between the existing portfolio and the future portfolio, I have made the following assumptions regarding the customer retention rates in the various insurance sectors:

Vehicles property and vehicles mandatory	- 60%[5]
Other property	- 70%
Liabilities (excluding mandatory vehicle)	- 80%
Health insurance	- 90%
Other	- 70%

8.5.8 The capitalized values obtained under these assumptions of customer retention rates (in million NIS):

Existing general insurance portfolio	206
Future general insurance portfolio	135
	341

8.6 Surplus assets

8.6.1 As is apparent from the distribution of assets related to liabilities, the company has capital surpluses (over and above minimum capital required according to the regulations) of approximately 588 million NIS, of which approximately 71 million NIS relates to fixed assets and approximately 9 million NIS relates to other debtors and other assets.

8.6.2 I am of the opinion that the aforementioned capital surpluses should be added to values arising from the company's businesses. Of this amount approximately 332 million NIS are in cash.

[5] The rate of renewals of the Phoenix in the property insurance sectors in 2005 was approximately 58%. There are no data available regarding the rate of renewals in other insurance sectors, and the data shown regarding other insurance sectors are estimates.

8.6.3 This surplus assets amount takes into account the effect of the distribution of dividends in cash in an amount of 250 million NIS executed at the start of 2006.

8.6.4 I have added to the above assets surplus amount of 588 million NIS an amount of 53 million NIS, which represents the difference between the book fair value of the company's investment in the following assets:

	Million NIS
Givatayim Mall	19.7 (a)
Rothschild 1	20.3 (b)
Mehadrin shares	13.0 (c)

	53.0
	---

a. In May 2006 the company sold all of its rights in the asset, making a capital gain (net, after tax) of approximately 23.13 million NIS. From considerations of prudence I have assumed that 85% of this gain was already created up to 31.12.2005, and I have therefore added an amount of 19.7 million NIS out of this net capital gain, to the surplus assets as at 31st December 2005.

b. In June 2006 the company sold all of its rights in the asset, making a capital gain (net, after tax) of approximately 23.9 million NIS. I have assumed here as well that 85% of this gain was already created up to 31.12.2005, and I have therefore added an amount of 20.3 million NIS out of this net capital gain, to the surplus assets as at 31st December 2005.

c. Mehadrin is a public company the shares of which are listed for trading on the Tel Aviv Stock Exchange and is involved mainly in the property sector and in the cultivation and processing of citrus fruit. The Phoenix holds 41.42% of the share capital of Mehadrin, this being after partial realization of a purchase offer published by the company together with Hadarim Properties Ltd. The overall investment is recorded in an amount of approximately 108.5 million NIS in the financial statements of the Phoenix as at 31st December 2005.
The price on the Stock Exchange of the Mehadrin shares on the last day of trading in 2005, 29/12/2005, was 93.5 NIS per share. The value of the holding of the Phoenix in Mehadrin (including the shares purchased within the framework of the purchase offer) is 128.8 million NIS. I am of the opinion that this market value can be regarded as a reasonable estimate of the fair value of the holdings of the Phoenix in Mehadrin as at 31st December 2005.[6] From the 20.3 million NIS difference between the fair value and the book value I have deducted the tax expected to apply on realization of the

[6] The market value of the investment is currently approximately 160 million NIS.

investment (approximately 7.3 million NIS). I have added the net balance of approximately 13.0 million NIS to the amount of surplus assets.

8.7 Financial liabilities:

The company's main liabilities are the result of the issue of deferred instruments of liability the balance of which stands at 30th September 2005 is 678.6 million NIS. An amount of 83.8 million NIS out of this total is payable in 2006. Consideration should be given to the fact that these deferred liability instruments are taken into account as subsidiary equity for the purposes of the capital requirements from the Insurance Business Supervision (Insurer's Minimum Equity Requirement), 5748 - 1998.

9. **Calculation of value of option value**:

9.1 For the purpose of the estimation of the value of the options I have used the binomial value. I entered the highest and lowest share values recorded during the period between 1st January 2005 and 30th September 2005, as representing the expected values of the shares during the option period (nine months from the date of purchase).

9.2 I have set interest rate in the model at 5%, being the rate of interest for the transaction.

9.3 The result obtained is a value of approximately 10 million NIS for the call options.

10. Allocation of surplus cost of purchase

10.1 Surplus cost calculation:

Phoenix equity according to consolidated balance sheet as at 31st December 2005	1,253.7
Dividend distributed after the purchase	250.0
1,503.7	
The share purchased	25.01%
Value of purchased share	376.1
Consideration paid	720.2
Surplus cost of purchase	344.1

10.2 I have allocated in the first instance an amount of 10 million NIS out of the said surplus amount to the value of the call options given to Delek and as detailed in Section 9 above.

10.3 Afterwards, I allocated an amount of 68 million NIS to the goodwill component, representing the surplus cost of purchase over the fair value of the company. At the next stage I applied to the surplus cost the surplus values identified in the company's investments in the Givatayim Mall (4.9 million NIS), in the 1 Rothschild (5.1 million N IS) and Mehadrin (3.3 million NIS). The balance

amount of 252.9 million NIS was allocated between the components of the value of the insurance operations according to their proportionate value, as set forth in Section 6 as follows:

Activity/investment	Relative weighting of total value	Amount allocated (Million NIS)
Value of existing life insurance portfolio	78.3%	198.1
Value of future life insurance portfolio	8.6%	21.7
Value of existing general insurance portfolio	7.9%	20.0
Value of existing general insurance portfolio	5.2%	13.1
Total	100.0%	**252.9**

10.4 From the amount of 198.1 million NIS allocated to the existing life insurance portfolio, I deemed it proper to allocate an amount of approximately 41.4 million NIS, in respect of the relative share of the company in the extraordinary life insurance risks reserve (165.5*25.01%=41.4). To the best of my understanding the extraordinary life insurance risks reserve represents additional concealed capital of the insurance company. The reserve is recorded in the insurance company's balance sheets as a result of tax considerations and as a result of agreements signed between the Tax Commission and the Life Insurance Companies Society Ltd. Thus the reserve represents by its nature hidden equity and not an additional actuarial liability, from which can be derived that the recording of the reserve is a "privilege" given to the insurance companies, some of which prefer not to utilize, and also form the fact that the provision rates change from time to time, from tax considerations and not from actuarial considerations.

11. Amortization period and mode of amortization

11.1 The amount applied to the value of the call option should be amortized in line with the exploitation of the call options.

11.2 The amount of 41.4 million NIS applied to the share of the purchase in the life insurance extraordinary risks reserve should be amortized in line with the utilization of the reserve.[7]

11.3 The rest of the amount, net after tax, of 156.7 million NIS which was allocated to the existing life insurance portfolio should be amortized in line with the rate of portfolio retention. I am of the opinion that this period can be estimated at 15 years on average which is the period of amortization of most of the deferred purchase expenses (DAC). Since the amortized expenses are not recognized for tax purposes, the reserve for deferred taxes should be applied against it, in accordance with the tax rates expected to apply in the future, as detailed in Section 8.3.3 above.

[7] Assuming that the reserve represents concealed equity, and is not utilized, then the amount applied to it will not be reduced in the future.

11.4 In my opinion, the amount to be attributed to the future life insurance portfolio should be considered as a sign of goodwill, since it does not derive from any legal obligation created in the past, or any link to customers who can be identified at present, and therefore it does not meet the criterion of identifiability as specified in paragraph 6 of Accounting Standard no. 6 (amended).

11.5 The amortization period for the existing general insurance portfolio of the company has been calculated as the weighted average of the various amortization periods for the various insurance sectors:

Vehicle property and mandatory vehicle	3 years;
Other property insurance	5 years
Liabilities insurance	8 years
Health insurance	15 years
Other	5 years

The weighted average of the amortization periods is approximately 8 years [8]

11.6 I am of the opinion that the amount attributed to the future general insurance portfolio should be seen as reputation since it does not derive from any legal liability that was created in the past or in connection with current identifiable clients and therefore do not fulfill the ability to identify criterion set forth in Section 6 of Accounting Standard Number 20 (Amended).

11.7 The amount attributed to Delek's portion of the expected profit from the sale of the rights to the Givatayim mall should be deducted upon realizing the investment in June 2006.

11.8 The amount attributed to Delek's portion of the expected profit from the sale of the rights in the Rothschild 1 project should be deducted upon realizing the investment in June 2006.

11.9 The difference between the market value and the investment value in Mehadrin should be deducted concurrent with realizing the investment in Mehadrin or upon a decrease in value.

12. There is a need to examine, from time to time, if there was no fall in value of the Insurance portfolios (including the amount that was added thereto with respect to deferred tax liabilities), and the investment in Mehadrin and this in accordance with the provisions in Accounting Standard No. 15 pertaining to the decline in the assets value.

13. This opinion is based on the information presented to my and which is described above and solely upon such information. I seek to stress that in the

[8] The weightings for the calculation of the weighted averages are the relative shares of each sector in the expected profit for the year from general insurance businesses.

event of a change of facts and circumstances stated above this opinion may also change.

14. I know that you seek to use this opinion for the purpose of executing the reviewed financial statements for the Delek Investments and Assets Ltd. Company and as necessary even to publicly publish it and I agree thereto.

15. I request to note that I have no personal interest whatsoever in the companies' shares that were referenced in this opinion.

16. I ask to add that in the past I gave a couple of financial/accounting opinions to the Phoenix Group, including but not limited to valuating companies and activities within the Group that was executed in March 2006, for the purpose of supporting its application to approve a change in structure pursuant to Sections 350 and 351 of the Companies Law and Part 2 of the Income Tax Ordinance.

Sincerely,

Professor Yoram Eden
Accountant

APPENDIX A

PROFESSOR YORAM EDEN - DETAILS PERTAINING TO EDUCATION AND PROFESSIONAL EXPERIENCE

Academic Education

Professor, tenure, , College of Management in Tel-Aviv.
Doctorate degree (Doctor) - Tel-Aviv University, majoring in accounting and financing.
Masters of Business (MBA) (Excellence) - Tel-Aviv University.
Graduate of the Accounting Group - Tel-Aviv University.
Graduate of the Economics Group - Hebrew University, Jerusalem.

Qualifications and Professional Activities

Holder of an accountant's license since July 1978.
Member of the Central Committee of the Israeli Accountants Association, 1988.
Chief Editor of the "Accountants" Magazine since October 1991.
Senior member of the academic staff of the accountants' council. Member of the Council's Examination Board and chairman of the sub-committee for financial accounting examination.
In 2000-2004 I served as a member of the Education Committee of IFAC (International Federation of Accountants)
Dean of the School of Business Management, College of Management since 2000.
1990-1999 I served as head of the accounting apprenticeship at the , College of Management.
Guest lecturer at the Baruch College, The City University of New York.
Director and Chairman of the Investments Committee of C.F.I. an Israeli company managing the rights of the Electricity Company Ltd. employees.
I published many articles on issues pertaining to accounting in academic magazines and professional periodicals in Israel and abroad.

Jerusalem, August 30, 2006

Revital Deutscher, CPA
The Delek Group
7 Giborei Yisrael
Netanya

Dear Revital Deutscher,

Accounting Opinion on the Accounting Treatment of the Excess of Cost Recognized When Delek Investments and Assets Ltd. Purchased an Additional Share Package of 8.03% of Phoenix Holdings Ltd. Share Capital [1]

1. I was requested to prepare an opinion on the appropriate accounting treatment of the excess of cost that was recognized when Delek Investments and Assets Ltd. ["Delek"] exercised its option for the purchase of a share package of 8.03% of Phoenix Holdings Ltd. ["Phoenix" or "company"] for NIS 213.5 million. The transaction was recognized at the beginning of June 2006.

2. At the end of 2005 Delek purchased 25.01% of Phoenix's share capital ["the first purchase"] such that after exercise of the purchase option under which the additional 8.03% was purchased, Delek holds 33.04% of Phoenix's capital and 31.33% of its voting rights, as detailed in table 1 on page 2 below.

3. The market value of the share package that was purchased is as follows:

June 29, 2006	**NIS 237.5 million**
March 30, 2006	**NIS 240.1 million**
December 29, 2005	**NIS 218.8 million [without any dividends]**

4. This opinion should be read in conjunction with the opinion on the allocation of excess cost recognized on the first purchase ["first opinion"], and that said there will also be relevant here, with necessary changes, as relevant. If you make reference to this opinion in the financial statements for the interim period ended June 30, 2006, you are requested to cite the first opinion.

[1]. Formerly - Israel Phoenix Insurance Company Ltd. See section 5 for information on changes in structure and name. .

Table 1 - Details of Delek's Holdings of Phoenix, as at June 30, 2006 *

Share capital:	**Quantity**	**Par Value Per Share**	**Total**
Ordinary shares, NIS 1, par value	164,376,576	1	164,376,576
Ordinary shares, NIS 5, par value	4,931,293	5	24,656,465
	169,307,869		**189,033,041**
First purchase:			
	41,570,721	1	41,570,721
	1,142,318	5	5,711,590
	42,713,039		**47,282,311**
Rights to share capital purchased			25.01%
Voting rights purchased	25.23%		
Second purchase through exercise of purchase option:			
	9,119,991	1	9,119,991
	1,213,345	5	6,066,725
	10,333,336		**15,186,716**
Additional rights to capital			8.03%
Additional voting rights	6.10%		
Total Delek holdings	50,690,712	1	50,690,712
	2,355,663	5	11,778,315
	53,046,375		**62,469,027**
Total rights to capital			**33.04%**
Total voting rights	**31.33%**		

* See section 15 below for changes in holdings made from August 2006.

5. Change in structure

On April 10, 2006, the Court approved a change in the structure of the Phoenix Group, effective January 1, 2006. Under the change, the insurance operations of Phoenix Israel Insurance Company Ltd. were split vertically into Hadar Insurance Company Ltd. [a fully controlled owned subsidiary], under Section 105i of the Income Tax Ordinance. In addition, some assets were transferred to Atra Investment Company Ltd., under section 104a of the Income Tax Ordinance. With completion of the structural change, the Phoenix Insurance Company Ltd. remained a holding company with a division that coordinates insurance operations and a division that coordinates investment operations.

During April 2006, the Companies Registrar approved a change of name from "Phoenix Israel Insurance Company Ltd." to "Phoenix Holdings Ltd." In addition, the Registrar approved name change from "Hadar Insurance Company Ltd." to "Phoenix Insurance Company Ltd.," and from "Atra Investment Company Ltd." to Phoenix Financial Investments Company Ltd."

The structural and name changes did not have any effect on the overall value of the company.

6. In preparing this opinion, I drew on professional reports and information listed in section 4 of the first opinion, and Phoenix Holdings Ltd's unaudited financial statements as at June 30, 2006.

In this opinion, I related, as said, also to forward-looking information provided me by company management. Forward-looking information is information that is not certain, is based on company information available on the date of its estimate, and includes estimates or intentions of company management on the date of its estimate. If management's estimates will not be realized, the actual results may differ significantly from the results anticipated or inferred from this information.

7. Estimated fair value of Phoenix as of the date of exercising the purchase option.

7.1 In my first opinion, I estimated the fair value of the company as at December 31, 2005 at NIS 2,567.8 million.

7.2 At the end of June 2006, Value Added Tax Order [Tax Rates for Not for Profit Organizations and Financial Institutions], 5766-2006 ["Amendment"] was published. Following the Amendment, "profit tax" on financial institution's income decreased from 17% to 15.5% from July 1, 2006.

As a result of this Amendment and as Phoenix is a "financial institution", its weighted tax rates will be reduced [including "profit tax" on income], as follows:

2006-40.65%;
2007-38.53%;

2008-36.80%;
2009-35.93%;
2010 and forward-35.06%.

7. I updated the estimated value as at December 31, 2005 using said tax rates. The result was NIS 2,616.6 million.

7.4

7.5 According to the Embedded Value Concept [EV], income earned during the first half of 2006 from insurance operations, does not necessarily represent added value, but rather an internal change in the EV components: the transfer from a component of expected future value to shareholders' equity. The addition to EV results only from new insurance business, as earned during the first half of the year.

7.6 There is a significant difference in insurance operations income between the first two quarters of 2006, as detailed in table 2 below.

Table 2 - Income from Insurance Operations During the First Two Quarters of 2006

	January - March 2006	April - June 2006	Total January - June 2006
Income from life insurance operations	103,386	21,723	125,109
Income from general insurance operations	52,137	8,141	60,278
Total income form insurance operations	155,523	29,864	185,387

The changes in income are the result of changes in capital market investment gains, which are charged to the statement of insurance operations.

