

AMPAL-AMERICAN ISRAEL CORP
Form 10-K
March 29, 2006

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-K

**ANNUAL REPORT PURSUANT TO SECTIONS 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2005

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-538

AMPAL-AMERICAN ISRAEL CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

New York
(State or Other Jurisdiction of
Incorporation or Organization)

13-0435685
(I.R.S. Employer
Identification No.)

111 Arlozorov Street, Tel Aviv, Israel
(Address of Principal Executive Offices)

62098
(Zip Code)

Registrant's telephone number, including area code (866) 447-8636
Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:
Class A Stock, par value \$1.00 per share
4% Cumulative Convertible Preferred Stock, par value \$5.00 per share
6 1/2% Cumulative Convertible Preferred Stock, par value \$5.00 per share
(Titles of Classes)

Indicate by check mark if the registrant is a well-known seasoned issuer (as defined in Rule 405 of the Securities Act).

Securities registered pursuant to Section 12(g) of the Act: Class A Stock, par value \$1.00 per share 4% Cumulative

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Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K .

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).

Yes No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

The aggregate market value of the registrant's voting stock held by non-affiliates of the registrant on June 30, 2005, the last business day of the registrant's most recently completed second fiscal quarter was \$33,398,212 based upon the closing market price of such stock on that date. As of March 6, 2006, the number of shares outstanding of the registrant's Class A Stock, its only authorized and outstanding common stock is 20,157,772.

AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES

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**ANNUAL REPORT ON FORM 10-K
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005
OF AMPAL-AMERICAN ISRAEL CORPORATION**

PART I

ITEM 1. BUSINESS

As used in this report (the Report), the term Ampal or registrant refers to Ampal-American Israel Corporation. The term Company refers to Ampal and its consolidated subsidiaries. Ampal is a New York corporation founded in 1942.

For industry segment financial information and financial information about foreign and domestic operations, see Note 13 to the Company's consolidated financial statements included elsewhere in this Report. The companies described below under Telecommunication, High Technology and Capital Markets and Other Holdings are included in the Finance segment. The companies described under Real Estate are included in the Real Estate segment. The companies described under Leisure-Time are included in the Leisure-Time segment.

The Company primarily acquires interests in businesses located in the State of Israel or that are Israel-related. Ampal's investment focus is principally on companies or ventures where Ampal can exercise significant influence, on its own or with investment partners, and use its management experience to enhance those investments. An important objective of Ampal is to seek investments in companies that operate in Israel initially and then expand abroad. In determining whether to acquire an interest in a specific company, Ampal considers quality of management, potential return on investment, growth potential, projected cash flow, investment size and financing, and reputable investment partners.

The Company's strategy is to invest opportunistically in undervalued assets with an emphasis on the following sectors: Energy, Real Estate and Project Development and Leisure Time. We believe that past experience, current opportunities and a deep understanding of the above-referenced sectors both domestically in Israel and internationally will allow the Company to bring high returns to its shareholders. The Company emphasizes investments which have long-term growth potential over investments which yield short-term returns.

The Company provides its investee companies with ongoing support through its involvement in the investees' strategic decisions and introduction to the financial community, investment bankers and other potential investors both in and outside of Israel.

On December 1, 2005, the Company acquired a 2% interest in East Mediterranean Gas Company, an Egyptian joint stock company which has been given the right to export natural gas from Egypt to Israel and other locations in the East Mediterranean basin. On October 3, 2005, the Company sold its interest in MIRS Communications Ltd. which it held through Ampal Communications L.P., a limited partnership controlled by Ampal and in which Ampal holds a 75% equity interest.

Listed below by industry segment are all of the substantial investee companies in which the Company had ownership interests as of December 31, 2005, the principal business of each and the percentage of equity owned, directly or indirectly, by Ampal. The table below also indicates whether the investee's securities are listed on the New York Stock Exchange (NYSE), NASDAQ National Market (Nasdaq), the American Stock Exchange (AMEX) or the Tel Aviv Stock Exchange (TASE). Further information with respect to the more significant investee companies is provided after the following table. For additional information concerning the investee companies, previously provided annual reports on Forms 10-K of Ampal are incorporated by reference herein.

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Industry Segment	Principal Business	Percentage as of December 31, 2005 ⁽¹⁾
Energy		
East Mediterranean Gas Company (E.M.G)	Natural Gas Provider & Pipeline Owner	2.0
Real Estate		
Am-Hal Ltd	Chain of Senior Citizen Facilities	100.0
Ampal (Israel) Ltd	Holding Company and Real Estate	100.0
Bay Heart Limited	Shopping Mall Owner/Lessor	37.0
Ophir Holdings Ltd. ("Ophir Holdings")	Holding Company	42.5
Lysh The Coastal High-way Ltd	Commercial Real Estate	10.6 ⁽²⁾
Meimadim Investments Ltd.	Commercial Real Estate	4.2 ⁽²⁾
New Horizons (1993) Ltd	Commercial Real Estate	34.0 ⁽²⁾
Leisure-Time		
Coral World International Limited	Underwater Observatories and Marine Parks	50.0
Country Club Kfar Saba Limited	Country Club Facility	51.0
Hod Hasharon Sport Center (1992) Limited Partnership	Country Club Facility	50.0
Finance:		
Capital Markets and Other Holdings		
Ampal Development (Israel) Ltd	Holding Company	100.0
Ampal Holdings (1991) Ltd	Holding Company	100.0
Carmel Container Systems Limited	Packaging Materials and Carton Production	
	Holding Company	21.8
Fimi Opportunity Fund, L.P	Investment Fund	2.1
High Technology		
Telecommunication		
		--
		--

(1) Based upon current ownership percentage. Does not give effect to any potential dilution.

(2) As of December 31, 2005, Ophir Holdings held the following percentage interests:

Lysh The Coastal High-way Ltd.	25.0
Meimadim Investments Ltd.	10.0
New Horizons (1993) Ltd.	80.0

The Company's percentage interest in the above-referenced companies set forth in the chart reflects the Company's 42.5% ownership of Ophir Holdings.

Significant Developments Since the Fiscal Year Ended December 31, 2005

None

Energy

EAST MEDITERRANEAN GAS COMPANY (EMG)

On December 1, 2005, the Company, through Merhav Ampal Energy, Ltd., a wholly-owned subsidiary of the Company, entered into an agreement with Merhav M.N.F. Ltd. (Merhav) for the purchase from Merhav of a portion of its interest in EMG. Under the terms of the transaction, the Company acquired the beneficial ownership of 1,200 shares of EMG's capital stock, representing a 2% beneficial ownership in EMG. The purchase price for the shares was \$29,960,000. Additionally, the Company was granted the exclusive right to negotiate to acquire a substantial portion of Merhav's remaining shares of EMG. The Company also has the right for a period of time to require Merhav to repurchase the EMG interest.

EMG is an Egyptian joint stock company organized in accordance with the Egyptian Special Free Zones system which has been given the right to export natural gas from Egypt to Israel and other locations in the East Mediterranean basin and other countries. Egyptian natural gas shall reach the Israeli market via an underwater pipeline owned by EMG, which EMG expects to be completed during 2007. (See also Item 7. Related Party Transactions).

Real Estate

In Israel, most land is owned by the Israeli government. In this Report, reference to ownership of land means either direct ownership of land or a long-term lease from the Israeli Government, which in most respects is regarded in Israel as the functional equivalent of ownership. It is the Israeli government's policy to renew its long-term leases (which usually have a term of 49 years) upon their expiration.

AM-HAL LTD. (AM-HAL)

Am-Hal is a wholly-owned subsidiary of the Company, which develops and operates luxury retirement centers for senior citizens.