7.7 However, the results for the first half of 2006 in general, are within the value estimates that were included in the first opinion.

7.8 Accordingly, I believe that there was no significant change in the value of Phoenix's insurance operations during the first half of 2006.

7.8 However, there was a minor change in the fair value of the company's shareholdings of Mehadrin. Mehadrin is a public company whose shares

are registered for trading on the Tel Aviv Stock Exchange and is mainly involved in real estate and in citrus fruit growing and processing. Phoenix holds 41.42% of Mehadrin's share capital. The investment is recoded at NIS 108.1 million in Phoenix's June 30, 2006 financial statements.

Mehadrin's market value [at market prices] on the last trading day of the second quarter of 2006 was NIS 355.8 million. The value of Phoenix's holdings is NIS 147.3 million. I believe that the market value can be considered as a reasonable estimate of the fair value of Phoenix's holdings of Mehadrin as at June 30, 2006 [2]. I deducted the tax expected to be binding on the sale of the investment [approximately NIS 13.7 million] from the difference of NIS 39.2 million between the fair value and the book value. The net implicit excess value is NIS 25.5 million. Of this excess, NIS 13.0 million was included in the first opinion. I added the increase in value during the first half of 2006 of NIS 12.5 million, net, to the estimated value of the company as at June 30, 2006.

7.9 The updated valuation as on June 30, 2006 is, therefore, NIS 2,629.1 Million, as set forth in Table 3 below:

Table 3 - Valuation as on June 30, 2006 (In NIS Millions)

	The Amount	**See Discussion in Section**
Valuation as on 31.12.2005 - pursuant to the first opinion	2,567.8	
Updated valuation as on 31.12.2005 in light of the amendment of the tax rates	2,616.6	**7.2 and 7.3**
Increase in the value of the investment in Mehadrin	12.5	**7.8**
Total	**2,629.1**	
The part that was acquired	8.03%	
	211.1	
Surplus of purchase cost over the fair value	12.4	
	223.5	
The amount paid	213.5	
Cost attributed to purchase options	10.0	**8**
	223.5	

8. In the previous opinion I assessed the value of the purchase option, at the time it was granted (October 2005) at a sum of approximately NIS 10.0 Million. Since this amount was reduced for the purpose of calculating the surplus cost over the purchase price of the first shares package of 25.01%, this is to be added to the purchase cost of the second shares package (which includes as stated 8.03% of the company's shares).

[2]. The current market value of this investment is NIS 151 million.

9. In accordance with the methodology that I took in the first opinion I first attributed the purchase cost to the elements of the fair value that were purchased as set forth in Table 4 below:

	Revised Value Assessment (after tax amendment)	**The part that was purchased 8.03%**
Value of existing life insurance portfolio	2.063.3	165.7
Value of future life insurance portfolio	230.5	18.5
Value of existing general insurance portfolio	218.3	17.5
Value of future general insurance portfolio	142.1	11.4
Total value of the insurance activity	**2,654.2**	**213.1**
Surplus value of holdings in Mehadrin	25.5	2.1
Financial Liabilities, net less surplus assets	(50.6)	(4.1)
TOTAL	**2,629.1**	**211.1**

10. Calculating The Surplus Purchase Cost:

Table 5 below sets forth the manner to calculate the surplus cost of a sum of NIS 111.5 Millions that was created upon the purchase:

Table 5 - Surplus Cost Created Upon The Second Purchase

	Millions NIS
Paid consideration	213.5
Add: Cost of realized option[9]	10.0
	223.5
Phoenix's Equity pursuant to reviewed consolidated balance as on March 31, 2006	1,394.7
The portion that was purchased -	8.03%
	112.0
Surplus Cost	**111.5**
	=====

11. Allotment Of Surplus Cost

[9] See Section 9 of the first opinion.

11.1 In accordance with the calculation results and the assessment set forth in Tables 4 and 5 above I allotted the surplus cost that was created by the purchase to the fair value elements as set forth in Table 6 below:

Table 6 - Allotment Of Surplus Cost Of Purchase Into Fair Value Elements

	The amount in NIS Millions
Surplus Cost (See Table 5 below)	**111.5**
of which:	
Existing life insurance portfolio	75.4
Future life insurance portfolio	8.4
Existing general insurance portfolio	8.0
Future general insurance portfolio	5.2
Total insurance activity	**97.0**
Mehadrin Surplus value	2.1
Control surplus value	12.4
Total	**111.5**

11.2 Allotment of an amount of NIS 97.0 Million between the various elements of the insurance activity, executed pursuant to their relative value, as set forth in Table 7 below:

The Activity	**Relative Value**	**Amount Allotted (NIS Millions)**
Existing life insurance portfolio	77.7%	75.4
Future life insurance portfolio	8.7%	8.4
Existing general insurance portfolio	8.2%	8.0
Future general insurance portfolio	5.4%	5.2
	100.0%	**97.0**

11.3 From the amount of NIS 75.4 Millions that was allotted to the existing life insurance portfolio I deemed it correct to allot an amount of approximately NIS 13.7 Million with respect to the company's relative portion in the reserves for exceptional risks in the life insurance (171.0*8.03%=13.7). To the best of my understanding, the reserve for exceptional risks constitutes in practice the insurance company's additional hidden capital. The reserve is recorded in the insurance company's balances due to tax considerations and by virtue of agreements that were signed by the Income Tax Commissioner and between the Life Insurance Companies Ltd. Association. The fact that the reserve constitutes, in substance, hidden equity and not an additional actuary liability, one can learn that recording the reserve is a "privilege" that was given to the insurance companies and some of them prefer, for their own reasons, not to exercise them and also of the fact that the contribution rates fluctuated from time to time due to tax considerations and not actuary considerations.

12. Deduction Period and Manner of Deduction

12.1 Table 8 below briefly represents the allotment of the surplus cost and deduction period.

Table 8 - Attribution Of The Surplus Purchase Cost And Manner By Which It Is To Be Deducted In The Future

Activity/Investment	Gross Amount (NIS Millions)	Less Reserves for Deferred Taxes (in NIS Millions)	Net Amount (in NIS Millions)	Manner of Deduction	See Discussion in Section
Existing life insurance portfolio	13.7	-	13.7	Parallel to using the reserves with respect to exceptional risks	12.2
Balance in existing life insurance portfolio	96.2	34.5	61.7	Based on preserving the portfolio (15 years on average)	12.3
Existing general life insurance portfolio	12.6	4.6	8.0	Based on preserving the portfolio (8 years on average)	12.5
Investment in "Mehadrin"	3.2	1.1	2.1	Parallel to realizing investment	12.7
Total Identifiable Assets	**12.5**	**40.2**	**85.5**		
Reputation Elements:*					
Future life insurance portfolio	8.4	-	8.4	Won't be reduced	12.4
General life insurance portfolio	5.2	-	5.2	Wont' be reduced	12.6
Surplus cost over fair value	12.4	-	12.4	Wont' be reduced	
Total Reputation	26.0	-	**26.0**		
Total	**151.7**	**40.2**	**111.5**		

12.2 The sum of NIS 13.7 Millions that was attributed to the part that was purchased of the exceptional risks reserves in the life insurance should be deducted parallel to using the reserve.[10]

12.3 The balance of the sum of NIS 61.7 Million (net, after tax), that was allotted to the existing life insurance portfolio should be deducted parallel to the pace of preserving the portfolio. I am of the opinion that one can estimate this period to be 15 years on average which is the maximum deduction period for deferred acquisition charges (DAC). Since the deduction charges are not recognized for tax purposes one should credit the deferred tax reserve against them at the tax rate that is expected to apply in future years as set forth in Section 7.2 above.

[10] Based on the assumption that the reserve constitutes in fact hidden equity and it is not used, hence the amount that was also attributed to it will not be reduced in the future.

12.4 In my opinion, the amount attributed to the future life insurance portfolio should be seen as reputation since it does not derive from any legal liability that was created in the past or in connection with clients who are identifiable today.

12.5 I think that the amount attributed to existing insurance portfolios of the company should be deducted over a period not to exceed 8 years. Since the deduction expenses are not recognized for tax purposes one should credit the deferred tax reserve against them at the tax rate that is expected to apply in future years.

12.6 I think that one should see the amount attributed to future general insurance portfolios as reputation since it does not derive from any legal liability that was created in the past or connected with identifiable clients today and therefore does not fulfill the identifiable ability criteria set forth in Section 6 of Accounting Standard Number 20 (amended).

12.7 The difference between the market value and the value of the investment in Mehadrin should be deducted parallel to realizing the investment in Mehadrin or if its value declines.

13. One needs to examine from time to time if there was no fall in value of the insurance portfolios (including the amount that was added to them with respect to deferred tax liabilities) and the investment in Mehadrin and this in accordance with the provisions of Accounting Standard No. 15 pertaining to a decrease in value of assets.

14. This opinion is based on information that was presented to me and described above and only upon such information. I ask to stress that in the event that facts and circumstances above change my opinion may also change.

15. <u>Acquiring Additional Shares Package Granting Control Over The Company</u>

On August 26, 2006 a memorandum was signed between the previous controlling owners of the company (Meir Trucks Ltd. Group) and the Delek Capital Ltd. Company for the sale of some of its holdings in the company constituting approximately 28.5% of the issued and paid share capital in the company and granting 28.5% of the voting rights in the company in consideration of a sum of 213,750 Thousands US Dollars. The validity of the transaction is contingent upon the fulfillment of the suspending conditions including but not limited to obtaining all the regulatory approvals required by law and approval from the parties' competent organs.
Despite the fact that the transaction reflects the total value of the company to be about NIS 3,285 Millions which is higher than my valuation I did not deem it correct to amend the valuation that I executed. Insofar as apparent, the transaction price also reflects the control premium which is a relatively high amount.

16. I know that you seek to use this opinion for the purpose of executing the reviewed financial statements for the Delek Investments and Assets Ltd.

Company as on June 30, 2006 and as necessary even to publicly publish it and I agree thereto.

17. I request to note that I have no personal interest whatsoever in the companies' shares that were referenced in this opinion.

18. I ask to add that in the past I gave a couple of financial/accounting opinions to the Phoenix Group, including but not limited to valuating companies and activities within the Group that was executed in March 2006, for the purpose of supporting its application to approve a change in structure pursuant to Sections 350 and 351 of the Companies Law and Part 2 of the Income Tax Ordinance.

Sincerely,

Professor Yoram Eden
Accountant

Jerusalem, February 28, 2007
Delek Group
7 Giborei Israel Street,
Netanya

Accounting Opinion Concerning Accounting Methods To Handle The Cost Surplus That Was Created By The Transaction In Which The Delek Capital Group Ltd. Acquired An Additional Share Package Constituting About 28.5% Of The Phoenix Holdings Ltd. Company's Share Capital[1].

1. I was asked to furnish my opinion with respect to the appropriate accounting methods to handle the surplus cost of an amount of NIS 501.2 Million that was created by a transaction in which the Delek Capital Ltd. Company acquired, during the month of November 2006, a share package constituting 28.5% of the Phoenix Holdings Ltd. Company issued share capital (hereinafter: "The Phoenix" or "The Company") in consideration of a sum of NIS 939.6 Million (including transaction costs)[2].

2. At the end of the 2005 fiscal year the Delek Group[3] acquired a share package constituting 25.01% of the Phoenix's share capital (hereinafter: "The First Acquisition"). In June 2006 the Delek Group exercised an acquisition option within the structure of which an additional 8.03% of the company shares were acquired (hereinafter: "The Second Acquisition"). After executing the acquisition of 28.5% in November 2006 (hereinafter: "The Third Acquisition") the Delek Group became the controlling owner of the company and it held approximately 61.55% of Phoenix's capital and approximately 59.83% of the voting rights as set forth in Table 1 on page 2 below.

   In December 2006 Phoenix executed a private offering to institutional investors following which the Delek Group's holdings fell to approximately 55.5% of Phoenix's capital and approximately 53.3% of the voting rights.

3. The market value of the share package that was acquired was as follows:

September 28, 2006 -	NIS 924.8 Million
November 16, 2006 (Acquisition Date) -	NIS 1,031.1 Million
December 31, 2006	NIS 1,202.3

4. This opinion is to be read in conjunction with the opinion that relates to the attribution of the surplus cost that was created by the first acquisition (hereinafter: "The First Opinion"), the opinion that relates to the attribution of surplus costs that was created by the second acquisition (hereinafter: "The Second Opinion") and the provisions therein will also apply hereto, *mutatis mutandis*, pursuant to the matter at hand, accordingly. Should you reference

[1] Formerly - "The Israeli Phoenix Insurance Ltd Company. With respect to the change of structure and company name see Section 5 below.
[2] The consideration that was paid was a sum of NIS 924.3 Million and transaction costs (primarily the results of a protection transaction) amounting to approximately NIS 15.3 Million.
[3] Through the Delek Investments and Assets Ltd. Company.

this opinion in the financial statements for the 2006 fiscal year you are requested to reference the previous opinions too.

Table 1 - Itemization of Delek Holdings in the Phoenix after completing the third acquisition of shares in November 2006

Company Capital:			
	Quantity	**Par Value of Shares**	**Total**
Registered Shares with a par value of 1 NIS each	164,376,576	1	164,376,576
Registered Shares with a par value of 5 NIS each	4,931,293	5	24,656,465
	169,307,869		**189,033,041**
First Acquisition			
Registered Shares with a par value of 1 NIS each	41,570,721	1	41,570,721
Registered Shares with a par value of 5 NIS each	1,142,318	5	5,711,590
	42,713,039		**47,282,311**
Rights in capital that was acquired			25.01%
Voting rights that were acquired	25.23%		
Second Acquisition (Exercising Acquisition Option			
Registered Shares with a par value of 1 NIS each	9,119,991	1	9,119,991
Registered Shares with a par value of 5 NIS each	1,213,345	5	6,066,725
	10,333,336		**15,186,716**
Additional rights in capital			8.03%
Additional voting rights	6.10%		
Current Acquisition			
Registered Shares with a par value of 1 NIS each	46,847,324	1	46,847,324
Registered Shares with a par value of 5 NIS each	1,405,419	5	7,027,095

	48,252,743		**53,874,419**
Rights in capital that were acquired			28.50%
Voting rights that were acquired	28.50%		
Total Delek Group Holdings			
Registered Shares with a par value of 1 NIS each	97,538,036	1	97,538,036
Registered Shares with a par value of 5 NIS each	3,761,082	5	18,805,410
	101,299,118		**116,343,446**
Rights in capital that were acquired			61.55%
Voting rights that were acquired	59.83%		

5. Change of Structure

On 10.4.2006 the court approved the change of structure of the Phoenix Group validated on 1.1.2006. As part of the change of structure the insurance transactions of the Israeli Phoenix Insurance Company Ltd. were split by a "vertical split" into the Hadar Insurance Company Ltd. (a subsidiary company with 100% control), pursuant to the provisions in Section 105I of the Income Tax Ordinance. Likewise, a number of assets were conveyed to Atara Investments Company Ltd. pursuant to the provisions in Section 104A of the Income Tax Ordinance. Upon completion of the change of structure the Israeli Phoenix Insurance Company Ltd. a holdings company was left with a division that focused on insurance transactions and a division focusing on investment activities.

In April 2006 the Companies Registrar approved the change of its name from "The Israeli Phoenix Insurance Company Ltd. "to" The Phoenix Holdings Ltd. Likewise, the change of name was approved for "Hadar Insurance Company Ltd." to "The Phoenix Insurance Company Ltd." and the change in name of "Atara Investment Company Ltd." to "The Phoenix Investments and Finances Ltd."

The change of structure and name had no ramifications on the total value of the company.

6. In order to prepare this opinion I used the following reports and professional material:

   6.1 The reports and professional material set forth in Section 4 of the first opinion.
   6.2 The reviewed financial statements of The Phoenix Holdings Ltd. Company as on September 30, 2006.

6.3 An internal valuation as on June 30, 2006 (furnished to me by the Delek Group), of a chain of 131 parking lots in Britain all owned by the included company Linchfield Limited[4]. The valuation was conducted by external appraisers.

6.4 Reviewed financial statements of the Linchfield Limited Company as on September 30, 2006.

6.5 Annual and periodic reports of the Arzim Holdings Ltd. Company for the 2005 fiscal year.

6.6 Financial valuation as on September 30, 2006 of the NITSBA EUROPE S.A. Company that was executed by Mr. Yehiel Even of the Giza, Zinger, Even Company in December 2006.

6.7 Valuation that was executed in December 2006 pertaining to the Am-Hal Ltd. Company.

In this opinion I referred, as stated, also to forward-seeing information that was furnished to me by the company's management. Forward-seeing information is uncertain information with respect to the future, based on information that already exists in the company on the date of the valuation and includes the company's management assessments or intentions as on the date of the valuation. If these assessments by the management are not exercised the results in practice may be materially different from the estimated or implied results from this information.
In this opinion no accounting, engineering, legal and physical Due Diligence were executed and it is based on reports, data and representations as set forth below which, to the exclusion of checking reasonableness thereof, were not reviewed by me.

7. Fair Valuation Of The Phoenix As On The Date Of The Third Acquisition:

7.1 In the first opinion I valuated the company's fair value as on December 31, 2005 at an amount of approximately NIS 2,567.8 Million.

7.2 At the end of June 2006 a Value Added Tax Order was published (The Tax Rate Applicable to Non-Profit Organizations and Financial Institutions) 5766-2006 (hereinafter: "The Amendment"). Following the amendment the rate of capital gain tax applicable to a financial institution would be reduced from 17% to 15.5% and this commencing from July 1, 2006.

As a result of this amendment the weighted tax rates will be reduced (including capital gain tax imposed on income) applicable to the Phoenix as a financial institution pursuant to the Value Added Tax Law, in 2006 and the following years thereafter:

2006	-	40.65%;
2007	-	38.53%;
2008	-	36.80%;

[4] The parking lots are owned by the English NCP company. In November 1993 the Linchfield Company acquired all the rights to NCP.

2009 - 35.93%;
2010 onwards - 35.06%.

7.3 I revised the valuation as of December 31, 2005 pursuant to the foregoing tax rates. The result that was received was NIS 2,616.6 Millions as set forth in Table 2 below:

Table 2 - The Company's Fair Valuation Elements As On December 31, 2005 (Revised) NIS Thousands

Value of Existing Life Insurance Portfolios	2,063.3
Value of Future Life Insurance Portfolios	230.5
Value of General Insurance Portfolios	360.4
Total Value of Insurance Activities	2,654.2
Surplus Assets	641.0
	3,295.2
Less:	
Financial Liabilities	(678.6)
Total Fair Value	**2,616.6**
	====

8. For the purpose of this opinion I reexamined each one of the company's fair value elements and this in light of the additional data that was brought to my attention and set forth in Section 6 above.

9. Value of Life Insurance Portfolios:

9.1 **Pursuant to the Embedded Value (EV) perception of the profit that was obtained in the first three quarters of the 2006 fiscal year from life insurance business does not necessarily represent an additional value but rather constitutes, for the most part, an internal change to the EV elements: transfers from a future value element to equity. The addition to EV derives only from new insurance business insofar as these were obtained during the first nine months of the year.**

9.2 There are vast differences in the profit from insurance business between the first three quarters of the 2006 fiscal year as set forth in Table 3 below:

Table 3 - Profit From Insurance Business During The First Three Quarters Of The 2006 Fiscal Year

	Quarter I 2006	Quarter II 2006	Quarter III 2006	Total January-September 2006
Profit from life insurance business	103,386	21,723	63,365	188,474
Profit from general insurance business	52,137	8,141	87,045	147,323

Total Profit from insurance business	**155,523**	**29,864**	**150,410**	**335,797**

The vast differences in the profits derive from differences in the investment profits originating in the capital market and credited against the insurance business reports.

9.2 Notwithstanding the above, the results for the first half of the 2006 fiscal year in general, are within the borders of the valuation that was included in the first opinion.

9.3 In July 2006 the Insurance Commissioner published a draft of the Monitoring of Finances (Provident Funds)(Transferring Monies Between Funds), 5766-2006 Regulations and a draft circular pertaining to the transfer of savings (including but not limited to insurance coverage with respect to risks of disability and death) between provident funds. The purpose of the drafts is to enable the consumer to mobilize the pension savings that accrued at any time, between the bodies that manage the pension savings. Within the structure of the suggested changes, *inter alia* unlimited transfers of savings that accumulated in the insurance policies to a comprehensive pension fund and vice versa will be allowed and also a transfer from capital plans (insurance policies, provident funds and advanced education funds) granting a once-off capital amount to a pension fund or pension policy.

If in fact the mobility of pension savings monies as described above is allowed this may substantially impede upon the value of the life insurance portfolios since some of the Insureds will have a clear financial incentive to mobilize the savings in the life insurance polices to pension funds.

The company denotes in clarification 2E of its reviewed financial statements as on September 30, 2006 that "since it is unclear whether the draft regulations will be adopted as is or with changes and since one cannot estimate the Insureds conduct following publication of the foregoing regulations hence we cannot at this time envision the ramifications of the regulations".

9.4 Under these circumstances I did not deem it correct to change the value of the Phoenix's life insurance portfolios (existing and future portfolios) that I valuated in the first opinion.

10. <u>Value of the General Insurance Portfolio</u>

10.1 The data in Table 4 below points to vast differences in the results of the company's general insurance business in the first three quarters of the year.

10.2 The total profit from the general insurance business during the first nine months of the year amount to approximately NIS 147.3 Million in contrast with a profit of approximately NIS 43.5 Million in the nine months of the 2005 fiscal year and the profit of approximately NIS 53 Million in the entire 2005 fiscal year.

10.3 Prima facie, we are referring to a substantial increase in profit however one needs to consider the fact that deriving from the Board of Directors report a substantial part of the increase in profit derives from once-off factors as follows:

a. In the vehicle-property field, exceptional income due to a large indemnification claim that was received in the third quarter.

b. In the vehicle-compulsory "release" aggregate surplus from the 2003 underwriting year from the pending claims to profit and loss[11].

10.4 Notwithstanding the above I did deem it correct to reexamine the valuation of the general insurance portfolio. Table 4 below denotes data concerning the insurance profit rate in the various insurance fields in recent years with respect to the company and the entire insurance industry.

	Property Vehicle	Compulsory Vehicle	Other Property	Liabilities	Health	Other	Total
Revenue from Insurance Premiums*	668	311	248	204	370	19	1,819
Percentage of Total	36.71%	17.12%	13.61%	11.22%	20.32%	1.02%	100.00%
Profit Percentages:							
Industry in 2003	5.06%	33.60%	6.00%	13.38%	7.97%	7.97%	
The Phoenix in 2003	(4.36)	4.19%	6.50%	22.86%	0.16%	38.09%	
The Industry in 2004	5.06%	5.06%	5.06%	5.06%	5.06%	5.06%	
The Phoenix in 2004	(3.28%)	8.54%	7.66%	18.42%	(32.69%)	13.22%	
The Industry in 2005	5.57%	30.14%	3.36%	6.04%	4.33%	26.59%	
The Phoenix in 2005	0.08%	-3.06%	6.14%	2.05%	10.39%	20.43%	
The Phoenix in 2006	6.64%	17.25%	3.36%	4.86%	20.07%	32.07%	
Average	2.11%	13.68%	5.44%	10.38%	2.17%	20.49%	
Valuation in coming years	2.00%	2.00%	3.50%	4.00%	10.00%	10.00%	
Anticipated Profit before tax	13.36	6.23	8.67	8.16	36.96	1.86	75.24

* The Company's income for the first nine months of the 2006 fiscal year annual grossing up.

10.5 Close to 54% of the premiums from the company's general insurance business are expected to be obtained from the vehicle industry (compulsory and comprehensive). In this field the Phoenix lagged behind in earlier years the industry average. One should consider accounting deviations in the reported results in earlier years in the compulsory vehicle insurance field due to the sales reporting method in profit only after three years from the end of the underwriting year. I am of the opinion that the reform that was executed in recent years in the compulsory vehicle insurance field will intensify the competition in the

[11] In accordance with the Calculation of General Insurance Contributions Regulations one cannot recognize the surplus revenue over the expenses less the contributions (hereinafter: "The Aggregate") in fields with long lists of claims such as compulsory vehicle fields and other liabilities, before the end of the third year from the date the policies were issued.

industry. In my estimation the expected profit from insurance premiums in the vehicle field (property and compulsory) in the coming years will be approximately 2.0%.

10.6 After consulting with the company's managers I deemed it correct to revise the expected profit percentage in the liabilities industry to 4% (as opposed to 6% in the first opinion), and to revise, upwardly, the profit percentage expected in the health industry to 10% (as opposed to 5% in the first opinion).

10.7 The annual profit expected for the company in the general insurance business is approximately NIS 75.24 Million. From this profit I deducted the applicable tax in accordance with the tax rates set forth in Section 7.2.

10.8 I capitalized the annual profit after the expected tax from the general insurance business pursuant to an annual capitalization rate of 12.5%. This capitalization rate reflects the equitable resources required by the regulations against the income from premiums from the general insurance business. The result which was received was approximately NIS 381.7 Millions.

10.9 I assumed that 60% of the expected capitalized profits in the future (NIS 229.0 Millions) originate from existing general insurance portfolios and 40% (NIS 152.7 Millions) originating from future general insurance business.

11. Surplus Assets

11.1 As apparent from Clarification 3 of the company's reviewed financial statements as on September 30, 2006 the company has surplus capital (above the minimum capital required by the regulations) of an amount of approximately NIS 315 Millions, of which approximately NIS 52 Millions are attributed to fixed property and approximately NIS 10 Millions are attributed to other property.

11.2 I am of the opinion that the foregoing surplus in capital can be seen as surplus assets that should be added to the value deriving from the insurance business. From this amount approximately NIS 249 Millions is cash and negotiable financial assets[12].

[12] Distribution of dividends from the foregoing surplus capital is also subject to the liquidity requirements, compliance with the ways of investing regulations and complying with the restrictions pursuant to the permit that was given to the Delek Group. Pursuant to this permit no more than 50% of the annual profits in the Phoenix Holdings will be distributed as dividends for a period of 3 years from the date the permit was given. This restriction will only apply if Phoenix Insurance's capital falls below 120% of the equity required pursuant to the provisions of the Monitoring of Insurance law or any regulation or law replacing it.

11.3 I added a sum of NIS 130.5 Millions to the foregoing sum of surplus assets of NIS 315 Millions, constituting the difference between the fair value and the Phoenix value of the company's investment in the following assets set forth in Table 5 below:

Table 5 - Additional Surplus Assets

Investment In:	Surplus Fair Value Of The Balance Value Less Tax Ramifications (NIS Millions)	See details below in Section
Investment in the chain of parking lots in England	72.3	11.3.1
Option warrants of the Arzim Investments Ltd. Company	17.0	11.3.2
Investments in Mehadrin shares	32.7	11.3.3
Investment in Nitsba Europe	6.0	11.3.4
Option Warrants in the Am-Hal Ltd. Company	2.5	11.3.5
Total	**130.5**	

11.3.1 Value Of Investment In The Chain Of Parking Lots In England

a. The company holds 5% of the capital in the English company, Linchfield Limited.

b. An additional 40% of the Linchfield capital is held by Delek Real Estate Ltd. Company and an additional 8% is held by the Giron Development and Construction Ltd. Company. The three foregoing companies are affiliated by voting agreements relating to their joint holdings in Linchfield.

c. Linchfield holds all the rights in the English NCP company that owns a chain of 131 parking lots throughout England.

d. The income from rent is approximately 42,454 Thousands Sterling Pounds per annum.

e. External appraisers valuated the value of the chain of parking lots owned by the NCP Company in the range of 839,750 Thousands Sterling Pounds and 868,500 Sterling Pounds. The valuation was based on the assumption that the parking lots portfolio will be sold as one unit in a transaction between a willing buyer and a willing seller. For cautionary reasons I adopted the lower amount of 839,750 Thousands Sterling Pounds.

f. The value of Linchfield's net financial liabilities of a sum of approximately 576,663 Thousands Sterling Pounds that is included in its balance as on September 30, 2006 needs to be deducted from this operational value as follows:

	Thousands Sterling Pounds
Long-Term Loans from Banks	586,458

Other Bank Liabilities	2,776
	589,234
Less cash balance	(12,571)
	576,663
	=====

g. I did not include as part of Linchfield's financial liabilities the shareholders loans of a sum of 27,181 Thousands Sterling Pounds (as on September 30, 2006) since the company's portion in these loans constitutes a superfluous part of its investment in Linchfield (as set forth in Section K below).

h. Assuming that the exchange rate of Sterling Pounds, as on 30.9.2006 is approximately NIS 8, we find that the fair value (before tax) of the company's holdings in Linchfield is, pursuant to the lower value of the external valuation, to NIS 105,235 Thousand as set forth in Table 6 below.

i. The investment in Linchfield is included in the company's financial statements as on September 30, 2006 according to the balance of the owners' loan that was given and which is paid in installments, of a sum of 11,414 Thousands Sterling Pounds. Realization of the investment based on its fair value will involve the payment of tax. Therefore, I deemed it correct to deduct from the foregoing fair value 25% from the difference between the fair value and the balance value. The fair value less the applicable tax is therefore, based on the lower value, approximately NIS 72,341 Thousands as set forth in Table 6 below.

Table 6 - The Fair Value Of The Company's Investment In Linchfield

	Thousands Sterling Pounds
Valuation of the Linchfield's operational value (Thousands Sterling Pounds), based on the lower value	839,750
Less: net financial liabilities	576,663
	263,087
The Company's Share - 5%	**13,154**
Translated into NIS Thousands (1 Sterling Pound = NIS 8)	**105,235**
Balance value of the investment	11,414
Capital gain from realization	93,821
Applicable tax - 35.06%	**32,894**
Net Fair Value of the Investment	**72,341**

11.3.2 Investment in Option Warrants of the Arzim Investments Ltd. Company

In December 2004 the Arzim Investments Ltd. Company (hereinafter: "Arzim") engaged with the Phoenix in a loan agreement pursuant to

which the Phoenix would extend a loan of a sum of NIS 100 Million for a period of 15 years. As part of the loan agreement terms Arzim allotted 865,143 unregistered to be traded on the stock exchange option warrants to the Phoenix. Below are the main terms of the option warrants:

(a) Each option warrant can be exercised by 30.11.2009 to one regular share in Arzim.

(b) The realization addition is NIS 33 (linked to the index published on 15.11.2004) and this using adjustment in the event of a distribution of dividends in cash and/or bonus shares after 1.12.2004.

(c) The option warrants can be exercised in installments provided that the exercise thereof is at the very most six times and no later than the last date to exercise the option warrants as noted above.

(d) Assuming that all the option warrants are exercised, all the realization shares constitute 8.28% of Arzim's issued share capital and approximately 9.57% of the voting rights therein.

(e) Thus far the Phoenix has exercised 400,000 option warrants on three different dates. The balance of 465,143 option warrants as on 30.9.2006 constitutes approximately 4.45% of Arzim's issued share capital and approximately 5.15% of the voting rights therein.

The value of a regular share in Arzim as on 28.9.2006 (the last trading day in the third quarter of the year) was NIS 85.90. Pursuant to the calculation I executed using the Black and Scholes formula the value of all the option warrants is approximately NIS 57. The value of the balance of the option warrants is therefore approximately NIS 26.5 Million.

No expression was given in the Phoenix's financial statements of the option warrants balance yet to be exercised. I added the fair value of the option warrants less a sum of NIS 9.5 Million - the applicable tax amount (pursuant to the expected rate in 2009). The net additional amount is therefore approximately NIS 17.0 Million (26.5-9.5).

11.3.3 Investment in the Mehadrin Ltd. Company

Mehadrin is a public company whose securities are registered to be traded on the Tel-Aviv Stock Exchange and primarily deals in real estate and growing and processing citrus fruits. The Phoenix holds 41.42% of Mehadrin's share capital and this after a partial realization of the purchase offering that was published by the company together with the Hadarim Assets Ltd. Group. The investment is included in the Phoenix's financial statements as on September 30, 2006 at a sum of approximately NIS 105.3 Million.