In March 1992, the first center was opened in Rishon LeZion, a city located approximately 10 miles south of Tel-Aviv. This center, of about 120,000 square feet, includes 149 self-contained apartments, a 74-bed nursing care ward, a 21-bed assisted-living ward, a swimming pool, a health care center and other recreational facilities. The nursing care ward is leased to a non-affiliated health care provider until 2006.

In June 2000, the second center was opened in Hod Hasharon, a city located approximately 7 miles north of Tel Aviv. This center, which is approximately 250,000 square feet, includes 235 self-contained apartments, a 33-bed nursing care ward and a 22-bed assisted-living ward.

On April 7, 2005 Am-Hal Ltd. entered into an agreement to build a new project in Tel-Aviv. Am-Hal Ltd. holds 75% of the new project through a limited partnership (Ad 120 Ramat-Hahayal), the project, which is in its early stages, is still subject to further regulatory and financing approvals.

AMPAL HOLDINGS (1991) LTD. (AMPAL HOLDINGS)

In 2004, as part of the Company's reorganization of certain of its wholly owned subsidiaries, Ampal Holdings purchased most of the high-tech investee companies from Ampal Industries (Israel) Ltd. In 2005, Ampal Holdings sold most of its investee companies.

AMPAL (ISRAEL) LTD. (AMPAL ISRAEL)

In 2004, as part of the Company's reorganization of certain of its wholly owned subsidiaries, Ampal Israel purchased various investee companies from Ampal Industries (Israel) Ltd.

OPHIR HOLDINGS LTD. (OPHIR HOLDINGS)

Ophir Holdings is a holding company that owns interests in real estate companies and is owned 42.5% by the Company. The Company and Polar Investments Ltd., which owns 57.5% of Ophir Holdings, are parties to a shareholders' agreement regarding joint voting, directorships and rights of first refusal with respect to Ophir Holdings.

Ophir Holdings owns a 25% equity interest in Lysh The Coastal High-way Ltd. (Lysh). Lysh has a 50% holding in Beit Herut-Lysh Development Company Ltd. (BHL), which is constructing a 180,000 square foot commercial project for rental near Moshav Beit Herut on land owned by the Israeli Land Authority. Ophir Holdings has also undertaken to provide guarantees in an amount equivalent to 25% of the construction costs. As of December 31, 2005, BHL had taken out bank loans of approximately \$14.3 million, by drawing on a credit line extended by a financial institution in connection with the project.

Ophir Holdings owns a 10% interest in a joint venture which had agreed to purchase 4.4 million square feet of land near Haifa for approximately \$15 million, on which the parties intend to develop a commercial real estate project for rent. Ophir Holdings has obligated itself to invest up to \$1.5 million in the first stage of this project and its share of development costs is estimated to be as much as \$17 million.

BAY HEART LIMITED (BAY HEART)

Bay Heart was established in 1987 to develop and lease a shopping mall (the Mall) in the Haifa Bay area. Haifa is the third largest city in Israel. The Mall, which opened in May 1991, is a three-story facility with approximately 280,000 square feet of rentable space. The Mall is located at the intersection of two major roads and provides a large mix of retail and entertainment facilities including seven movie theaters. The total cost of the Mall was approximately \$53 million, which was financed principally with debt instruments. A train station on the west side of the Mall was completed in September 2001. A transportation complex, in conjunction with a subsidiary of Egged Bus Corporation, was opened in January 2002. The Company owns 37% of Bay Heart. Bay Heart has refinanced the loan relating to the Mall, which loan has a fifteen years term. Bay Heart received an additional approval for NIS. 18.5 million for renovating the Mall which started in 2005. The Company has agreed to guarantee a portion of the new loan in an amount equal to NIS 6.8 million.

Leisure-Time

CORAL WORLD INTERNATIONAL LIMITED (CORAL WORLD)

Coral World, which is 50%-owned by the Company, owns and controls three marine parks in Eilat (Israel), Perth (Australia) and Maui (Hawaii).

Coral World's Eilat marine park is located next to the coral reefs and visitors to this park view marine life in its natural coral habitat through a unique underwater observatory. Coral World's marine parks in Perth and Maui allow visitors to walk through a transparent acrylic tube on the bottom of a man-made aquarium surrounded by marine life. In addition to admission charges, Coral World derives significant revenue from its food and beverage facilities and retail outlets.

Coral World's parks hosted 1,034,283 visitors during 2005. Coral World has approximately 220 full-time equivalent positions as of December 31, 2005.

Coral World has entered into a joint development project for a new marine park in Palma de Majorca which is scheduled to open at the end of 2006.

COUNTRY CLUB KFAR SABA LIMITED (KFAR SABA)

Kfar Saba operates a country club facility (the Club) in Kfar Saba, a town north of Tel Aviv. Kfar Saba holds a long-term lease to the real estate property on which the Club is situated. The Club's facilities include swimming pools, tennis courts and a clubhouse. The Club currently is seeking to obtain building permits for an additional 30,000 square feet of commercial development on the Club grounds.

The Club, which has a capacity of 2,000 member families, had approximately 1,735 member families for the 2005 season. The Company owns 51% of Kfar Saba.

HOD HASHARON SPORT CENTER (1992) LIMITED PARTNERSHIP (HOD HASHARON)

Hod Hasharon operates a country club facility (the H.H. Club) in Hod Hasharon, a town north of Tel Aviv. The H.H. Club, which opened in July 1994 and has a capacity of 1,600 member families, has operated at capacity for the past three years. In 2005, the H.H. Club repaid owner's loans of \$0.2 million to each of the partners. As of December 31, 2005, the Company holds a 50% direct interest in Hod Hasharon.

Capital Markets And Other Holdings

AMPAL DEVELOPMENT (ISRAEL) LTD. (AMPAL DEVELOPMENT)

Ampal Development, a wholly owned subsidiary of the Company, issued debentures which were publicly traded on the TASE. An aggregate of approximately \$2.0 million of these debentures were outstanding as of December 31, 2004. On March 1, 2005, Ampal Development paid off all of its outstanding and remaining debentures which were publicly traded on the TASE.

CARMEL CONTAINERS SYSTEMS LIMITED (CARMEL)

Carmel is one of the leading Israeli companies in designing, manufacturing and marketing carton boards and packaging products. Carmel and its subsidiaries manufacture a varied line of products, including corrugated shipping containers, moisture-resistant packaging, consumer packaging, triple-wall packaging and wooden pallets and boxes. The Company's equity interest in Carmel is 21.75%. As of December 31, 2005, the Company accounts for this investment pursuant to the equity method as \$2.4 million (which includes impairment in an amount of \$3.0 million).

EMPLOYEES

On March 31, 2004, the Company closed its New York office located at 555 Madison Ave, New York, New York. Other than the executive officers listed in Item 11 below, Ampal has no other employees. As of December 31, 2005, Ampal (Israel) Ltd. had 13 employees, Am-Hal Ltd. (a wholly owned subsidiary of Ampal) had 170 employees and Country Club Kfar Saba Ltd. (owned 51% by the Company) had 103 employees.

Relations between the Company and its employees are satisfactory.

CONDITIONS IN ISRAEL

Most of the companies in which Ampal directly or indirectly invests conduct their principal operations in Israel and are directly affected by the economic, political, military, social and demographic conditions there. A state of hostility, varying as to degree and intensity, exists between Israel and the Arab countries and the Palestinian Authority (the PA). Israel signed a peace agreement with Egypt in 1979 and with Jordan in 1994. Since 1993, several agreements have been signed between Israel and Palestinian representatives regarding conditions in the West Bank and Gaza. While negotiations have taken place between Israel, its Arab neighbors and the PA to end the state of hostility in the region, it is not possible to predict the outcome of these negotiations and their eventual effect on Ampal and its investee companies. Political developments in Israel, notably the ability of the Hamas movement to win a majority of seats in the Palestinian parliament has increased the economic, political and military uncertainty in Israel and the Middle East. See Item 1A Risk Factors below for further discussion of the possible impact of this situation on the Company.