The stock exchange rate of the Mehadrin shares on the last day of trading in the third quarter of 2006 was NIS 119.8 per share. The

value of Phoenix's holdings (including the shares that were acquired within the purchase offering) based on the stock exchange rate on that date was approximately NIS 155.6 Million. I think that one can see the value of this market as a reasonable valuation of the fair value of the Phoenix's holding in Mehadrin on September 30, 2006[13]. From the difference in the amount of a sum of NIS 50.3 Million between the fair value and the balance value I deducted the expected applicable tax upon realizing the investment (approximately NIS 17.6 Million). I added the net balance of a sum of approximately NIS 32.7 Million to the amount of the surplus assets.

11.3.4 Investment in the Nitsba Europe S.A. Company

a. Nitsba Europe S.A. (hereinafter: "Nitsba Europe") holds (directly and indirectly through subsidiary companies) approximately 18 income generating real estate properties in France. Nitsba Europe's only business is management and leasing these properties.

b. The company's equity as on 30.9.2006 amounted to 8,778 Thousands Euro. In addition thereto the company was given an owners loan of a sum of 38,447 Thousands Euro.

c. Within the structure of the loan contract that was signed in the past between the company and Nitsba Europe, the company was given an option to purchase 10% of Nitsba Europe's capital at a price equal to 10% of the equity and owners loan. The Phoenix exercised this option and invested a sum equal to 4,723 Thousand Euro in consideration of a holding of 10% of Nitsba Europe's capital and the owners' loan that it was given.

d. Two thirds of the investment in Nitsba Europe was financed by the aggregate funds of the participating life insurance policies and one-third (constituting 3.33% of Nitsba Europe's capital and owners loan) was financed from the Phoenix Nostro funds and relevant to this opinion.

e. Pursuant to the appraisal that was executed by Mr. Yehiel Even of the Giza, Zinger, Even Company (see Section 6.6 above) the fair value of the Nitsba Europe properties is higher by approximately 51,582 thousands Euro than the cost in the books. The company's portion (in Nostro - 3.33%) in this surplus is approximately 1,702 Thousand Euro being approximately NIS 9,249.0 Thousands.

f. I deducted the expected applicable tax upon exercising the option (approximately NIS 3,258.5 Thousands). I added the net balance of a sum of approximately NIS 6,035.5 Thousands to the surplus assets amount.

[13] The market value of the investment as on December 31, 2006 was approximately NIS 165 Million.

11.3.5 Option Warrants in the Am-Hal Ltd. Company

a. Am-Hal Ltd. is a private company wholly owned by the Ampal Group. Am-Hal operates two residential centers for old-age pensioners (protected living): in Rishon Le'Zion and Hod Hasharon, under the brand name "Until 120".

b. Within the structure of the loan contract that was given by the company to Am-Hal, it was given an option to purchase 19.9.% of Am-Hal based on the company value of 24 Million dollars. The last date to exercise the option is December 31, 2009. The option has yet to be exercised.

c. The company's portion in option warrants (Nostro) is 49.8% (approximately 9.9% of Am-Hal), and the rest of the option warrants belong to the aggregate of participating life insurance plans.

d. Am-Hal, as valuated by the company in December 2006 was worth approximately NIS 113.7 Million and the value of all the option warrants were estimated to be approximately NIS 7.7 Million. The company's Nostro portion in the option value is NIS 3.8 Million and less the applicable tax of a sum of NIS 1.3 Million, NIS 2.5 Million.

11.4 Financial Liabilities

Most of the company's financial liabilities derive from issuing deferred letters of undertaking whereby the balance thereof as on September 30, 2005 was NIS 635.6 Million. One should consider the fact that a sum of 483.4 of the balance of the deferred letters of undertaking were taken into account as secondary capital for the purpose of the capital requirements deriving from the Monitoring of Insurance Businesses (Minimum Equity Required from an Insurer) Regulations, 5758-1998.

12. The revised valuation as on September 30, 2006 is therefore, NIS 2,485.3 Million, as set forth in Table 7 below:

Table 7 - Estimate of value as of September 30, 2006 (NIS in millions)

	Valuation	**Percentage acquired - 28.5%**	**See discussion in section:**
Value of existing life assurance portfolio	2,063.3	588.0	9
Value of future life assurance portfolio	330.5	65.7	9
Value of existing general insurance portfolio	229.0	65.3	10
Value of future general	152.7	43.5	10

insurance portfolio			
Total value of insurance activity	**2675.5**	**762.5**	
Surplus assets:			
Shareholders' equity surpluses	314.9	89.8	11.1, 11.2
Excess value of investment in Linchfield	72.3	20.6	11.3.1
Options in Arazim	17.0	4.8	11.3.2
Investment in Mehadrin	32.7	9.3	11.3.3
Excess value of investment in Nizba Europe	6.0	1.7	11.3.4
Option in Am-Hal	2.5	0.7	11.3.5
Total surplus assets	**445.4**	**126.9**	
Net of:			
Monetary liabilities	**(635.6)**	**(181.1)**	11.4
Total valuation	2,485.3	708.3	
Goodwill (excess cost of control over fair value)		231.3	
Price paid (including transaction expenses)		**939.6**	

13. Calculation of excess of cost: of acquisition

Table 8 below includes a summary of the method of calculating the excess cost totalling NIS 501.2 million arising on the acquisition:

Amount paid (including transaction expenses)	939.6
Shareholders' equity, according to the balance sheet of Phoenix as of September 30, 2006	1,484.7
Percentage acquired -	28.5%
Equity acquired	**423.1**
Excess cost	**516.5**

14. Allocation of excess cost

14.1 In accordance with the methodology that I used in the first opinion, I first allocated the amount of NIS 230.3 million to goodwill, representing the excess cost of acquisition over the fair value of the Company.

14.2 In the next stage, I attributed to the excess cost the excess value identified in the Company's investments in Linchfield (NIS 20.6 million), in Arazim options (NIS 4.8 million), Mehadrin (NIS 9.3 million), in Nizba Europe (NIS 1.7 million) and in Am-Hal options (NIS 0.7 million)

14.3 I allocated the balance of NIS 248.1 million to the various components of the value of the insurance activity at their relative value, as outlined in Table 9 below.

Table 9 - Allocation of excess cost to insurance activity

Activity	Proportional value	Amount allocated (NIS in millions)
Value of existing life assurance portfolio	77.1%	19.1.3
Value of future life assurance portfolio	8.6%	21.5
Value of existing general insurance portfolio	8.6%	21.2
Value of future general insurance portfolio	5.7%	14.1
	100.0%	**248.1**

14.4 Table 10 below sets forth the allocation of the excess of cost to the components of the fair value.

Table 10 - Allocation of excess of cost of acquisition to the components of the fair value

	Amount (NIS in millions)
Excess of cost (see in Table 8 below)	**516.5**
Of which:	
To the existing life assurance portfolio	191.3
To the future life assurance portfolio	21.5
To the existing general insurance portfolio	21.2
To the future general insurance portfolio	14.1
Total to insurance activities	**248.1**
Excess value of investment in Linchfield	20.6
Options in Arazim	4.6
Excess value of Mehadrin	9.3
Excess value of investment in Nizba Europe	1.7
Option in Am-Hal	0.7
Excess of cost of control	**231.3**
Total	**516.5**

14.5 Of the amount of NIS 19.3 million, which was allocated to the existing life assurance portfolio, I saw fit to allocate an amount of NIS 49.3 million, in respect of the Company relative share in the reserve for extraordinary life assurance risks (173.0*28.5% = 49.3). To the best of my understanding, the reserve for extraordinary risks can be seem as additional shareholders' equity pf the insurance company. To the best of my knowledge, the Supervisor of Insurance is considering taking the amounts of the reserve accrued directly to the shareholders' equity of the insurance companies and has even published a draft circular in this regard.

14.6 Of the amount of NIS 21.2 million that was raised to the existing general insurance portfolio, I saw fit to allocate an amount of NIS 11.5 million to the Company's share in the accrued excess of earnings deferred in the sectors of the obligations, (64.1*28.5%) less the tax expected to apply in each of the

three following years. This is a question of an insurance profit that has already been achieved, but whose accounting recognition has been deferred, for reasons of prudence to the third year following the year of underwriting (see paragraph 10b below).

15. Period of amortization and method of amortization:

15.1 Table 11 below sets forth in summary form the allocation of the excess of cost and the period of its amortization

15.2 The amount of NIS 49.3 million that was attributed to the percentage acquired in the reserve for extraordinary life assurance risks, in my opinion, represents shareholders' equity, and therefore, should not be amortized.

15.3 The balance of the amount totalling NIS 142.0 million, net, after tax, which was allocated to the existing life assurance portfolio, should be amortized at the same rate that preserves the portfolio. I believe that this period can be estimated at an average of 15 years, which is the maximum period of amortization of the deferred acquisition costs (DAC). Since the amortization costs are not generally allowable for tax purposes, a deferred tax provision should be made against them, at the tax rate expected to apply in the future, as detailed in paragraph 7.2 above.

15.4 To the best of my understanding, the amounts attributed to the future life and general insurance and should not be amortized. In my opinion, these amounts should be viewed as goodwill, because it does not arise from any legal obligation created in the past, or any connection with customers that may be currently identified, and therefore does not fulfil the criterion of ability of identification as set forth in paragraph 6 to Accounting Standard No. 20 (amended).

15.5 The amortization of the component of accruals in the existing general insurance portfolio will be at the same rate to release the accrual to statement of operations over the next three years.

15.6 The period of amortization of the Company's existing general insurance portfolio (after the accrual component) was calculated as a weighted average of various amortization periods for the various insurance sectors as follows:

Vehicle property and compulsory vehicle	- 3 years;
Other property insurance	- 5 years;
Liability insurance	- 8 years;
Health insurance	- 10 years;[8]
Other	- 5 years

The weighted average of these periods of amortization is 7.3 years[9].

[8] In the first and second opinion, I made an estimate of 15 years. I saw fit to amend this estimate in the light of data that I obtained from the mgt of the Company.

[9] The weights for computation of the average were the proportional part of each sector in the expected profit for the years from general insurance business.

Table 11 - Allocation of the excess cost of acquisition and method of amortization in the future

Activity / Investment	Gross amount (NIS in millions)	Of which provision for deferred taxes (NIS in millions)	Net amount (NIS in millions)	Method of amortization	See discussion in paragraph:
Existing life assurance portfolio	49.3	-	49.3	In accordance with utilization of the reserve for extraordinary risks	15.2
Balance of existing life assurance portfolio	222.3	80.3	142.0	According to the maintenance of the portfolio (on average 15 years)	15.3
Existing general insurance portfolio	18.3	6.8	11.5	According to the release of the accrual to the statement of operations	15.5
Balance of existing general insurance portfolio	15.2	5.5	9.7	According to the maintenance of the portfolio (on average 7.3 years)	15.6
Investment in Linchfield	31.7	11.1	20.6	On the sale of the investment	13.3.1
Option in Arazim	7.5	2.7	4.8	On the exercise of the option	13.3.2
Investment in Mehadrin	14.4	5.1	9.3	On the sale of the investment	13.3.3
Investment of Nizba Europe	2.6	0.9	1.7		13.3.4
Options in Am-Hal	1.0	0.3	0.7		13.3.5
Total identified assets	**362.3**	**112.7**	**249.6**		
Components of goodwill: *					
Future life assurance portfolio	21.5	-	21.5	Not amortized	
Future general insurance portfolio	14.1	-	14.1	Not amortized	15.4
Excess cost of fair value	231.3	-	231.3	Not amortized	15.4

Total goodwill	**266.9**	**-**	**266.9**		
Total	**629.2**	**112.7**	**516.5**		

16. It is necessary to carry out an occasional check to see whether there has been no decline in the value of the insurance portfolios (including the amount added thereto in respect of deferred tax liability), and the investment in the surplus assets (set forth in paragraph 11.3 above), in accordance with the provisions of Accounting Standards No. 15 -Decline in the Value Of Assets.

17. This opinion is based on the data presented to me and outlined above and on this alone. I should stress that in the event of a change in the facts and circumstances above, my opinion would also change.

18. In light of the addition data that I obtained and additional checks that I conducted for the purposes of this opinion, I saw fit to make a number of amendments to the first and second opinion. These amendments are set forth in Appendix B to the opinion.

19. We are aware that you are requested to make use of my opinion for the purposes of preparing the financial statements of the Delek Group as of December 31, 2006, and, if necessary, also publish it to the public, and with this, I concur.

20. I would like to note that I have no personal interest whatsoever in the shares of the companies mentioned in this opinion.

21. I would like to add that in the past I have rendered a number of economic/accounting opinions, including a valuation of companies and Group activities, which I conducted in March 2006, in order to support its request for approval of a change in structure, pursuant to Sections 350 and 351 of the Companies Law and Part 2e of the Income Tax Ordinance.

Sincerely,

Professor Yoram Eden
Certified Public Accountant

Appendix A

Professor Yoram Eden - Details regarding education and professional experience

University education

Professor Haber, Academic Stream of the College of Management, Tel Aviv
Doctorate - Tel Aviv University, specializing in Accounting and Finance
Qualified in Business Management (with distinction) - Tel Aviv University
Graduate of the Accounting Department - Related Aviv University
Graduate of the Economics Department - Hebrew University, Jerusalem

Training and professional activity

Holder of Auditor's licence since July 1978.
Member of Central Committee of the Institute of Certified Public Accountants - 1988.
Chief Editor of periodical "Ro'eh Heshbon" since 1991.
From 2000 to 2006, I was senior member of the academic staff in the Auditors' Council.
Member of the Examination Committee of the Council and Chairman of the sub-committee for examination in financial accounting
From 2000 to 2004, I served as member a member of the Education Committee of the International Federation of Accountants (IFAC).
Dean of the School of Business Management in the Academic Stream of the College of Management since 2000
From 1990 to 1999, I acted as head of Accounting in the Academic Stream of the College of Management
Guest lecturer at Baruch College, City University of New York
Director and Chairman of the Investments Committee of C.F.I, - The Israeli Company for the Management of the Rights of Israel Electricity Corporation Ltd.
Published several articles on accounting matters in academic periodicals and professional journals in Israel and abroad.

Appendix B - Amendments to the previous opinions

Amendments to the first opinion:

1. Options in Arazim (see paragraph 11.3.2 of this opinion)

1.1 The relevant data were brought to my attention when preparing the third opinion. I saw fit to revise the first opinion and include therein the component of the fair value of these options.

1.2 As of December 31, 2005, the Company held 865,143 options of Arazim. The value of an ordinary share of Arazim as of December 29, 2005 (the last day of trading in 2005) was NIS 75.60. According to the calculation that I made using the "Black & Scholes" formula, the value of each option at that date was approximately NIS 47.90. The value of the options at December 31, 2005 is, therefore, NIS 41.4 million. The fair value of the percentage acquired (25.01%), net of applicable tax, (at the tax rates known at the end of 2005) is approximately NIS 6.4 million.

1.3 I added this amount to the sum of the surplus assets, at the same time, reducing the amount of the goodwill (arising from the excess of cost of acquisition over the fair value) from NIS 68.0 million to NIS 61.6 million, as set forth in Table A-1 below:

Table A - 1 - Calculation of the components of the fair value in the first acquisition (NIS in millions)

Amount paid	720.2
Less - value of options	10.0
	710.2
Equity acquired	
Shareholders' equity as of December 31, 2005	1253.7
Dividend paid	250.0
	1503.7
Percentage acquired	25.01%
	376.1
Excess cost of control	**334.1**
Of which:	
To the existing life assurance portfolio	198.1
To the future life assurance portfolio	21.7
To the existing general insurance portfolio	20.0
To the future general insurance portfolio	13.1
Total to insurance activities	**252.9**
Profit incorporated in the Givatayim Mall	4.8
Profit incorporated in Rothschild 1	5.1
Arazim options*	6.4
Excess of value of Mehadrin	3.3
	272.5
To excess of cost of control (goodwill)*	**61.6**
Total	**334.1**

* Restated

2. Allocation of the accrual (excess of revenues over expenses in the liability sectors) to the existing general insurance portfolio (see paragraph 14.6 to this opinion)

The amount of the accrual remaining as of December 31, 2005 is NIS 65.5 million. The value of the percentage acquired (25.01%) less the applicable tax is NIS 9.9 million. This amount represents part of the value of the existing general insurance portfolio.

3. Change in period of amortization of the balance of the existing general insurance portfolio

The amortization period was changed from 8 years to 7.3 years (see paragraph 15.6 to this opinion).

Amendments to the second opinion

4. Value of investment in the chain of car-0parks in England (see paragraph 11.3.1 to this opinion)

4.1 In the light of the valuation by the U.K. assessors as of June 30, 2006, which was brought to my attention only on preparing the third opinion, I saw fit to revise the second opinion and included therein the fair value of these options.

4.2 The excess of the fair value over the equity of the Company's investment in Linchfield, net of the applicable tax, as of June 30, 2006, is approximately NIS 62,475 thousand (as the exchange rate that was in effect at June 28, 2006, £ 1 sterling = NIS 8.1376). The value of the percentage acquired (8.03%) is approximately NIS 5,017 thousand.

4.3 I added this amount to the amount of the surplus assets.

5. Options in Arazim

5.1 On June 30, 2006, the Company held 445,143 options in Arazim. The value of an ordinary share in Arazim as at June 29, 2006 (the last trading day in the second quarter of 2006) was NIS 90.44. According to the calculation that prepared, using the "Black & Scholes" formula, the value of each option at that date was NIS 61.9. The value of the option as of June 30, 2006, is therefore approximately NIS 28.8 million. The fair value of the percentage acquired, (8.03%), net of applicable tax, is approximately NIS 1.5 million.

5.2 I added this amount to the amount of the surplus assets.

6. After making these two amendments, the amount of the excess of the cost of investment over the fair value fell from NIS 12.4 million to NIS 5.9 million, as set forth in Table A- 2 below.

Table A - 2 - Calculation of the components of the fair value in the second acquisition (NIS in millions)

Amount paid	213.5
Less -cost of options realized	10.0
Equity acquired	
Shareholders' equity as of June 30, 2006	1394.7
Percentage acquired	8.03%
	112.0
Excess cost of control	**111.5**
Of which:	
To the existing life assurance portfolio	75.4
To the future life assurance portfolio	8.4
To the existing general insurance portfolio	8.0
To the future general insurance portfolio	5.2
Total to insurance activities	**97.0**
Investment in Linchfield	5.0
Arazim options*	1.5
Excess of value of Mehadrin	2.1
	105.6
To excess of cost of control (goodwill)*	**5.9**
Total	**111.5**

* Restated

7. Allocation of the accrual (excess of revenues over expenses in the liability sectors) to the existing general insurance portfolio

The percentage acquired in the amount of the accrual in the remainder, net of tax, is approximately NIS 3.2 million.

8. Change in period of amortization of the balance of the existing general insurance portfolio

As stated in paragraph 3 above, the amortization period was changed from 8 years to 7.3 years.

Appendix E - Summary of excess costs arising in the three acquisitions

Table C - 1 presents a summary of the excess costs arising in the three acquisitions.

Table C - 1 - Summary of excess costs

	Acquisition I	Acquisition II	Acquisition III	Total
Amount paid	720.2	213.5	939.6	1,873.3
Add/ (less) value of option	(10.0)	10.0	-	-
	710.2	223.5	939.6	1,873.3
Equity acquired				
Shareholders' equity at date of acquisition	1,253.7	1,394.7	1,484.7	4,133.1
Dividend paid	250.0	-	-	250.0
	1,503.7	1,394.7	1,484.7	4,383.1
Percentage acquisition	25.01%	8.03%	28.05%	61.54%
	376.1	**112.0**	**423.1**	**911.2**
Excess of cost of control	**334.1**	**111.5**	**516.5**	**962.1**
Of which:				
To the existing life assurance portfolio	198.1	75.4	191.3	464.8
To the future life assurance portfolio	21.7	8.4	21.5	51.6
To the existing general insurance portfolio	20.0	8.0	21.2	49.2
To the future general insurance portfolio	13.1	5.2	14.1	32.4
Total to insurance activities	**252.9**	**97.0**	**248.1**	**598.0**
Investment in Linchfield	-	5.0	20.6	25.6
Profit incorporated in the Givatayim Mall	4.9	-	-	4.9
Profit incorporated in Rothschild 1	5.1	-	-	5.1
Options in Arazim	6.4	1.5	4.8	12.7
Excess value of Mehadrin	3.3	2.1	9.3	14.7
Nizba Europe			1.7	1.7
Option in Am-Hal			0.7	0.7

	19.7	8.6	37.1	65.4
Excess of cost of control (goodwill)*	61.6	5.9	231.3	298.8
Total	334.1	111.5	516.5	962.1

Delek Capital US Inc.
Republic Companies Group, Inc.

Management Report of the Accounting for the Acquisition of Republic Companies Group, Inc. by Delek Capital US Inc.

December 7, 2006

CONFIDENTIAL

Delek Capital US Inc.
Republic Companies Group, Inc.

In connection with the acquisition of Republic Companies Group, Inc. by Delek Capital US Inc. on December 7, 2006, we have prepared the following management report. The report documents the process and rationale used in developing the significant accounting adjustments required to record the acquisition in the financial statements of Republic Companies Group, Inc. and Delek Capital US Inc. The report is intended solely for the use of management of Republic Companies Group, Inc. and Delek Capital US Inc. in preparing their respective financial statements and is not intended for any other use. In preparing this report we utilized the services of various external valuation experts. We believe the report provides meaningful information supporting the accounting for the acquisition in all material respects.

March 27, 2007

Martin B. Cummings
Vice President, Chief Financial Officer

ACCOUNTING FOR THE ACQUISITION OF REPUBLIC COMPANIES GROUP, INC. BY DELEK CAPITAL US INC.

Index

Executive Summary

Republic Companies Group, Inc. ("RCGI") is the holding company of a group of insurance carriers and related entities that provide personal and commercial insurance products (informally known as the Republic Group). Members of the Republic Group distribute products to individuals and small to medium-size businesses through a network of independent agents primarily in Texas, Louisiana, Oklahoma and New Mexico. Members of the Republic Group also capitalize on the group's unique combination of charters and licenses to develop and manage target-niche insurance products that are distributed through managing general agents and other insurers in many additional states. In 2006, RCGI wrote $603 million of gross premiums and reported double-digit premium growth and mid-teens return on average equity. As of September 2006 RCGI reported stockholders' equity of $176 million. RCGI completed an initial public offering in August 2005, trading on the NASDAQ market. Members of the Republic Group are rated A- ("Excellent") by A.M. Best.

Delek Group, Ltd. ("Delek Group") is a large holding company domiciled in Israel with interests in energy, real estate, financial services, automotive, communications and insurance. Established in 1951, Delek Group is now traded on the Tel Aviv stock exchange with a market capitalization of approximately $2 billion and is a member of the TA-25 Index. Delek Group is rated AA by S&P's Israeli affiliate.

On December 7, 2006, Delek Capital US Inc. ("DCUSI") (a US subsidiary of the Delek Group incorporated in Delaware) acquired the stock of RCGI in a reverse triangular merger. Each share of RCGI stock was exchanged for the right to receive $20.40 in cash. The purchase price was approximately 1.6X RCGI's September 2006 book value. The agreement provided for no contingent payment or other post-closing price adjustments. The price of the RCGI stock was approximately $289 million and combined with acquisition expenses the total purchase price was approximately $298 million. The acquisition was funded by a capital contribution from Delek Finance US Inc. (top US holding company) and a senior bank loan.

After application of purchase accounting, RCGI recorded goodwill of $115 million and intangible assets of $15 million and stockholder's equity of approximately $247 million.

Transaction Description

Transaction Overview

On August 4, 2006 RCGI and a subsidiary of Delek Group entered into an Agreement and Plan of Merger ("Merger Agreement"). Regulatory approvals from the Texas, Oklahoma and Arizona Departments of Insurance and shareholder approvals were completed in early December 2006, and the transaction closed on December 7, 2006. The price paid was $20.40 per share of common stock outstanding in cash with no potential price adjustments or contingent payments. The transaction was structured as a reverse triangular merger pursuant to which RCGI merged into a newly formed transitory subsidiary of DCUSI and RCGI's existing shareholders received the right to receive $20.40 per share.

Acquisition Rationale

Delek Group was desirous of building a financial services group in the U.S. starting with an insurance company acquisition. They viewed the U.S. insurance markets as large and

fragmented with substantial opportunity for expansion. Delek's acquisition target was a company with a:

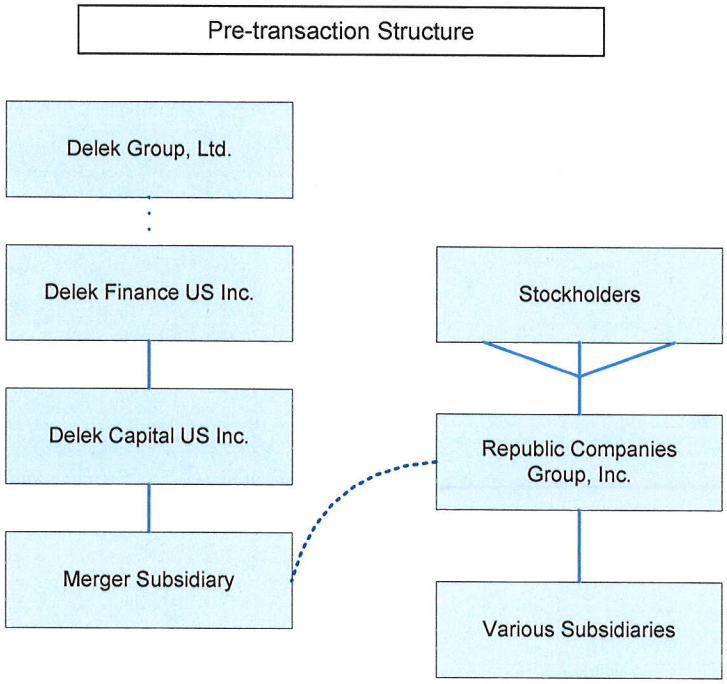
- clean balance sheet
- short-tailed line of business focus
- proven management team and operating strategy
- scalable platform for larger operations
- ownership structure that allowed for a rapid close process.

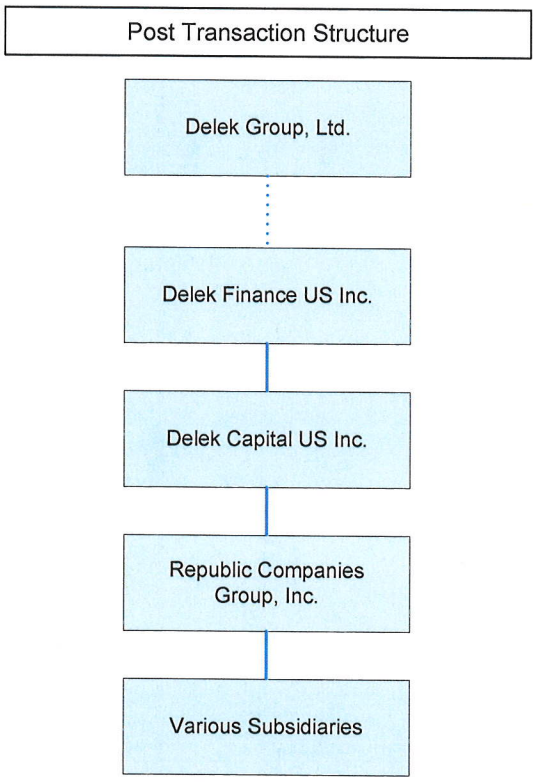
RCGI supported the transaction because it:

- provided an owner with a longer-term investment horizon than its existing private equity ownership base
- provided access to capital for expansion
- retained the existing management team and operating strategy
- provided for a reduction of costs associated with being a public company

Acquiring Entity

In the Merger Agreement, the acquiring enterprise is DCUSI. The condensed legal structure of the new group before and after the acquisition is as follows:





Acquisition Date

The transaction closed on December 7, 2006 at which time Delek transferred cash to a third party transfer agent to facilitate the individual shareholder transactions. For accounting purposes, the date of acquisition is ordinarily the date assets are transferred; however, for ease of administration, the parties may designate as the effective date the end of an accounting period between the dates a business combination is initiated and consummated. For accounting purposes, the Company has elected to use November 30, 2006 balances to determine fair values and apply PGAAP accounting. The Company's computer systems and other processes only allow for a month-end close and do not provide a feasible way to compute earned premiums and losses incurred at a date other than a month-end. Republic is not aware of any significant events, claims activity or other transactions occurring between November 30 and December 7 that would make using the November 30 balances inappropriate.

Accounting Methodology

The transaction will be recorded by the purchase method as prescribed by SFAS 141 and related accounting literature. Acquisitions and mergers are generally measured on the basis of the fair values exchanged. SFAS 141 defines fair value as the amount at which an asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale. The excess of the cost of an acquired entity over the net of the fair values of assets acquired and liabilities assumed is recognized as an intangible asset referred to as goodwill. DSUCI is required to record the acquisition using PGAAP accounting.

Applicable Accounting Literature

APB 16: Business Combinations
SFAS 60: Accounting and Reporting by Insurance Enterprises
SFAS 109: Accounting for Income Taxes
SFAS 123(R): Share-Based Payment
SFAS 141: Business Combinations
SFAS 142: Goodwill and Other Intangible Assets
SFAS 157: Fair Value Measurements (not yet adopted, but provides meaningful guidance)
APB 23: Accounting for Income Taxes—Special Areas
EITF 01-3: Accounting in a Business Combination for Deferred Revenue of an Acquiree
SAB 61: Adjustments of Allowances for Loan Losses in Connection With Business Combinations Accounted For by the Purchase Method
SAB 62: Discounting by Property-Casualty Insurance Companies
SAB 73: Application of "Push down" Accounting in Separate Financial Statements of Subsidiaries Acquired in Purchase Transactions

Push-Down Basis of Accounting

RCGI, as the target company and as a wholly owned subsidiary of the Delek Group, is not required to apply PGAAP accounting to its financial statements. However, RCGI will apply PGAAP accounting on a "push-down" basis. Push-down accounting is defined as "the establishment of a new accounting and reporting basis for an entity in its separate financial statements, based on a purchase transaction in the voting stock of the entity, that results in a substantial change of ownership of the outstanding voting stock of the entity". This definition states that the basis for the acquired entity's assets, liabilities, and stockholders' equity should be derived from the purchase transaction, as if the acquiring entity had purchased the assets and assumed the liabilities of the acquired entity rather than purchasing the stock of that entity. That is, the carrying value of the stock to the investor is "pushed down" and is deemed to be the new basis for the acquired assets and liabilities. Push-down accounting is required for all SEC registrants when most of the outstanding stock is purchased. Push-down accounting is not required for private company financial statements; however, RCGI has elected to apply push-down accounting. Push down accounting requires the acquired entity to also reflect any acquisition financing even though such was not directly incurred by the acquired entity. According, RCGI will also record the $50 million senior debt incurred by its parent DCUSI in the acquisition transaction. (See Staff Accounting Bulletin, Topic 5—Miscellaneous Accounting, Paragraph 3—Push Down Basis of Accounting Required In Certain Limited Circumstances, Question 3).

Calculation of Purchase Price

The cost of a business combination should be measured based on the fair values exchanged. The Merger Agreement provided for an exchange of shares in RCGI for cash. In addition to the direct purchase of the stock, the purchase price also includes the direct costs of acquisition and the fair value of share-based compensation assumed. Internal costs are not included in the purchase price of the acquired enterprise even if the costs are incremental, nonrecurring and related directly to a business combination.

Purchase of RCGI Common Stock

The Merger Agreement provided that all common shares outstanding at the acquisition date would be acquired for cash at $20.40 per share. Additionally, the Merger Agreement provided that all outstanding restricted stock and stock options (except for a portion of Parker Rush's options that were rolled into the new entity) became vested and were exercised as of the date of the transaction. Therefore, all of the outstanding shares were included in the purchase price

calculation. The total outstanding shares and the related purchase price is computed as follows:

Number of common shares purchased		
Outstanding common shares		14,107,118
Price per share	$	20.40
Cost of shares outstanding		287,785,207
Option exercise adjustment		1,222,217
Deferred director phantom shares		70,339
Cost of common stock	$	289,077,763

The purchase of the stock by DSUSI was primarily funded from a $245 million infusion of capital from Delek Finance US, Inc. and a $50 million senior bank loan from a group of banks lead by Frost National Bank.

Direct Costs of Acquisition

In addition to the value of the common stock, the purchase price may also include the direct costs of the business combination. While direct acquisition costs incurred by an acquiring enterprise in a business combination are included in the purchase price, direct acquisition expenses incurred by the acquirer are generally not included as part of the purchase price. If, however, the acquirer agrees before the transaction is completed to reimburse the acquired enterprise for acquisition costs incurred, the acquirer should include those reimbursements in the purchase price. DCUSI agreed to reimburse RCGI for the acquisition expenses incurred. Thus, the purchase price includes costs incurred and paid by both Delek as the acquirer and RCGI as the acquired enterprise.