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All male adult citizens and permanent residents of Israel under the age of 48 are obligated, unless exempt, to perform military reserve duty annually. Additionally, all these individuals are subject to being called to active duty at any time under emergency circumstances. Some of the officers and employees of Ampal's investee companies are currently obligated to perform annual reserve duty. While these companies have operated effectively under these requirements since they began operations, Ampal cannot assess the full impact of these requirements on their workforce or business if conditions should change. In addition, Ampal cannot predict the effect on its business in a state of emergency in which large numbers of individuals are called up for active duty.

Economic and Financial Developments

In 2005, unemployment in Israel averaged 9.0%. The rate of unemployment in 2004 averaged 10.4% as compared to 10.7% in 2003. Management believes that the decrease resulted mainly from the improvement in the industrial and high tech sectors and the Israeli government's employment initiatives.

2005 was characterized by rapid growth in all components of Israeli GDP. The GDP grew by 5.2% and the business-sector product grew by 6.7%. In 2004 and 2003, GDP growth was 4.4% and 1.7%, respectively.

The change in consumer price index in 2005 was 2.4% compared to 1.2% in 2004.

CERTAIN UNITED STATES AND ISRAELI REGULATORY MATTERS

SEC Exemptive Order

In 1947, the SEC granted Ampal an exemption from the Investment Company Act of 1940, as amended (the 1940 Act), pursuant to an Exemptive Order. The Exemptive Order was granted based upon the nature of Ampal's operations, the purposes for which it was organized, which have not changed, and the interest of purchasers of Ampal's securities in the economic development of Israel. There can be no assurance that the SEC will not reexamine the Exemptive Order and revoke, suspend or modify it. A revocation, suspension or material modification of the Exemptive Order could materially and adversely affect the Company unless Ampal were able to obtain other appropriate exemptive relief. In the event that Ampal becomes subject to the provisions of the 1940 Act, it could be required, among other matters, to make changes, which might be material, to its management, capital structure and methods of operation, including its dealings with principal shareholders and their related companies.

TAX INFORMATION

Ampal (to the extent that it has income derived in Israel) and Ampal's Israeli subsidiaries are subject to taxes imposed under the Israeli Income Tax Ordinance. Through December 31, 2003, the corporate tax rate was 36%. In July 2004, Amendment No. 140 to the Income Tax Ordinance was enacted. One of the provisions of this amendment is that the corporate tax rate is to be gradually reduced from 36% to 30%. In August 2005, a further amendment (No. 147) was published, which makes a further revision to the corporate tax rates prescribed by Amendment No. 140. As a result of the aforementioned amendments, the corporate tax rates for 2004 and thereafter are as follows: 2004 35%, 2005 34%, 2006 31%, 2007 29%, 2008 27%, 2009 26% and for 2010 and thereafter 25%.

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A tax treaty between Israel and the United States became effective on January 1, 1995 (the Treaty). The Treaty has not substantially affected the tax position of the Company in either the United States or in Israel.

Ampal generated income from interest and dividends resulting from its investments in Israel. Under Israeli law, Ampal has been required to file tax returns, with the Israeli tax authorities with respect to such income. Under Israeli domestic law Ampal, as a non-resident, is generally subject to withholding tax at a rate of 25% on dividends it receives from Israeli companies (20% as of January 1, 2006). This rate may be reduced to either 15% or 12.5%, (under Israeli law and/or the provisions of the Treaty), depending on the ownership percentage in the investee company, and on the type of income generated by such investee company, from which the dividend is distributed (by contrast, dividends received by one Israeli company from another Israeli company are generally exempt from Israeli corporate tax, unless (i) they arise from income generated from sources outside of Israel, in which case they are subject to tax at a rate of 25%; or (ii) they are paid out of the profits of an approved enterprise to either residents or non-residents, in which case tax is withheld at a rate of 15%).

Pursuant to an arrangement with the Israeli tax authorities, Ampal's income from Israeli sources has been taxed based on principles generally applied in Israel to income of non-residents. Ampal has filed tax returns with the Israeli tax authorities through the tax year 2004. Based on the tax returns filed by Ampal through 2004, it has not been required to make any additional tax payments in excess of the tax withheld on dividends it has received. In addition, pursuant to Ampal's arrangement with the Israeli tax authorities, the aggregate taxes paid by Ampal in Israel and in the United States on interest, rent and dividend income derived from Israeli sources has not exceeded the tax which would have been payable by Ampal in the United States had such interest, rent and dividend income been derived by Ampal from United States sources. There can be no assurance that this arrangement will continue to be effective in the future. This arrangement does not apply to taxation of Ampal's Israeli subsidiaries.

Generally, under the provisions of the Israeli Income Tax Ordinance, taxable income from Israeli sources paid to non-residents of Israel by residents of Israel is subject to withholding tax at the rate of 25%. However, such rate of withholding tax may be reduced under the Treaty, with respect to certain payments made by Israeli tax residents to US tax residents that qualify for benefits of the Treaty. For example, under the Treaty, the rate of withholding tax applicable to interest is generally reduced to 17.5%. The continued tax treatment of Ampal by the Israeli tax authorities in the manner described above is based, among other things, on Ampal continuing to be treated, for tax purposes, as a non-resident of Israel that is not doing business in Israel. As of January 1, 2006, a different withholding rate may apply.

Under Israeli law, Israeli tax residents are taxed on capital gains generated from sources in Israel or outside of Israel, whereas non residents are taxable only with respect to gains generated from sources in Israel. Gains are generally regarded as being from Israeli sources if arising from the sale of assets either located in Israel or which represent a right to assets located in Israel (including gains arising from the sale of shares of stock in companies resident in Israel, and of rights in non-resident entities that mainly represent ownership and rights to assets located in Israel, with regard to such assets). Under the Treaty, US tax residents are subject to Israeli capital gains tax on the sale of shares in Israeli companies, if they have held 10% or more of the voting rights in such company at any time during the 12 months immediately preceding the sale.

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Since January 1, 1994, the portion of the gain attributable to inflationary differences prior to that date is taxable at a rate of 10%, while the portion of the gain attributable to inflationary differences between such date and the date of disposition of the asset is exempt from tax. Non-residents of Israel are exempt from the 10% tax on the inflationary gain derived from the sale of shares in companies that are considered Israeli tax residents if they elect to compute the inflationary portion of the gain based on the change in the rate of exchange between Israeli currency and the foreign currency in which the shares were purchased, rather than the change in the Israeli consumer price index⁽¹⁾. The remainder of the gain (Real Capital Gain), if any, is taxable to corporations at the rate of 25%. However, Real Capital Gains arising from the sale of capital assets that had been acquired prior to January 1, 2003 shall be apportioned on a linear basis to the periods before and after the same date, namely the portion of the gain attributed to the period before January 1, 2003 shall be subject to tax at a rate equal to the corporate tax rate in effect at the time of the sale (in 2005 34%), whereas the portion of the gain attributed to the period after January 1, 2003 shall be taxed at the preferential rate of 25%. This 25% preferential tax rate may also apply to a certain portion of the profit upon the sale of Israeli shares.

Foreign corporations are generally exempt from tax on gains from the sale of shares in publicly traded companies. Amendment No. 147 introduces a broader exemption under domestic law for non-residents regardless of their percentage holding in an Israeli company (not holding real estate rights) to include capital gains from the sale of securities (even where not traded in Israel), which were purchased between July 1, 2005 through December 31, 2006, provided certain conditions are met.