A calculation of the full purchase price is as follows:

($ in thousands)	Amount
Common stock	
Common stock outstanding	289,078
Value of outstanding stock options (1)	120
Value of outstanding preferred stock (2)	13
Total common stock	$ 289,211
Direct acquisition expenses:	
Delek acquisition expenses:	
Legal	1,565
Investment banking	2,515
Accounting and tax	784
Actuarial	204
Other	281
Total Delek acquisition expenses	5,349
RCGI acquisition expenses:	
Capital advisors	1,507
Fairness opinion	625
Legal	679
Accounting	70
Tax	34
Other	67
Total RCGI acquisition expenses	2,982
Total acquisition expenses	8,331
Total purchase price	$ 297,542

(1) An additional agreement was reached with Parker Rush for 97,087 options to continue in the new entity. The stock options were originally granted on February 15, 2006 with a strike price of $15.25 and an equally graded vesting schedule of three years. At the grant date the value of the option was $5.15 per option ($500,000 total value to be rolled-over). The number of options and strike price were changed to coincide with the RCGI post merger outstanding share structure; however, no economic modifications were incurred as a result of this change. Exchanges of share options or other equity instruments or changes to their terms in conjunction with a business combination are recorded as a modification and revalued at fair value. The options are valued at approximately $447,000 using the Black-Scholes model. Of this amount, approximately $120,000 will be allocated to the purchase price, based on the portion of the original vesting period that occurred prior to the acquisition.

(2) Republic Home Protectors, Inc. (RHP), an indirect subsidiary of RCGI awarded 500 shares of preferred restricted stock in 2005 as part of a stock compensation agreement with the President of RHP. As part of the RCGI acquisition, the terms of the agreement were changed to accelerate the vesting schedule. The change in the fair value of the agreement will result in approximately $13,000 being allocated to the purchase price.

Summary of Fair Value Adjustments

Assumptions

SFAS 141 generally requires identifiable assets and liabilities to be valued at fair value. SFAS 141 defined fair value as "the amount at which an asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale." SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and thus not effective for this transaction. However, RCGI does not believe that SFAS 157 would result in a significantly different result.

In connection with SFAS 141, RCGI:

- Adjusted assets to FMV using:
  - external sources to value investments
  - other estimating analysis to value an equity investment in a foreign insurance company
  - historical collection patterns to value receivables
  - external sources to value certain fixed assets
  - internal estimates of the value of certain software
  - external valuation specialists to value certain intangible assets
- Adjusted liabilities to FMV using:
  - actuarial data, historical payout patterns and reinsurance intermediaries to value net loss and loss adjustment expense reserves
  - historical trends and loss ratio projections to value unearned premium reserves
  - external pension actuaries to value pension liabilities and assets
  - external valuation specialist to value lease obligations
  - internal estimates to value debts and other liabilities
- Computed goodwill as the excess of the purchase price over fair market value of net assets acquired and liabilities assumed

Following is a reconciliation of the pre-acquisition balance sheet to the PGAAP balance sheet.

Republic Companies, Inc.
Consolidated Financials - GAAP
Reconciliation from Reported November 30, 2006 to PGAAP Balances

Consolidated RCGI Balance Sheet ($ 000s)	**HGAAP Balances 12/7/2006**	**Fair Value Adjustment**		**Financing Adjustment**		**PGAAP Balances 12/7/06**
Assets						
Investments:						
Fixed maturities available for sale	359,052					359,052
Equity securities available for sale	1,928					1,928
Investment in unconsolidated foreign ins. co.	36,466	(9,966)	(1)			26,500
Other invested assets	929			619	(9)	1,548
Short-term investments	37,829					37,829
Total investments	436,204	(9,966)		619		426,857
Cash and cash equivalents	5,482			(647)	(9)	4,835
Accrued interest and dividends receivable	2,894					2,894
Premiums receivable from agents and insureds (net of allowance of $570)	79,429					79,429
Balances due from reinsurance companies	190,122					190,122
Prepaid reinsurance premiums	118,533					118,533
Deferred policy acquisition costs	37,643	(37,643)	(3)			-
Net deferred tax asset	10,181	(5,444)	(4)			4,737
Amortizable intangible assets	-	3,740	(5)			3,740
Unamortizable intangible assets	-	11,360	(5)			11,360
Goodwill	-	4,530	(5)	110,790		115,320
Other assets	19,629	(4,206)	(2)	577	(9)	16,000
Total assets	900,117	(37,629)		111,339		973,827
Liabilities and Stockholders' Equity						
Liabilities:						
Losses and loss adjustment expenses	298,531					298,531
Unearned premiums	290,505	(37,643)	(3)			252,862
Predecessor senior debt	20,063	-		(20,063)	(6)	-
Successor senior debt				50,000	(11)	50,000
Subordinated notes payable (incl. accrued interest of $296)	31,225			20,619	(9)	51,844
Accrued expenses and other liabilities	64,763	14	(7)	(225)	(10)	64,552
Federal income tax payable	2,810					2,810
Drafts and checks payable	5,474					5,474
Total liabilities	713,371	(37,629)		50,331		726,073
Minority interest in consolidated subsidiary, net of tax	212					212
Stockholders' equity:						
Common stock $0.01 par value, 10 million authorized, issued 1 million shares	141			(131)		10
Additional paid-in capital	119,614			127,918		247,532
Accumulated other comprehensive loss net of taxes	(1,688)	-		1,688	(8)	-
Retained earnings	68,467	-		(68,467)	(8)	-
Total stockholders' equity	186,534	-		61,008		247,542
Total liabilities and stockholders' equity	900,117	(37,629)		111,339		973,827

The most significant fair value adjustments were recorded to:

1) equity investment in Seguros Atlas
2) fixed assets, software and leasehold improvements
3) unearned premium reserves and deferred acquisition costs
4) deferred tax asset

5) intangible assets and goodwill
6) acquisition financing
7) stock compensation
8) retained earnings and other comprehensive income
9) Primarily for RIG Capital Trust III transactions
10) ESPP and deferred director awards
11) New senior debt pushed down to RCGI

Assets

The following accounts are carried at historical cost because historical cost approximates fair value and the time to settlement is short. In some cases no adjustment was recorded due to the relative immateriality of the amounts.

- Short-term investments
- Cash and cash equivalents
- Accrued interest and dividends receivable
- Other invested assets (the Company's investment in the trust preferred debt capital trusts)

Fixed Maturities and Equity Securities Available for Sale

Marketable securities are valued at fair values which results in a new basis for each security. Republic's accounting policy is to mark all fixed maturities and equity securities to market as required by SFAS 115. The investments will take on a new cost basis as of the acquisition.

- FMV recorded based on market value at 11/30/06
- Unrealized loss of $2.3 million in bond portfolio
- No permanent impairment existed on any bond
- Value of each bond adjusted to respective FMV

Seguros Atlas Stock

The Company owns a 30% interest in the stock of Seguros Atlas ("Atlas"). Atlas is a Mexican insurance company with grandfathered licenses that allow it to write premiums in the life, accident & health, property and auto lines of business. Atlas has conservative operations, experienced management and has been profitable many years. It is largely privately owned with significant control residing in two families.

Republic's 30% ownership in Atlas includes the contractual right to appoint four members of Atlas' 15 member board and approval rights over various corporate matters, including the annual budget. Based on the Company's ownership percentage and ability to influence Atlas' operations, the investment is carried on the equity method of accounting. Republic and Atlas do not participate in or foresee the opportunity to participate in any cross border transactions. Republic originally acquired the investment in 1994 as a member of the Winterthur Swiss Group when the international operations of that group were expanding. Atlas is not strategic to Republic's operations. Atlas is one of only two old-line Mexican insurance companies that are not currently part of an international organization or a larger banking organization. Due to its unaffiliated status and its grandfather licenses, Atlas could be an attractive target for a larger internationally focused insurance conglomerate.

In the prior year, Republic was approached with an unsolicited offer from a large international insurance organization to purchase its equity interest in Atlas for a price in excess of $40 million, contingent upon the buyer reaching an agreement with Atlas regarding certain operational and control issues. However, after many months of negotiation, the potential buyer and Atlas were unable to reach agreement and the buyer terminated the negotiations. Subsequent to the breakdown in these negotiations, the management of Atlas made an informal proposal to purchase the Company's interest in Atlas for approximately $26 million. This was rejected by the Company's private-equity controlled Board. Although not a strategic asset, the private-equity based Board was content to carry the asset as a long-term investment due to its historic profitability and potential long-term value. However, Delek is concerned about having a large

asset that is not core to the Company's ongoing business and that is generally viewed unfavorably by A.M. Best, the insurance regulators and the broader investment markets. Delek places greater emphasis in the liquidity value rather than the long-term value of this asset. Delek has requested Republic to explore alternatives regarding the investment including revisiting Atlas' prior discounted offer, although no specific strategy or timetable has been mandated. While international insurers have been active in purchasing Mexican insurers, there appears to be little market interest for partial, non-controlling interest.

Seguros Atlas Valuation at 9/30/06
(000s)

(Note: 9/30/06 is the most recent date for which US GAAP numbers are available.
These amounts were provided by E&Y Mancera - Mexico City)

Total stockholders' equity ($NP)	1,435,093	(US GAAP basis of accounting)
Exchange rate	10.99	
Total stockholders' equity ($US)	130,594	
Republic's ownership percentage	30%	
Republic's share of the book value in Atlas ($US)	39,178	
Republic's recorded value in Atlas ($US) at 11/30/2006	36,466	

The difference between the recorded value and the book value of Atlas resulted from an "illiquid asset" discount reflected in the PGAAP accounting at the August 2003 acquisition of Republic by a private-equity based consortium.

SFAS 157 provides the premise that the valuation of an asset should be based on the highest and best use of the asset either as an "in-use" asset or as an "in-exchange" asset. An "in-use" valuation would consider the value of the asset in combination with other assets that as a group could provide a higher value. An "in-exchange" valuation would consider that the asset's maximum value is on a stand-alone basis. The highest and best use concept is based on factors that market participants would consider. Based on Republic experience, large international insurance groups are not attracted to a 30% ownership and would prefer at least a 51% ownership position. Accordingly, it appears that without a prior agreement from Atlas' other shareholders to simultaneously sell a portion of their holdings to an acquiring company so as to allow the acquiring company to obtain 51% of the stock of Atlas, the most likely market participant would ***not*** be an international insurance group. The more likely market participant for Republic's investment in Atlas would be Atlas itself (to increase ROE or per share performance) or other current owners or management of Atlas (to increase their control of the company or to not have to deal with the complexity of foreign investors). These appear to be the more likely market participants and therefore they would represent the most advantageous market for Republic's shares in Atlas. Republic has already demonstrated the ability to hold the investment for an extended period of time without being forced to sell it in a liquidation or distress sale. Accordingly, a sale to Atlas' other shareholders or management at a price below Atlas' GAAP book value is not viewed as a liquidation or distress sale price. Rather it is viewed as the highest and best use of a 30% ownership in a Mexican insurance company in which a substantial portion of the remaining ownership is controlled by a family group. RCGI estimates a fair value of $26.5 million principally on the basis of Atlas' prior proposal and in consideration of the Delek's perspective on this holding.

Estimated fair value **$ 26,500**

The Company will continue to carry its investment in Atlas on the equity method.

Premiums Receivable

- **Direct bill receivables from policyholders**
  - Republic offers multiple payment plans on annual policies.
  - The net receivable balance turns over several times each year, thus the face value of the receivables are equivalent to FMV.
- **Allowance for uncollectible receivables**
  - Allowance at 11/30/06 was approx. $0.6 million based upon historical write-off patterns experienced by Republic.
  - Cannot readily identify specific receivables that will be uncollectible.
  - No specific receivable adjustment will be made for PGAAP purposes.
  - Purchased receivables that will be written off will approximate the additions to the allowance account during the coming year. Thus, the income statement impact of the specific identification and write-off of uncollectible receivables is equal to the normal income statement impact of the collection and allowance process.

Reinsurance Recoverables

- Approximately 97% of all reinsurance recoverables are from reinsurers rated A- or better (this has improved from approximately 88% after the 2003 acquisition).
- Republic has aggressively pursued collection of outstanding reinsurance balances
- Republic has not experienced any significant write offs of reinsurer balances in the past year.
- Almost all balances due from reinsurers are current as of 11/30/06.
- No allowance for uncollectible reinsurance is deemed necessary at 11/30/06.

Deferred Policy Acquisition Costs

Deferred policy acquisition costs (DAC) represent those expenses that vary with and are directly related to the acquisition of insurance policies. This represents the seller's cost of obtaining insurance policies existing at the date of sale. The buyer's cost of obtaining the policies is reflected in the total purchase price of the company and specifically identified in various intangible assets. Future profits embedded in the unearned premium reserves are computed in the fair value adjustment of this liability. We have determined that the fair value adjustment of the unearned premium reserve (see separate analysis below) is substantially equivalent to the $37.6 million DAC balance at 11/30/06. Pursuant to the SEC response received in connection with RCGI's 2005 IPO, RCGI will adjust the DAC balance to zero and record a fair value adjustment of $37.6 million against the unearned premium reserve. This approach also provides accounting administrative relief in allocating the equity value adjustment in the unearned premium reserves to the respective segments, lines of business and operating territories since DAC is already computed in such manner on Republic's books.

Intangible Assets

- **General definitions of intangible assets**:
  - Intangible assets are assets with economic properties that grant rights and privileges to their owners and are expected to generate future benefits in production of goods and services. They are nonphysical in nature with the ability to be used simultaneously and repetitively without diminishing their value.
  - They are generally separable from the owning legal entity and transferable.
  - Intangible assets are generally measured indirectly using various valuation approaches.
  - An intangible asset should be recognized as an asset apart from goodwill if it arises from contractual or other legal rights. If an intangible asset does not arise from contractual or other legal rights, it shall be recognized as an asset only if it

is capable of being separated or divided from the acquired entity and sold, transferred, licensed, rented or exchanged.

- **Methods of valuing intangible assets:**
  - Traditional approach focuses on variations in cash flows and an interest rate commensurate with the risk (including risk-free rate plus inherent uncertainty in the asset, regulatory approval, customer acceptance, viability of technology, time to market, competitor response, and performance.)
  - Three basic methods:
    - Cost to recreate the asset:
    - Discounted cash flows: focuses on variations in amount and timing of cash flows and their relative probability of occurrence.
    - Market comparables.
- **RCGI approach to valuing intangibles**
  - The Company engaged an unaffiliated valuation specialist to identify and value certain acquired intangible assets. The valuation specialist identified intangible assets related to marketing, customer, contracts and technology. All intangible assets are to be regularly evaluated for impairment according to SFAS 142. Intangible assets that have a definite life will be amortized over the period that cash flows derived from the intangible asset will be realized.

- **The following intangible assets have been identified:**

($ in thousands)	Fair Value	Life
Marketing-related intangible assets		
Tradename	$ 6,160	indefinite
Customer-related intangible assets		
Personal lines relationship--in force	2,000	9 years
Personal lines relationship--new business	340	9 years
Commercial lines relationship	300	4 years
Program management relationship	1,100	5 years
Contract-based intangible assets		
Insurance licenses	4,200	indefinite
Unique charter management contract	1,000	indefinite
Total	$ 15,100	

- **Marketing related intangible assets**
  - General comments
    - trade name differentiates one carrier from others
      - level of service
      - tenure in marketplace
      - operations in particular niche market
    - value is measured based upon
      - earnings potential under the name (a royalty in perpetuity) or
      - based upon the cost of licensing a comparable name and promoting it in developing agency relationships
  - "The Republic Group" and "Republic - Your Regional Company of Choice"
    - Well recognized and respected name among insurance agency force and managing general agents in Southwestern states and among regulators.
    - Policyholders do not recognize our name (not a common household name).