The Income Tax Law (Adjustment for Inflation), 1985, which applies to companies which have business income in Israel or which claim a deduction in Israel for financing costs, has been in force since the 1985 tax year. The law provides for the preservation of equity, whereby certain corporate assets are classified broadly into Fixed (inflation resistant) and Non-Fixed (non-inflation resistant) Assets. Where shareholders equity, as defined therein, exceeds the depreciated cost of Fixed Assets, a tax deduction which takes into account the effect of the annual inflationary change on such excess is allowed, subject to certain limitations. Conversely, if the depreciated cost of Fixed Assets exceeds shareholders equity, then such excess, multiplied by the annual inflation change, is added to taxable income.

Individuals and companies in Israel pay VAT at a rate of 16.5% (17% until August 2005) of the price of assets sold and services rendered. However, according to a Temporary Order issued by the state of Israel the VAT rate was increased from 17% to 18% for the period commencing on June 15, 2002 and ending on December 31, 2003. This period was extended by an additional two months and was terminated on February 29, 2004, when the VAT rate was reduced back to 17%. In computing its VAT liability, Ampal's Israeli subsidiaries are entitled to claim as a deduction input VAT it has incurred with respect to goods and services acquired for the purpose of the business.

United States Federal Taxation of Ampal

Ampal and its United States subsidiaries (in the following discussion, generally referred to collectively as Ampal U.S.) are subject to United States taxation on their taxable income, as computed on a consolidated basis, from domestic as well as foreign sources. The gross income of Ampal U.S. for United States tax purposes includes or may include (i) income earned directly by Ampal U.S., (ii) Ampal U.S.'s pro rata share of certain types of income, primarily subpart F income earned by certain Controlled Foreign Corporations in which Ampal U.S. owns or is considered as owning 10 percent or more of the voting power; and (iii) Ampal U.S.'s pro rata share of ordinary income and capital gains earned by certain Passive Foreign Investment Companies in which Ampal U.S. owns stock, and with respect to which Ampal has elected that such company be treated as a Qualified Electing Fund. Subpart F income includes, among other things, dividends, interest and certain rents and capital gains. Since 1993, the maximum rate applicable to domestic corporations is 35%.

⁽¹⁾ Beginning January 1, 2006, the section of the Israeli Tax Ordinance under which the regulations providing such tax exemption to non-Israeli residents were promulgated, was rescinded. It is therefore unclear whether this exemption shall continue to be applicable

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Certain of Ampal's non-U.S. subsidiaries have elected to be treated as partnerships for U.S. tax purposes. As a result, Ampal is generally subject to US tax on its distributive share of income earned by such subsidiaries (generally computed with reference to Ampal's proportionate interest in such entity), as it is earned, i.e. without regard to whether or not such income is distributed by the subsidiary. Certain of Ampal's wholly-owned non-U.S. subsidiaries have elected to be treated as disregarded entities for U.S. federal tax consequences. As a result, Ampal is subject to US tax on all income earned by such subsidiaries, as it is earned.

Ampal U.S. is generally entitled to claim as a credit against its United States income tax liability all or a portion of income taxes, or of taxes imposed in lieu of income taxes, paid to foreign countries. If Ampal U.S. receives dividends from a non-US corporation in which it owns 10% or more of the voting stock, Ampal U.S. is treated (in determining the amount of foreign income taxes paid by Ampal U.S. for purposes of the foreign tax credit) as having paid the same proportion of the foreign corporation's post-1986 foreign income taxes as the amount of such dividends bears to the foreign corporation's post-1986 undistributed earnings.

In general, the total foreign tax credit that Ampal U.S. may claim is limited to the same proportion of Ampal U.S.'s United States income taxes that its foreign source taxable income bears to its taxable income from all sources, US and non-US. This limitation is applied separately with respect to various items of income (baskets), which may further limit Ampal's ability to claim foreign taxes as a credit against its U.S. tax liability. The use of foreign taxes as an offset against United States tax liability is further limited by certain rules pertaining to the sourcing of income and the allocation of deductions. As a result of the combined operation of these rules, it is possible that Ampal U.S. would exercise its right to elect to deduct the foreign taxes, in lieu of claiming such taxes as a foreign tax credit.

Ampal U.S. may also be subject to the alternative minimum tax (AMT) on corporations. Generally, the tax base for the AMT on corporations is the taxpayer's taxable income increased or decreased by certain adjustments and tax preferences for the year. The resulting amount, called alternative minimum taxable income, is then reduced by an exemption amount and subject to tax at a 20% rate. As with the regular tax computation, AMT can be offset by foreign tax credits as well as net operating losses (NOLs) both of which are separately calculated under AMT rules and both of which are generally limited to 90% of AMT liability as specially computed for this purpose. The 90% limitation of the foreign tax credit allowed against AMT was repealed in the Jobs Creation Act of 2004, effective for tax years beginning after December 31, 2004.

FORWARD-LOOKING STATEMENTS

This Report (including but not limited to factors discussed in the Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as those discussed elsewhere in this Report on Form 10-K) includes forward-looking statements (as such term is defined in the Private Securities Litigation Reform Act of 1995) and information relating to the Company that are based on the beliefs of management of the Company as well as assumptions made by and information currently available to the management of the Company. When used in this Report, the words anticipate, believe, estimate, expect, intend, plan, and similar expressions, as they relate to the Company or the management of the Company, identify forward-looking statements. Such statements reflect the current views of the Company with respect to future events or future financial performance of the Company, the outcome of which is subject to certain risks and other factors which could cause actual results to differ materially from those anticipated by the forward-looking statements, including among others, the economic and political conditions in Israel, the Middle East, including the situation in Iraq, and in the global business and economic conditions in the different sectors and markets where the Company's portfolio companies operate. These risks and uncertainties include, but are not limited to, those described in Part I, Item 1A. Risk Factors and elsewhere in this report and those described from time to time in our future reports filed with the Securities and Exchange Commission.

Should any of those risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results or outcome may vary from those described therein as anticipated, believed, estimated, expected, intended or planned. Subsequent written and oral forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by the cautionary statements in this paragraph and elsewhere described in this Report and other Reports filed with the Securities and Exchange Commission.

ITEM 1A. RISK FACTORS

An investment in our securities involves risks and uncertainties. These risks and uncertainties could cause our actual results to differ materially from our historical results or the results contemplated by any forward-looking statements contained in this report on Form 10-K or that we make in other filings with the SEC under the Securities and Exchange Act of 1934 or in other public statements. The risks described below are not the only risks facing the Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results. You should consider the following factors carefully, in addition to the other information contained in this Form 10-K, before deciding to purchase, sell or hold our securities:

Because most of the companies in which we invest conduct their principal operations in Israel, we may be adversely affected by the economic, political, social and military conditions in the Middle East.

Most of the companies in which we directly or indirectly invest conduct their principal operations in Israel. We may, therefore, be directly affected by economic, political, social and military conditions in the Middle East, including Israel's relationship with the Palestinian Authority and Arab countries. In addition, many of the companies in which we invest are dependent upon materials imported from outside of Israel, including East Mediterranean Gas Company, an Egyptian joint stock company in which we own a 2% stake. We also have interests in companies that export significant amounts of products from Israel. Accordingly, our operations could be materially and adversely affected by acts of terrorism or if major hostilities should occur in the Middle East or trade between Israel and its present trading partners should be curtailed, including as a result of acts of terrorism in the United States. Any such effects may impact our value and the value of our investee companies.

The SEC may re-examine, suspend or modify our exemption from the Investment Company Act of 1940, as amended.

In 1947, the SEC granted us an exemption from the Investment Company Act of 1940, as amended (the "1940 Act"), pursuant to an exemptive order. The exemptive order was granted based upon the nature of our operations, the purposes for which we were organized, which have not changed, and the interest of purchasers of our securities in the economic development of Israel. There can be no assurance that the SEC will not re-examine the exemptive order and revoke, suspend or modify it. A revocation, suspension or material modification of the exemptive order could materially and adversely affect us unless we were able to obtain other appropriate exemptive relief. In the event that we become subject to the provisions of the 1940 Act, we could be required, among other matters, to make changes, which might be material, to our management, capital structure and methods of operation, including our dealings with principal shareholders and their related companies.

As most of our investee companies conduct business outside of the United States, we are exposed to foreign currency and other risks.

We are subject to the risks of doing business abroad, including, among other risks, foreign currency exchange rate risks, changes in interest rates, equity price changes of our investee companies, import restrictions, anti-dumping investigations, political or labor disturbances, expropriation and acts of war. No assurances can be given that we will be protected from future changes in foreign currency exchange rates that may impact our financial condition or performance.

Foreign securities or illiquid securities in our portfolio involve higher risk and may subject us to higher price volatility. Investing in securities of foreign issuers involves risks not associated with U.S. investments, including settlement risks, currency fluctuations, local withholding and other taxes, different financial reporting practices and regulatory standards, high costs of trading, changes in political conditions, expropriation, investment and repatriation restrictions, and settlement and custody risks.

Changes in accounting standards and taxation requirements could affect our financial results.

New accounting standards or pronouncements that may become applicable to the Company from time to time, or changes in the interpretation of existing standards and pronouncements, could have a significant effect on our reported results for the affected periods. We are also subject to income tax in the numerous jurisdictions in which we generate revenues. Increases in income tax rates could reduce our after-tax income from affected jurisdictions.

The loss of key executives could cause our business to suffer.

Yosef A. Maiman, our Chairman, and other key executives have been key to the success of our business to date. The loss or retirement of such key executives services could adversely affect us.

Y.M. Noy Investments Ltd. s control of us could discourage attempts to acquire us.

Y.M. Noy Investments Ltd., an Israeli company held approximately 58.29% of the voting power of our Class A Stock as of March 6, 2006. Yosef A. Maiman, the Chairman of our board of directors, owns 100% of the economic shares and one-third of the voting shares of Y.M. Noy Investments Ltd. In addition, Mr. Maiman holds an option to acquire the remaining two-thirds of the voting shares of Y.M. Noy Investments Ltd. (which are currently owned by Ohad Maiman and Noa Maiman, the son and daughter, respectively, of Mr. Maiman). By virtue of its ownership of Ampal, Y.M. Noy Investments Ltd. is able to control our affairs and to influence the election of the members of our board of directors. Y.M. Noy Investments Ltd. also has the ability to prevent or cause a change in control of Ampal.

Because we are a controlled company, we are exempt from complying with certain Nasdaq listing standards.

Because Y.M. Noy Investments Ltd. own more than 50% of our voting power, we are deemed to be a controlled company under the rules of the Nasdaq National Market. As a result, we are exempt from the Nasdaq rules that require listed companies to have (i) a majority of independent directors on the board of directors, (ii) a compensation committee and nominating committee composed solely of independent directors, (iii) the compensation of executive officers determined by a majority of the independent directors or a compensation committee composed solely of independent directors and (iv) a majority of the independent directors or a nominating committee composed solely of independent directors elect or recommend director nominees for selection by the board of directors. Accordingly, our directors who hold management positions or who are otherwise not independent have greater influence over our business and affairs.

Our activities could be restricted as a result of agreements between our controlling shareholder and its lender.

Based upon statements of beneficial ownership filed with the SEC by Y.M. Noy Investments Ltd., Yosef A. Maiman, Ohad Maiman and Noa Maiman, the repayment of the borrowed funds used to finance Y.M. Noy Investment's Ltd.'s acquisition of a controlling interest in us, consisting of 11,444,112 shares of our Class A Stock, was principally financed by Bank Leumi Le-Israel B.M. According to the statements of beneficial ownership, the repayment of the borrowings are guaranteed by a personal guarantee by Mr. Maiman and secured by Y.M. Noy Investment Ltd.'s pledge of such shares of our Class A Stock to the bank.

The statements of beneficial ownership report that the pledge agreement with the bank includes restrictions on Y.M. Noy Investments Ltd.'s voting rights and grants the bank certain voting rights with respect to the pledged shares, and that its credit agreement with the bank requires Y.M. Noy Investments Ltd. to maintain a controlling interest in us for so long as any amounts remain outstanding pursuant to the credit facilities. The statements of beneficial ownership also report that Y.M. Noy Investments Ltd. agreed that it will cause us to not issue any shares of our Class A Stock or options to acquire shares of our Class A Stock, except for employee stock options to our employees, consultants and directors and provided that Y.M. Noy Investments Ltd. owns at least 50.1% of Ampal. In addition, the statements of beneficial ownership reported that Y.M. Noy Investments Ltd. has agreed, unless it has received the prior consent of the bank and until the borrowings have been repaid in full, to cause us to refrain from making any decisions with regard to our winding-up, change in corporate structure, reorganization or merger. The statements of beneficial ownership also reported that Y.M. Noy Investments Ltd. has agreed, unless it has received the prior consent of the bank, not to sign any voting or other agreement regarding the shares and to oppose any change in our certificate of incorporation and by-laws and any resolution or other act which will or might result in the dilution of Y.M. Noy Investments Ltd.'s interest in Ampal.

We do not typically pay cash dividends on our Class A Stock.

We have not paid a dividend on our Class A Stock other than in 1995. Past decisions not to pay cash dividends on Class A Stock reflected our policy to apply retained earnings, including funds realized from the disposition of holdings, to finance our business activities and to redeem debentures. The payment of cash dividends in the future will depend upon our operating results, cash flow, working capital requirements and other factors we deem pertinent.

The market price per share of our Class A Stock on Nasdaq fluctuates and has traded in the past at less than our book value per share.

Stock prices of companies, both domestically and abroad, are subject to fluctuations in trading price. Therefore, as with company like ours that invests in stocks of other companies, our book value and market price will fluctuate, especially in the short term. As of December 31, 2005, the market price on Nasdaq of \$3.95 per share of our Class A Stock is less than our book value of \$4.43 per share calculated in accordance with our consolidated financial statements. You may experience a decline in the value of your investment and you could lose money if you sell your shares at a price lower than you paid for them.

We do not publish the value of our assets.

It is our policy not to publish the value of our assets or our views on the conditions of or prospects for our investee companies. To the extent the value of our ownership interests in our investee companies were to experience declines in the future, our performance would be adversely impacted.

Our Class A Stock may not be liquid.

Our Class A Stock is currently traded on Nasdaq. The trading volume of our Class A Stock may be adversely affected due to the limited marketability of our Class A Stock as compared to other companies listed on Nasdaq. Accordingly, any substantial sales of our Class A Stock may result in a material reduction in price of our Class A Stock because relatively few buyers may be available to purchase our Class A Stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTY

Ampal's corporate headquarters in Israel, which is owned by the Company, is located at 111 Arlozorov Street in Tel Aviv.

Ampal currently leases an office at 555 Madison Avenue in New York City from Rodney Company N.V., Inc. The lease period is seven years commencing on October 15, 2002. The annual rent for this lease is \$119,794. On March 31, 2004, the Company closed this office. The office space has been subleased.