        - "Republic" and "Your Regional Company of Choice" have not been registered or restricted. This also diminishes their value.
    - **The valuation specialist estimated the value of our trade name at $6.16 million.**
    - **Per SFAS 141, this intangible asset carries an indefinite life**

- **Customer related intangible assets**
    - **Assumptions**
        - Economic value of agent relationships and policyholder renewals is computed based upon assumed runoff of the business (without replacement policies). Business is transferable and separable in a sale.
        - Value is computed as the present value of projected future earnings less the capital required on day-one to support the underwriting leverage by segment. Underwriting leverage is net premium written divided by required surplus/equity.
        - Attrition rates based upon historical experience.
        - Loss ratios based upon adjusted actuarially analysis.
        - Loss payment patterns based upon actual experience.
        - Expense ratios based upon commission schedules and projected expenses.
        - Investment yields based upon actual in 2006 (bond portfolio yield of 4.2%).
        - Investment income computed on assumed level of investments equal to required surplus plus unearned premium reserves plus loss reserves less DAC less premium receivables.
        - Assumes that all annual profits and excess surplus are dividended and redeployed. Excess surplus is the amount not required to support the underwriting leverage.
          The valuation specialist estimated the value of our customer-related intangibles at $3.74 million.

    - **Life**
        - The average personal lines agency relationship based on premium-weighted average is approximately 15 years for personal lines and 11 years for commercial lines. Program management relationships do not lend themselves to averages; however, the primary producer Texas General Agency has been with Republic for more than 20 years.
        - Most of the projected earnings from the inforce business are recognized in the first 5 years with a decreasing pattern of expected earnings.
        - **Selected the following estimated lives:**
            - **Personal Lines Agency Relationships – 9 years**
            - **Commercial Lines Agency Relationships – 4 years**
            - **Program Management Relationships – 5 years**

    - **Discount Rate**
        - Pre-tax risk rate of return of 13% is appropriate for the cost of capital for regional companies and is adequate to provide for all inherent risks associated with the purchase of the business in force.

- **Contract based intangibles**
    - **Insurance licenses and charters**

        - State insurance licenses have value to other insurance companies who could buy a licensed entity to save time in filing and waiting for approval. Profits in writing business can be realized sooner since operations could be started sooner. The Company's licensed subsidiaries are separable and transferable.
        - used market valuation approach (cost approach should also be comparable).
        - estimated value varies by size of insurance market in the state ($100k larger states, $50k smaller states, $50k surplus lines)
        - Republic operates through 8 insurance companies allowing the group to operate in various states with multiple tiers for rates and to achieve favorable premium tax rates
    - **Texas county mutual charter**
        - Charter offers limited rate freedoms not available from licensed insurance companies. 2003 legislation substantially diminished county mutual company rate freedoms.
        - Only 23 county mutual charters are available and all but 4 are used solely for captive company writings. Southern County's charter expires in 2025. The value of the county mutual is in the management contract (Republic Group No. Two Company, a wholly owned subsidiary of RCGI, holds the contract).
        - The management contract is separable and transferable.
        - Management believes that the competitive advantage in the county mutual charter after the legislation is substantially diminished. The present value of the fronting fees related to pure-fronted auto writings is substantially in excess of $5 million. There have been no recent sales of county mutual charters to compare to. However; one such sale, several years ago, indicated the value may be only $1 million. Accordingly, a value of $1 million is established for the value of the SCM management contract.
    - **Eagle General Agency and Republic Home Protectors**
        - Prior to 2003 legislation corporate MGAs had a competitive advantage regarding licensing of officers and directors. This advantage was eliminated and the license represents no competitive advantage.
    - **Lloyds plan**
        - Republic Lloyds is a Texas Lloyds plan company which previously had certain rate flexibility for Texas property writings.
        - Charters for Texas Lloyds plans are easily obtained and represent no competitive value. This is further evidenced in that some Lloyds plans are now converting to stock companies and the Texas legislature is considering regulatory changes that will further eliminate any advantage for Lloyds plan insurers.
    - **The valuation specialist estimated the value of our contract-based intangibles at $4.2 million.**
    - **An additional intangible of $1.0 million for the county mutual management agreement should be recorded**
    - **Per SFAS 141, these intangible assets carry an indefinite life**

- **Other intangible assets**
    - **Assembled workforce**
        - The valuation specialist established a value for the assembled workforce of Republic only for the purposes of estimating the contributory charge associated with the workforce in developing the value of agency-related

intangible assets. An assembled workforce is not an intangible asset because it does not meet the separability and transferability criteria contained in paragraph 39 of SFAS 141.

- **Employment contract value is de minimus**
  - 5-year contract with Rush and 3-year contracts with Cummings, Ditto, Howey and Vaccaro are at current salary terms that are not in excess of market ranges. The contracts are cancelable with 90 days notice.
  - Valuation of employment contracts is generally based upon the cost to replace and the cost of lost productivity during the learning curve of a new employee. Cost of replacement and lost productivity is generally measured as one-half of the annual salary. This would not be a material amount. No intangible asset was established.

Goodwill

Goodwill is the excess of the cost of an acquired entity over the net of the fair value assets acquired and liabilities assumed. After the recognition of goodwill on the financial statements, goodwill is not amortized but tested for impairment at least annually or when evidence exists that the fair value is less than the recorded goodwill. The annual test for impairment can be performed any time during the fiscal year provided the test is performed at the same time every year. A calculation of goodwill recognized for the transaction is detailed below:

($ in thousands)	**Amount**
Assets Purchased:	
Cash	$ 4,835
Investments	426,857
Premiums receivable	79,429
Balances due from insurance companies	190,122
Prepaid reinsurance premiums	118,533
Deferred tax asset	4,737
Intangible assets	15,100
Other	18,894
Total	$ 858,507
Liabilities assumed:	
Losses and loss adjustment expenses	298,531
Unearned premiums	252,862
Debt	51,844
Minority interest	-
Accrued expenses and other	73,048
Total	676,285
Estimated fair value of net assets acquired	182,222
Acquisition price	297,542
Excess of cost over the fair value of acquired assets	$ 115,320

According to SFAS 142, paragraph 34, goodwill must be allocated to an entity's reporting segments as of the acquisition date. The allocation of goodwill allocated to the reporting unit should be determined in a manner similar to how the goodwill was recognized in the business combination. The value of a property and casualty company is generally determined by a regression analysis of the return on equity to the market multiple over the book value. This type

of analysis was conducted for the purposes of the Fairness Opinion rendered to the Board of Directors. The implied ROE by segment is plotted on the regression analysis to determine the implied market multiple by segment. RCGI allocated the goodwill to its segments as follows:

($ in thousands)	Amount
Independent Agents--Personal Lines Segment	$ 57,000
Independent Agents--Commercial Lines Segment	500
Program Management Segment	43,700
Insurance Services and Corporate Segment	14,120
Total Allocated Goodwill	$ 115,320

The reported goodwill for each segment is tested for impairment at least annually at the same time each year or more frequently if an event occurs or circumstances change that would indicate an impairment has occurred. Some events described by SFAS 142 paragraph 28 include an significant adverse change in legal factors or in the business climate, an adverse action or assessment by a regulator, unanticipated competition, a loss of key personnel, a more-likely-than-not expectation that a reporting unit or a significant portion of a reporting unit will be sold or otherwise disposed of, testing of a significant asset group within a reporting unit, and recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit.

Other Assets

Other assets include property and equipment, including leasehold improvements and software, plus miscellaneous other assets, including prepaid expenses, assets related to deferred compensation/benefit liabilities and other deposit-type assets. Following is a schedule of other assets:

($ in thousands)	Historical GAAP Balance	Financing and Fair Value Adjustment	PGAAP Balance
Property & Equipment:			
Furniture and equipment	5,246	(3,977)	1,269
Leasehold improvements	5,195	(2,945)	2,250
Software	11,753	(9,453)	2,300
Accumulated depreciation	(12,169)	12,169	-
Total Property & Equipment:	10,025	(4,206)	5,819
Miscellaneous other assets:			
Guaranty funds	$ 1,841	$ -	$ 1,841
Deferred compensation	2,072	-	2,072
Rabbi trust	1,625	-	1,625
Company fee	1,089	-	1,089
Maintenance contracts	1,398	-	1,398
Miscellaneous prepaids	1,579	577	2,156
Total miscellaneous other assets	9,604	577	10,181
Total other assets	19,629	(3,629)	16,000

- **Property and equipment**
  - Is generally valued at the current replacement cost for similar capacity unless the expected future use of the assets indicates a lower value to the acquiring entity. If the asset is expected to be sold, the value is fair value less cost to sell.

- **Furniture and equipment**
  - Republic hired an outside, independent consultant to evaluate our furniture and equipment (F&E). The consultant observed, evaluated, and appraised the Company's F&E and prepared an appraisal report in conformity with the Principles of Appraisal Practice and Code of Ethics of the American Society of Appraisers).
  - **The net fair value estimated by the appraiser was $1.269 million.**

- **Leasehold improvements**
  - Republic made considerable improvements to the building to accommodate its specific needs. Republic's needs included space for 320+ employees which needed to be aggregated by unique departmental disciplines, including a large space for claims adjustment activities, a large space for IT related activities, and a large executive area. Republic's needs included space for a corporate headquarters of a small cap insurance carrier with space for a Board room, training facilities, employee luncheon and exercise facilities, and other space requirements that would not be necessary of a branch office or other subdivision of an entity that had its corporate headquarters located elsewhere. It is very unlikely that another entity would have the exact same needs.
  - Republic is already experiencing the need to modify the existing building finish out and will likely incur some additional cost in the near future.
  - The cost to replace the improvements would substantially exceed the book value. However, under a new lease arrangement, tenant finish-out could be built into the lease rate - thus zero direct cost for improvements.
  - The Dallas real estate market continues to experience an elevated vacancy rate which provides potential tenants with many options which make Republic's home office building finish-out less attractive.
  - The leasehold improvements have value to Republic and are adequate for Republic's needs for the foreseeable future.
  - Republic has no residual interest in the leasehold and the improvements it has made.
  - The appraiser who performed the lease valuation indicated that tenant improvements could have as little as zero value to a new tenant with different needs. Alternately, a new tenant with needs similar to Republic's configuration would attach great value to the existing improvements. Most likely, the existing improvements would have little if any value to any party other than Republic.
  - The leasehold improvements could reasonably be assumed to have no value in any circumstance other than Republic's current needs. The improvements have no value to Republic at the conclusion of its lease. However, they have value to Republic's current operating needs.
  - **We believe a reasonable approach would be to estimate a fair value at half of the remaining book value, or approximately $2.25 million, to be amortized over the remaining life of the lease, or approximately 10 years.**

- **Software**
  - Total net book value of existing software

(millions)	Pre-acquisition balance	Fair Value Adjustment	PGAAP Balance
FAB	$ 1.30	$ (0.80)	$ 0.50
Agency Port	1.00	-	1.00
Instec	0.50	(0.25)	0.25
Garvin Allen	0.30	(0.20)	0.10
Mercury	0.40	(0.30)	0.10
Other	0.30	(0.30)	-
ImageRight	-	0.25	0.25
Repub*Link*	-	0.10	0.10
	$ 3.80	$ (1.50)	$ 2.30

  - Other systems (ALPS, PeopleSoft, ImageRight, Docucorp, AIS, DB2) are fully depreciated.
  - General valuation of software
    - Estimated to the extent the software reduces costs or to the extent it provides a competitive advantage
    - Could value using either an expense reduction or a cost to develop/implement approach
    - Republic's software would have limited, if any, utility to any other potential users due to significant customization.
    - Most of this software is generally functional and represents value to the company but does not provide a competitive advantage to the company. We clearly are not a cutting edge technology provider.
    - Much of the software represents an increase in cost due to the high level of required maintenance. Systems such as FAB and Instec have never provided the efficiencies originally anticipated and no staff reduction has occurred. In fact, considerable additional cost has been incurred to bring these systems online and there are still ongoing issues of accuracy and functionality.
    - Studies are underway to assess the adequacy of existing systems. It is widely anticipated that new enterprise-wide software will replace existing systems over the next two-to-four years.
    - Estimates of fair values shown above were provided by Republic's Chief Information Officer, with these additional comments:
      - FAB (billing system) - no competitive advantage, provides some level of efficiency
      - Agency Port (commercial lines web access) - provides a competitive advantage, provides significant efficiency
      - Instec (commercial lines rating and policy admin.) - no competitive advantage, provides some level of efficiency, written in older technology
      - Garvin Allen (farm and ranch system) - no competitive advantage, provides some level of efficiency, application architecture requires significant maintenance

- Mercury (change control) - internal tool used for change management/SOX compliance, no competitive advantage, provides no efficiency
- ImageRight (imaging and workflow system) - no competitive advantage, provides some level of efficiency
- Repub*Link* (agency internet interface) – estimate of value provided by the valuation specialist as described under Intangibles.

- **Internally Developed Software**
  - Repub*Link* represents the only internally developed software with a competitive advantage.
  - General valuation of software is based on the extent that the software reduces costs or to the extent it provides a competitive advantage. Could value using either an expense reduction or a cost to develop/implement approach.
  - Repub*Link* was originally implemented in 1999 and is currently based on technology that is outdated and does not provide Republic with any true competitive advantage.
  - A major overhaul of Repub*Link* is planned during the next two-three years
  - The valuation specialist valued Repub*Link* at $0.1 million with a four year life. This asset is included in the fair value of software as a fixed asset rather than as an intangible and amortized the fair value over three years consistent with other software.

- **Miscellaneous other assets**
  - Are generally assumed to be at fair value due to their short duration; therefore, no adjustment is required.

Liabilities

The following accounts are carried at historical cost because historical costs approximate fair value:

- Accrued expenses
- Federal income tax payable
- Draft and checks payable

Losses and loss adjustment expense reserves

The fair market value of loss and loss adjustment expense reserves must consider several key factors including:

- Adequacy of reserves
  - uncertainty inherent in the estimated net loss/LAE reserves mitigated by multiple actuarial reviews and by the short tailed nature of the book
  - RCGI reserves are adequate by line of business and in aggregate
- Time value of payments
  - discounted using risk free rate (5 year treasury rate of 4.40%)
  - historical company payment pattern actuarially developed by line of business based on analysis of most recently available Schedule P (2005 - same patterns used in valuing the unearned premium reserve)
- Short-tail nature of business
  - most business is short-tailed, meaning that the ultimate loss is known and paid within a short time frame
- Reinsurer profit / expense margin and risk load
  - management's estimate of cost to reinsure in a portfolio transfer transaction the full loss reserves to a 3rd party
  - estimate was developed with assistance from reinsurance intermediaries knowledgeable of the reinsurance market place
- No net adjustment of recorded reserve balance
  - the net reduction of adequate reserves for time value discount approximates profit/expense margins in the cost of reinsurance.
  - FMV loss reserves is equal to the recorded loss reserves less discounted cash payout plus reinsurer's load for profit and expense margin.

    $(6.7) discount on reserves
    6.7 cost of reinsurance
    $ (0.0) net adjustment
- Amortization
  - the discount would be amortized to expense over the duration of the losses (approximate average duration of 2 years – approximately 98% of reserves are paid after 4 years)
  - the cost of reinsurance would decline proportionately with the decrease in discount in the initial periods, but could be slightly higher in the future periods due to reinsurer's minimum expense and profit margins.
  - due do the relatively short-tail of the book, the amortization of the two items virtually offset each other with limited net impact.