Country Club Kfar Saba Ltd. occupies a 7-1/4 acre lot in the town of Kfar Saba which will be leased for five consecutive ten-year periods, at the end of which the land returns to the lessor. The lease expires on July 14, 2038, and lease payments in 2005 totaled \$179,619.

Other properties of the Company are discussed elsewhere in this Report. See Item 1. Business.

ITEM 3. LEGAL PROCEEDINGS

Ampal Communications L.P.

1. On May 10, 2004, Ampal Communications L.P., a limited partnership controlled by Ampal and in which Ampal holds a 75% equity interest, filed a claim in the Tel-Aviv District Court against Motorola Communications Israel Ltd., MIRS Communications Ltd. (MIRS), Motorola Israel Ltd., Elisha Yanai, Peter Brum, Rami Guzman, Nathan Gidron, and Shimon Tal (collectively, the Defendants), for injunctive and declaratory relief as described below. The claim is in connection with the exploitation by the defendants of Ampal Communications minority rights by virtue of its 33% holding in MIRS.

Ampal Communications L.P. requested the Court to issue relief as follows:

A. Declaring that the business of MIRS is conducted in such a way as to be prejudicial to the rights of Ampal Communications L.P. as a minority shareholder;

B. Appointing an appraiser to conduct a valuation of MIRS and Ampal Communications L.P.'s holdings therein, which will encompass a review of the way MIRS conducts its business, including a review of the related party transactions between MIRS and Motorola Israel Ltd. and/or any other of the Defendants;

C. Instructing each of the Defendants to acquire and purchase from Ampal Communications L.P. the shares it holds in MIRS at the highest of the following prices:

(1) based on a company valuation of MIRS as presented to Ampal Communications L.P. by Motorola prior to the signing of the Share Purchase Agreement for MIRS; or

(2) based on the amount paid by Ampal Communications L.P. for its share holding in MIRS plus linkage to the Israeli consumer index and interest; or

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(3) based on the company valuation that will be determined by the valuation specified in Section B above, excluding any material negative effect brought about by the Defendants' omissions and/or negligence in their management of MIRS, all as may be assessed and computed by the appraiser specified in Section B above;

D. Determining that each of the individual Defendants, as officers in MIRS, has violated his respective fiduciary obligations towards Ampal Communications L.P. as a minority shareholder in MIRS; and

E. Declaring that the Share Purchase Agreement pursuant to which Ampal Communications L.P. acquired its shareholding in MIRS and the Shareholders Agreement in respect thereof, are void.

2. On May 24, 2004 and on May 31, 2004 the Defendants requested the district court to strike out the claim in limine, on the grounds that Ampal had allegedly not paid sufficient fees when filing the claim, and further requested an extension of the time for filing statements of defense until after the district court had reached a decision regarding the request to strike out the claim. Ampal and the Defendants filed various responses and on June 30, 2004, the district court requested the Attorney General to furnish an opinion regarding the Defendants' request before issuing its own decision. On October 11, 2004 the Attorney General furnished its opinion that supported the Defendants' request that Ampal should pay the fees calculated on the basis of the value of the requested remedies in the claim.

On November 10, 2004 Ampal filed its response. The Court also decided that the statements of defense should be filed 10 days after it issues its decision regarding the striking out of the claim.

3. On March 1, 2005, Ampal requested the district court to enter judgment against Peter Brum on the grounds that he failed to file a defense to the Company's claim. On March 15, 2005, the district court granted Ampal's request and entered judgment against Peter Brum. On March 17, 2005, the district court ordered Mr. Brum to acquire and purchase from Ampal the shares it holds in MIRS for a total company valuation of \$ 765,998,000, which is the highest of the prices set forth in the complaint. The litigation with regard to the other defendants is ongoing. Peter Brum, Motorola and MIRS have appealed the district court's judgment on numerous grounds. Ampal has filed responses to the appeal.

4. On August 30, 2005, the Company, through Ampal Communications L.P. entered into a Stock Purchase and Indemnification Agreement, dated as of August 30, 2005, by and among Motorola Israel Ltd., Ampal Communications L.P. and MIRS (the Agreement) to sell Motorola Israel Ltd. all of its holdings of MIRS. In connection with the closing of the transactions contemplated by this Agreement the existing lawsuit among the parties and other relating to MIRS was dismissed.

5. On October 3, 2005 the Company, through Ampal Communications L.P., completed the sale to Motorola Israel Ltd. of all of its holdings of MIRS pursuant to the Agreement. In connection with the sale of its holdings of MIRS, Ampal Communications L.P. received approximately US \$89 million of total proceeds, composed of \$67.7 million for the purchase price and an additional \$ 21.3 million related to guaranteed dividend payments. Approximately \$ 74.0 million of the proceeds was used to repay all outstanding debt to banks incurred in connection with making the MIRS investment, and the Company received US\$ 15.0 million (\$11.0 million after the deduction of minority interest) of net proceeds from the sale.

Galha

On January 1, 2002, Galha (1960) Ltd. (Galha) filed a suit against the Company and other parties, including directors of Paradise Industries Ltd. (Paradise) appointed by the Company, in the Tel Aviv District Court, in the amount of NIS 10,249,609 (\$2.2 million). Galha claimed that the Company, which was a shareholder of Paradise, and another shareholder of Paradise, misused funds that were received by Paradise from an insurance company for the purpose of reconstructing an industrial building owned by Galha and used by Paradise which burnt down. Paradise is currently involved in liquidation proceedings. Ampal issued a guarantee in favor of Galha for the payment of an amount of up to NIS 4,022,085 (\$873,800) if a final judgment against the Company will be given.

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On May 26, 2003 the Company and the directors of Paradise appointed by the Company filed a third party claim against Arieh Israeli Insurance Company Ltd. in the Tel Aviv District Court claiming that, to the extent the court decides that the directors of Paradise appointed by the Company will have to pay any amounts to Galha, Arieh will pay such amounts on behalf of the directors in accordance with the Directors and Officers insurance policy that the Company had at that time with Arieh. Arieh filed a statement of defense and stated that the policy does not cover the claim. At this stage, the Company cannot estimate the impact this claim will have on it.

Claims Against Subsidiaries and Affiliates:

Legal claims arising in the normal course of business have been filed against subsidiaries and affiliates of the company. Based upon the opinions of legal counsel, the Company's management believes that all provisions made are sufficient.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**PRICE RANGE OF CLASS A STOCK**

Ampal's Class A Stock is listed on Nasdaq under the symbol AMPL. The following table sets forth the high and low bid prices for the Class A Stock, by quarterly period for the fiscal years 2005 and 2004, as reported by Nasdaq and representing inter-dealer quotations which do not include retail markups, markdowns or commissions for each period, and each calendar quarter during the periods indicated. Such prices do not necessarily represent actual transactions.

	<u>High</u>	<u>Low</u>
2005:		
Fourth Quarter	4.05	2.80
Third Quarter	4.09	3.21
Second Quarter	4.29	3.52
First Quarter	4.38	3.61
2004:		
Fourth Quarter	4.20	3.27
Third Quarter	3.70	2.65
Second Quarter	3.87	2.81
First Quarter	4.20	2.88

As of March 6, 2006, there were approximately 731 record holders of Class A Stock.

VOTING RIGHTS

Unless dividends on any outstanding preferred stock are in arrears for three successive years, as discussed below, the holders of Class A Stock are entitled to one vote per share on all matters voted upon. Notwithstanding the above, if dividends on any outstanding series of preferred stock are in arrears for three successive years, the holders of all outstanding series of preferred stock as to which dividends are in arrears shall have the exclusive right to vote for the election of directors until all cumulative dividend arrearages are paid. The shares of Class A Stock do not have cumulative voting rights in relation to the election of the Company's directors, which means that any holder of at least 50% of the Class A Stock can elect all of the members of Board of Directors of Ampal (the Board).