Net Loss and LAE Reserves by Segment
($ 000s)

	12/7/2006	2005	2004
Personal Lines			
Case	$ 13,297	$ 13,418	$ 13,545
IBNR (net of S&S)	9,609	12,582	16,388
LAE	7,182	8,513	11,289
Total	30,088	34,513	41,222
Commercial Lines			
Case	16,640	16,834	16,189
IBNR (net of S&S)	22,899	21,633	19,755
LAE	13,514	12,990	11,019
Total	53,053	51,457	46,963
Specialty			
Case	16,259	13,714	9,498
IBNR (net of S&S)	11,225	7,537	6,483
LAE	8,229	4,512	3,656
Total	35,713	25,763	19,637
Total Company	$ 118,854	$ 111,733	$ 107,822

- Discount methodology
  - Used internal discount patterns by line of business
  - Used 5 year US Treasury risk free rate for discount (4.40%)
  - Mid-year payment assumption
  - Reserves are adequate – therefore, the risk factor for adverse development is very small

PGAAP Reserve Adjustment (000s)	Net Reserves Per G/L 11/30/2006	Discounted Reserves	Discount	% Discount by LOB
Homeowners/Farmowners - Part 1A	10,692	10,134	558	5.22%
Private Passenger Auto Liability - Part 1B	19,383	18,443	940	4.85%
Commercial Auto Liability - Part 1C	29,307	27,640	1,667	5.69%
Workers Compensation - Part 1D	12,089	11,394	695	5.75%
Commercial Multi-Peril - Part 1E	26,781	24,975	1,806	6.74%
Other Liability Occurrence - Part 1H	15,490	14,601	888	5.73%
Special Property - Part 1I	2,538	2,460	78	3.08%
Auto Physical Damage - Part 1J	2,175	2,125	50	2.29%
Fidelity & Surety - Part 1K	208	203	4	2.13%
Products Liability Occurrence - Part 1R	190	172	18	9.44%
	118,854	112,148	6,706	5.64%
		94.3581%		5.64%

- Reinsurance profit/expense margin and risk loads
  - Reserves increased by cost of reinsurance
    - cost of reserve portfolio transfer to 3rd party reinsurer
      - the FMV of reserves includes implied cost to runoff the block
    - reinsurer would price the transfer with a margin for:
      - risk of development
      - expenses to runoff the portfolio
      - expected profit
        - expectation that the ultimate payout would be less than stated reserves
        - investment returns during the payout period (current investment market results would likely continue through the short-tailed payout period - assumed investment portfolio heavily weighted to fixed income securities)
    - Republic's reserves are adequate (multiple actuarial reviews; short duration). The reserves have developed marginally favorable over the past three years. A reinsurer margin for the risk of development would be minimal. The expense and profit margins would be the primary reinsurance loads and would be reduced by expected portfolio investment income.
  - Cost determined through discussions with knowledgeable and experienced reinsurers and reinsurance intermediaries including:
    - Reinsurance Brokers
    - Reinsurance Companies
  - Management's estimate is that the cost of reinsurance is approximately $6.5m to $7.0m

- **Reinsurer guidance**

Hypothetical Scenario asked of Reinsurance Specialists:

An Insurance Company has $100,000,000 of case and IBNR claim reserves for indemnity, allocated LAE and unallocated LAE. The reserves are accepted to be accurately estimated (i.e., not inadequate, not redundant, 99.99% confidence). The present value of the future payout of the reserves as claims reserve is estimated at $94,350,000. The present value assumptions include a 4.4% five year U.S. Treasury Note rate applied to the by line payout patterns from the Insurance Company's schedule P. The relatively small present value discount is a reflection of the predominantly short-tail mix of the Insurance Company's claims.

Question:

What is the price range (relative to the $100,000,000 stated reserves) that the Insurance Company should expect to pay to the reinsurer to take a loss portfolio transfer? Assume reinsurer has 99.99% confidence in the adequacy of the reserves. Because of confidence in the adequacy of reserves, assume the reinsurer will assume the reserves unconditionally.

Guidance from a Reinsurance Broker

We do not believe a reinsurer would do an unconditional loss portfolio assumption without "finite" risk limiting considerations such as an absolute limit, and other potential features such as a loss corridor, payment lags, additional premium features, etc.

Having said that, the required premium would certainly be in excess of the $94,350,000 you reference as the estimated NPV. It's quite likely the charged premium would be in excess of $100 million; particularly if you sought no state absolute limit to the booked reserves, and no other risk limiting features for the reinsurer.

Guidance from Reinsurance Broker

From the Head of the Reinsurance Broker's Structured Risk Specialty Group

It is unlikely a reinsurer would give benefit to the discount in reserves and provide unlimited coverage. I understand that the client is indicating we should assume carried reserves are accurate to a 99.9% confidence level but reinsurers just don't like to take that risk. At a minimum they would want the full value of the reserves to be paid.

From a Managing Director of the Reinsurance Broker:

I agree with the above and do not believe reinsurers would agree to a discount.

Responses received in the 2003 PGAAP development remain relevant and timely:

From a Reinsurance Broker

Based on past loss portfolio transfer deals ad 4-5% reinsurer margin is certainly within reason and in fact is probably on the low side....The actual transaction cost for such a deal is highly dependent upon the split of the classes of business and the perceived adequacy of the original loss reserve estimates.

From a larger Reinsurance Company

It's hard to me to say categorically what the price would be, since there are so many levers that can be pulled to change the price/margin; all finite, risk moderating mechanisms. But there are only four quarters in a dollar; so, I would think a reinsurer's margin would have to be greater than the discount you speak of; it would almost have to be by definition.

From a Reinsurance Broker

Based on general information you and SFAS 141 (paragraph 40B(2)—contingencies reasonably estimated)

- A reserves portfolio with a relatively short duration—providing less discount than likely required reinsurance loads (risk and profit margin)
- Recent purchase examples with no booked discount (White Mountains and Arch)
- Our understanding is that booking liabilities without discount at the actuarially deemed projected ultimate loss is reasonable at this time.

Unearned premium reserves

Unearned premiums represent the amount of premium that has been billed to the customer but has not been earned by the Company. The embedded underwriting earnings in the unearned premium reserves plus the inherent investment earnings on investments should be equal to the equity in UEPR. Investments in subsequent years are assumed to equal the loss reserves plus cumulative earnings on the UEPR.

The fair market value of the reserves are determined with reference to the adequacy of reserves, time value of payments, and the expected cost of runoff or the expected profit from existing unearned premiums. The assumptions used to determine the fair value of the deferred revenue are:

- Profit and expense margin
  - Unearned premiums are assumed to be earned within one year;
  - Loss ratio assumptions, actuarially determined, are equivalent to the 2007 budget; and
  - Resulting losses are paid out over historical payment patterns.
- Adequacy of rates
  - Rates ate adequate by line of business and by company.
- Time value of money
  - The discount rate used is 7.4%;
  - The elements of the risk based discount rate is the risk free five year US Treasury rate of 4.4%, the risk adjustments for early cancellation and non-collection of 2%, and the risk adjustment for reserve development of 1%;
  - Payment patterns assume a half year convention; and
  - Both earnings and discount rate used are based on a pre-tax basis which approximates a post-tax computation.
- Amortization period
  - The underlying policies are primarily one-year policies (with only a few six month or one month policies). Accordingly, the fair value adjustment of the UEPR will be amortized over one year.
  - The adjustment is approximately equal to the deferred acquisition cost asset. Accordingly, the adjustment amortization will be applied by line of business and segment following the recorded change in deferred acquisition costs. See additional comments regarding deferred acquisition costs above.

Using the assumptions described above, the following table estimates the fair value of the estimated profits as of the acquisition date:

($ in thousands)	Gross Estimated Profits	Discount Factor	Fair Value of Adjustment Unearned Premium Reserves
2007	$ 25,227	0.9649	$ 24,342
2008	5,169	0.8984	4,644
2009	3,496	0.8365	2,925
2010	2,593	0.7789	2,020
2011	2,039	0.7252	1,479
2012	1,828	0.6753	1,234
2013	1,737	0.6287	1,092
Total	$ 42,089		$ 37,736

The balance of deferred policy acquisition costs of $37,643,000 is substantially equivalent to the fair value adjustment shown above that would be recorded for unearned premiums; therefore, we will use the existing deferred policy acquisition cost balances by segment to record the fair value adjustment.

At the time of acquisition, the unearned reserve premiums and the related fair value adjustment were as follows on a gross and net basis:

($ in thousands)	Unearned Reserve Premium /----------Historical----------\ Gross	Ceded	Net	Fair Value Adjustment	Net PGAAP Balance	Gross PGAAP Balance
Standard Personal Property	$ 57,512	$ 1,244	$ 56,268	$ (11,433)	$ 44,835	$ 46,079
Standard Personal Auto	15,739	-	15,739	(2,898)	12,841	12,841
Non-standard Auto	8,164	-	8,164	(1,598)	6,566	6,566
Low-value Dwelling	10,570	-	10,570	(2,311)	8,259	8,259
Other Personal Lines	582	-	582	(162)	420	420
Total Personal Lines	$ 92,567	$ 1,244	$ 91,323	$ (18,402)	$ 72,921	$ 74,165
Commercial Property	$ 11,005	$ 534	$ 10,471	$ (2,358)	$ 8,113	8,647
Commercial Auto	10,575	-	10,575	(2,366)	8,209	8,209
Workers Compensation	6,354	-	6,354	(1,026)	5,328	5,328
Commercial Lliability	13,826	63	13,763	(3,103)	10,660	10,723
Farm and Ranch	4,783	159	4,624	(1,019)	3,605	3,764
Total Commercial Lines	$ 46,543	$ 756	$ 45,787	$ (9,872)	$ 35,915	$ 36,671
Program Management	70,524	35,662	34,863	(9,369)	25,494	61,155
Insurance Services	80,871	80,871	-		-	80,871
TOTAL	$ 290,505	$ 118,533	$ 171,973	$ (37,643)	$ 134,330	$ 252,862

Debt

The Company has three capital securities called RIG Capital Trust I, RIG Capital Statutory Trust II and RIG Capital Trust III. Trusts I and III contain floating rate debentures equal to the three-month LIBOR plus 4% and 3.2%, respectively. Trust II contains floating rate debentures at a fixed rate of 7.7% through October 2008, whereupon the rate converts to a floating rate equal to the three-month LIBOR plus 3.85%. The Company also has a $50 million senior bank credit facility with Frost Bank with a floating interest rate of LIBOR plus 2%. The debt and interest rates in effect at 12/7/06 include:

	Date of note	Amount	Current Rate	Life	Terms
Trust I	9/30/2003	10,310,000	9.360%	30 years	3-month LIBOR plus 4%
Trust II	10/29/2003	20,619,000	7.700%	30 years	Fixed until 10/08; thereafter, 3-month LIBOR plus 3.85%
Trust III	12/7/2006	20,619,000	8.025%	30 years	3-month LIBOR plus 3.2%
Frost Bank	12/7/2006	50,000,000	7.350%	5 years	Choice of 1-, 3- or 6-month LIBOR plus 2%
Total		101,548,000	7.762%	(Average rate)	

The Company believes the face value its debt represents fair value due to the floating interest rate nature for most of its debt. For Trust II, the fixed 7.7% rate represents a reasonable rate in the current market and appears consistent with other market rate debt. No fair value adjustment is required for the Company's debt.

Accrued expenses and other liabilities

Following is a schedule of accrued expense and other liabilities.

(000s)	Pre-acquisition Balance	Fair Value Adjustment	PGAAP Balance
Reinsurance payable	$ 14,037	$ -	$ 14,037
Commission payable	20,950	-	20,950
Deferred compensation	2,394	-	2,394
Retirement savings plan	1,108	-	1,108
Non-qualified pension liability	2,234	-	2,234
Deferred rent	2,805	-	2,805
Accrued payroll	3,041	-	3,041
Accrued taxes	3,436	-	3,436
Unearned company fees	3,099	-	3,099
Unsettled investment trades	5,789	-	5,789
Other	5,870	(211)	5,659
	$ 64,763	$ (211)	$ 64,552

In association with the Acquisition, the Company redeemed the shares related to the Employee Purchase Plan and the Directors Deferred Compensation for ($154,000) and ($70,000), respectively plus the fair value adjustment related to the preferred stock award of $13,000.

Pension Obligations

- Republic's qualified and non-qualified pension plans were frozen at 12/31/03
- Actuarial valuations of both plans were received from Prudential actuaries as of 12/31/06
- No significant difference in plan obligation or asset valuation between 11/30 and 12/31
- Benefit obligation for the qualified plan at 12/31/06 was $49.2 million and fair value of plan assets at 12/31/06 was $49.3 million.
- Benefit obligation for the non-qualified plan at 12/31/06 was $2.2 million and this liability is reflected on Republic's balance sheet. (The liability is funded in part by a Rabbi Trust with a fair value of $1.6 million at 12/31/06).
- No additional liability or PGAAP treatment is required
- Plan termination at the purchase date was considered by the Board but the unfavorable yield curve made this action impracticable.

Other Liabilities and Accrued Expenses

- No known significant pre-acquisition contingencies
- Existing other liabilities represent normal ongoing liabilities that are short-term in nature and book value approximates fair value.

- **Leases**
  - Republic has a lease in the 5525 LBJ Freeway building in Dallas, Dallas County, Texas. The leased building is a six story, concrete frame office building, two story concrete parking garage with basement, concrete paved surface parking with landscaped entry plaza, irrigation, and monument sign. The lease commenced on March 1, 2005 and terminates on February 28, 2017 with one five year option at the prevailing rental rate and is a triple net lease. Under a triple net lease, the tenant is responsible for providing for all of the operating expenses such as real estate taxes,

insurance, utilities, janitorial services, security services, and repairs and maintenance.

- We hired an independent appraisal firm to evaluate the fair value of the lease as required paragraphs 39 and A14 of SFAS 141. The appraisal firm did a market evaluation and an evaluation using three traditional approaches to value in the appraisal process: the income approach, sales comparison approach, and the cost approach. The fair value of the lease was adjusted for the tenant finish-out allowance and the aspects of the triple net lease conditions. The appraiser concluded the lease is considered to be at market rates and no leasehold interest (either positive or negative) appears to exist.

Deferred Taxes

A deferred tax asset/liability was computed for the difference between the assigned fair values of assets acquired and liabilities assumed over/under the tax basis of such assets and liabilities. The ultimate realization of deferred tax assets is dependent on the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Management believes it is more likely than not that the Company will realize the remaining benefits of these deductible differences in the foreseeable future.

- No IRC Section 338(h)(10) election was made with the acquisition. Accordingly, the historical tax basis of assets was used (carryover basis).
- Net operating loss carryforwards (NOL) of Republic Underwriters Insurance Company were valued (i.e., the ability to utilize them) under the new consolidated structure at their face value. No valuation allowance is considered necessary (i.e., it is reasonably likely that the NOLs will be utilized prior to expiration event with the Section 382 pre-acquisition limitations).
- The NOLs of Southern County Mutual will not expire for many years. However, under the current organizational and operational structure it is possible that these NOLs would not ultimately be utilized. The organizational and operational structure may be changed so that the NOLs could ultimately be used. However, Republic does not currently plan to change these structures in the near term. Accordingly, a valuation allowance will be provided for the NOLs associated with Southern County Mutual Insurance Company (SCM).
- SFAS 109 "Accounting for income Taxes" paragraph 133 provides that goodwill is the excess of purchase price over the assigned values of the identifiable net asset acquired. As such it is a residual asset. No deferred tax is recognized for goodwill since both goodwill and the related deferred tax liability are mutually dependent on each other for their computation and would result in undue financial statement complexity.
- SFAS 109 also provides that all identifiable intangible assets are not residual in nature and therefore do not qualify for the exception for deferred taxes. Accordingly, a deferred tax liability is recorded for all such assets whether or not amortizable for book purposes or for tax purposes.

Deferred Tax Computation (000s)	Book Value	Tax Value	Temporary Difference
Bonds	$ 359,051	$ 360,948	$ 1,897
Investment in unconsolidated foreign insurance company	26,500	28,762	2,262
Deferred Policy Acquisition Costs	-	-	-
Premium receivables	79,429	79,999	570
Intangibles--Amortizable	3,740	-	(3,740)
Intangibles--Non-amortizable	11,360	-	(11,360)
Fixed assets	10,025	13,658	3,633
Loss and LAE reserves	(132,891)	(121,600)	11,291
Unearned premiums	(134,330)	(137,579)	(3,249)
Employee plans	(4,449)	-	4,449
NOL and capital loss	-	12,650	12,650
Other	(5,135)	(3,081)	2,054
Gross difference			20,457
Valuation allowance			(6,921)
Net difference			13,536
x35% = Net Deferred Tax Asset			$ 4,737

Consolidated

Year of Loss	$ of NOL (000s)	Year of Expiration
2002	5,042	2022
Valuation allowance	0	

- NOL utilization subject to IRC 382 limitations
- No valuation allowance needed
- Risk of NOL expiration is minimal

Southern County Mutual

Year of Loss	$ of NOL (000s)	Year of Expiration
2000	1,430	2020
2001	2,606	2021
2002	2,250	2022
2003	627	2023
2006	8	2026
	6,921	
Valuation allowance	(6,921)	

- NOL not subject to IRC 382
- Not probable of being utilized in near term

SFAS 109 paragraphs 30 and 136 provides that when a valuation allowance is recognized for a deferred tax asset at the acquisition date, the future tax benefit for such items that may be recognized if the valuation allowance were eliminated in post acquisition financial statements shall be applied to reduce goodwill. Accordingly, if the net operating loss of Southern County Mutual were subsequently realized due to earnings or other post acquisition change in circumstance, then the goodwill be reduced for the amount realized.