DIVIDEND POLICY

Ampal has not paid a dividend on its Class A Stock other than in 1995. Past decisions not to pay cash dividends on Class A Stock reflected the policy of Ampal to apply retained earnings, including funds realized from the disposition of holdings, to finance its business activities and to redeem debentures. The payment of cash dividends in the future will depend upon the Company's operating results, cash flow, working capital requirements and other factors deemed pertinent by the Board.

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Dividends on all classes of Ampal's shares of preferred stock are payable as a percentage of par value. The holders of Ampal's presently authorized and issued 4% Preferred Stock and 6 1/2% Preferred Stock (each having a \$5.00 par value) are entitled to receive cumulative dividends at the rates of 4% and 6 1/2% per annum, respectively, payable out of surplus or net earnings of Ampal before any dividends are paid on the Class A Stock. If Ampal fails to pay such dividend to the preferred stockholders in any calendar year, such deficiency must be paid in full, without interest, before any dividends may be paid on the Class A Stock. If, after the payment of all cumulative dividends on the preferred stock and a non-cumulative 4% dividend on the Class A Stock, there remains any surplus, any dividends declared are to be participated in by the holders of 4% Preferred Stock and Class A Stock, pro rata. On December 18, 2005, Ampal announced that its Board had declared cash dividends on its classes of preferred stock (\$0.325 per share on its 6 1/2% classes of preferred stock and \$0.20 per share on its 4% Preferred Stock). The dividends were paid on December 30, 2005.

For equity compensation plan information required Item 2.01(d) of Regulation S-K, please see Item 12 below.

ITEM 6. SELECTED FINANCIAL DATA

FISCAL YEAR ENDED DECEMBER 31,	Fiscal year ended December 31,				
	2005	2004	2003	2002	2001
(U.S. Dollars in thousands, except per share data)					
Revenues	\$ 30,530	\$ 31,464	\$ 51,814	\$ 16,732	\$ 29,062
Net income (loss)	\$ (5,958)	\$ (18,385)	\$ 8,847	\$ (44,047)	\$ (6,974)
Earnings (loss) per Class A Share ⁽¹⁾ :					
Basic EPS	\$ (0.31)	\$ (0.94)	\$ 0.42	\$ (2.27)	\$ (0.38)
Diluted EPS	\$ (0.31)	\$ (0.94)	\$ 0.40	\$ (2.27)	\$ (0.38)
Total assets	\$ 210,904	\$ 304,947	\$ 354,367	\$ 323,699	\$ 383,833
Notes and loans and debentures Payable	50,366	120,796	138,334	136,803	145,901

⁽¹⁾ Computation is based on net income (loss) after deduction of preferred stock dividends (in thousands) of \$191, \$200, \$213, \$218 and \$227 for the years ended 2005, 2004, 2003, 2002 and 2001, respectively.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

We seek to maximize shareholder value through acquiring and investing in companies that we consider have the potential for growth. In utilizing our core competencies and financial resources, our investment portfolio primarily focuses on a broad cross-section of Israeli companies engaged in various market segments including Energy, Real Estate, Project Development and Leisure Time.

Our investment focus is primarily on companies or ventures where we can exercise significant influence, on our own or with investment partners, and use our management experience to enhance those investments. We are also monitoring investment opportunities, both in Israel and abroad, that we believe will strengthen and diversify our portfolio and maximize the value of our capital stock. In determining whether to acquire an interest in a specific company, we consider the quality of management, return on investment, growth potential, projected cash flow, investment size and financing, and reputable investment partners. We also provide our investee companies with ongoing support through our involvement in the investee companies' strategic decisions and introductions to the financial community, investment bankers and other potential investors both in and outside of Israel.

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Our results of operations are directly affected by the results of operations of our investee companies. A comparison of the financial statements from year to year must be considered in light of our acquisitions and dispositions during each period.

The results of investee companies which are greater than 50% owned by us are included in the consolidated financial statements. We account for our holdings in investee companies over which we exercise significant influence, generally 20% to 50% owned companies (affiliates), under the equity method. Under the equity method, we recognize our proportionate share of such companies' income or loss based on its percentage of direct and indirect equity interests in earnings or losses of those companies. The results of operations are affected by capital transactions of the affiliates. Thus, the issuance of shares by an affiliate at a price per share above our carrying value per share for such affiliate results in our recognizing income for the period in which such issuance is made, while the issuance of shares by such affiliate at a price per share that is below our carrying value per share for such affiliate results in our recognizing a loss for the period in which such issuance is made. We account for our holdings in investee companies, other than those described above, on the cost method or in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities . In addition, we review investments accounted for under the cost method and those accounted for under the equity method periodically in order to determine whether to maintain the current carrying value or to write off some or all of the investment. For more information as to how we make these determinations, see Critical Accounting Policies.

For those subsidiaries and affiliates whose functional currency is considered to be the New Israeli Shekel (NIS), assets and liabilities are translated at the rate of exchange at the end of the reporting period and revenues and expenses are translated at the average rates of exchange during the reporting period. Translation differences of those foreign companies' financial statements are included in the cumulative translation adjustment account (reflected in accumulated other comprehensive loss) of shareholders' equity. Should the NIS be devalued against the U.S. dollar, cumulative translation adjustments are likely to result in a reduction in shareholders' equity. As of December 31, 2005, the accumulated effect on shareholders' equity was a decrease of approximately \$19.7 million. Upon disposition of an investment, the related cumulative translation adjustment balance will be recognized in determining gains or losses.

CRITICAL ACCOUNTING POLICIES

The preparation of Ampal's consolidated financial statements is in conformity with accounting principles generally accepted in the United States which requires management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying consolidated financial statements and related footnotes. Actual results may differ from these estimates. To facilitate the understanding of Ampal's business activities, described below are certain Ampal accounting policies that are relatively more important to the portrayal of its financial condition and results of operations and that require management's subjective judgments. Ampal bases its judgments on its experience and various other assumptions that it believes to be reasonable under the circumstances. Please refer to Note 1 to Ampal's consolidated financial statements included in this Annual Report for the fiscal year ended December 31, 2005 for a summary of all of Ampal's significant accounting policies.

Portfolio Investments

The Company accounts for a number of its investments, including many of its investments in the high-technology and communications industries, on the basis of the cost method. Application of this method requires the Company to periodically review these investments in order to determine whether to maintain the current carrying value or to write off some or all of the investment. While the Company uses some objective measurements in its review, such as the portfolio company's liquidity, burn rate, termination of a substantial number of employees, achievement of milestones set forth in its business plan or projections and seeks to obtain relevant information from the company under review, the review process involves a number of judgments on the part of the Company's management. These judgments include assessments of the likelihood of the company under review to obtain additional financing, to achieve future milestones, make sales and to compete effectively in its markets. In making these judgments the Company must also attempt to anticipate trends in the particular company's industry as well as in the general economy. There can be no guarantee that the Company will be accurate in its assessments and judgments. To the extent that the Company is not correct in its conclusion it may decide to write down all or part of the particular investment.

Investment in MIRS

Our investment in MIRS, which we sold on October 3, 2005, was accounted for at cost (our equity interest was 25%). The cost method was applied due to preference features we were granted in our investment in preferred shares in MIRS. Revenues from guaranteed dividend payments from Motorola were recognized as income. We performed annual tests for impairment regarding our investment in MIRS. Our assessment of our investment in MIRS as of December 31, 2005, resulted in an impairment charge of \$13.3 million (see also, Item 1 Business, Results of Operations and Debt below and Note 2 to the Consolidated Financial Statements).

Marketable Securities

We determine the appropriate classification of marketable securities at the time of purchase. We hold marketable securities classified as trading securities that are carried at fair value, and marketable securities classified as available-for-sale that are carried at fair value with unrealized gains and losses included in the component of accumulated other comprehensive loss in stockholders' equity. We classify investment in marketable securities as investment in trading securities, if those securities are bought and held principally for the purpose of selling them in the near term (held for only a short period of time). All the other securities are classified as available for sale securities.

Statement of Financial Accounting Standards (SFAS) 115, Accounting for Certain Investments in Debt and Equity Securities, and Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) 59, Accounting for Noncurrent Marketable Equity Securities, provides guidance on determining when an investment is other-than-temporarily impaired. Investments are reviewed quarterly for indicators of other-than-temporary impairment. This determination requires significant judgment. In making this judgment, we evaluate, among other factors, the duration and extent to which the fair value of an investment is less than its cost; the financial health of the investee; and our intent and ability to hold the investment. Investments with an indicator are further evaluated to determine the likelihood of a significant adverse effect on the fair value and amount of the impairment as necessary. If market, industry and/or investee conditions deteriorate, we may incur future impairments.

Long-lived assets

On January 1, 2002, Ampal adopted SFAS 144, Accounting for the Impairment or Disposal of LongLived Assets. SFAS 144 requires that long-lived assets, to be held and used by an entity, be reviewed for impairment and, if necessary, written down to the estimated fair values, whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable through undiscounted future cash flows.

Accounting for Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves us estimating our current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income, and, to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the statement of operations. A valuation allowance is currently set against certain tax assets because management believes it is more likely than not that these deferred tax assets will not be realized through the generation of future taxable income. We also do not provide for taxes on undistributed earnings of our foreign subsidiaries, as it is our intention to reinvest undistributed earnings indefinitely outside the United States. In 2005, there were no undistributed earnings from foreign subsidiaries.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and our future taxable income for purposes of assessing our ability to realize any future benefit from our deferred tax assets. In the event that actual results differ from these estimates or we adjust these estimates in future periods, our operating results and financial position could be materially affected.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

FAS 123 (Revised 2004) Share-based Payment

In December 2004, the Financial Accounting Standards Board (FASB) issued the revised Statement of Financial Accounting Standards (FAS) No. 123, Share-Based Payment (FAS 123R), which addresses the accounting for share-based payment transactions in which the Company obtains employee services in exchange for (a) equity instruments of the Company or (b) liabilities that are based on the fair value of the Company's equity instruments or that may be settled by the issuance of such equity instruments. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the SEC's interpretation of FAS 123R.

FAS 123R eliminates the ability to account for employee share-based payment transactions using APB Opinion No. 25 Accounting for Stock Issued to Employees , and requires instead that such transactions be accounted for using the grant-date fair value based method. This Statement will be effective as of the beginning of the first interim period after June 15, 2005 (January 1, 2006 for the Company). Early adoption of FAS 123R is encouraged. This Statement applies to all awards granted or modified after the Statement's effective date. In addition, compensation cost for the unvested portion of previously granted awards that remain outstanding on the Statement's effective date shall be recognized on or after the effective date, as the related services are rendered, based on the awards' grantdate fair value as previously calculated for the pro-forma disclosure under FAS 123.

The Company estimates that the cumulative effect of adopting FAS 123R, as of its adoption date by the Company (January 1, 2006), based on the awards outstanding as of December 31, 2005, will not be material. This estimate does not include the impact of additional awards, which may be granted, or forfeitures, which may occur subsequent to December 31, 2005 and prior to the adoption of FAS 123R.

The Company expects that upon the adoption of FAS 123R, the Company will apply the modified prospective application transition method, as permitted by the Statement. Under such transition method, upon the adoption of FAS 123R, the Company's financial statements for periods prior to the effective date of the Statement will not be restated.

The Company expects, based on the awards outstanding as of December 31, 2005, that this statement will have an estimated effect of \$0.8 million on its financial position and results of operations in 2006.

FAS 154 - Accounting Changes and Error Corrections - a replacement of APB Opinion No. 20 and FASB Statement No. 3

In June 2005, the Financial Accounting Standards Board issued FAS No. 154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No.3". This Statement generally requires retrospective application to prior periods financial statements of changes in accounting principle. Previously, Opinion No. 20 required that most voluntary changes in accounting principle were recognized by including the cumulative effect of changing to the new accounting principle in net income of the period of the change. FAS 154 applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. This Statement shall be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005 (2006 for the Company). We do not expect the adoption of this statement will have a material impact on our results of operations, financial position or cash flow.

RESULTS OF OPERATIONS

Fiscal year ended December 31, 2005 compared to fiscal year ended December 31, 2004:

The Company recorded a consolidated net loss of \$6.0 million for the fiscal year ended December 31, 2005, as compared to \$18.4 million loss for the same period in 2004. The decrease in net loss is primarily attributable to an increase in earnings of affiliates, an increase in interest income and a decrease in loss from impairment of investments. The decrease in net loss was partially offset by a decrease in realized and unrealized gains from marketable securities and investments and an increase in translation losses in 2005, as compared to 2004.

Income from equity of affiliates increased to \$6.7 million for the fiscal year ended December 31, 2005 as compared to \$4.0 million for the fiscal year ended in 2004. The increase is primarily attributable to a \$6.6 million gain recorded by Ophir Holding Ltd. as a result of the sale of all its holdings in Industrial Building Corporation Ltd.

In the fiscal year ended December 31, 2005, the Company recorded \$14.0 million in losses from the impairment of its investments and loans relating primarily to MIRS (\$13.3 million) and Shiron Satelite Communications (1996) Ltd. (Shiron Ltd.) (\$0.6 million). On October 3, 2005, the Company, through Ampal Communications L.P., a limited partnership controlled by the Company, completed the previously announced sale to Motorola Israel Ltd. of all of its holdings of MIRS pursuant to the terms of a Stock Purchase and Indemnification Agreement, dated as of August 30, 2005, by and among Motorola Israel, Ampal Communications L.P. and MIRS. In connection with the sale of its holdings of MIRS, Ampal Communications L.P. received approximately US \$89 million of total proceeds, composed of \$67.7 million for the purchase price and an additional \$ 21.3 million related to guaranteed dividend payments. In the fiscal year ended December 31, 2004, the Company recorded \$38.8 million in losses from the impairment of its investments and loans which was comprised primarily of the following losses: MIRS (\$30.0 million), ShellCase (\$3.8 million) and Star Management (\$1.6 million).

During the fiscal year ended December 31, 2005, Ampal recorded \$2.7 million of realized losses on investments, as compared to \$6.0 million of realized gains in the same period in 2004. The loss recorded in 2005 was primarily attributable to the third-party investment in the high-tech portfolio (which is treated as a disposition for accounting purposes) which resulted in a \$7.3 million loss (\$4.6 net loss after tax). This loss was partially offset by the gain recorded from the sale of all of Ampal s shares of Modem Art Ltd. (\$3.3 million gain) and the sale of all of its shares in Epsilon investment (\$1.4 million gain). The \$6.0 million gain recorded in 2004 is mainly attributable to the sale of PowerDsine Ltd. and the sale of assets by PSINet Europe, one of the holdings of Ampal s investee company, Telecom Partners (TP).

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The Company recorded realized and unrealized gains from marketable securities in the amount of \$3.2 million in the year 2005 as compared to \$1.9 million in 2004.

The increase in real estate income and expenses in 2005 as compared to 2004 is primarily attributable to the increase in the tenant occupancy rate in Am-Hal Ltd.

Other income realized by the Company is principally composed of guaranteed dividend payments from Motorola equal to \$7.1 million for the years ended December 31, 2005, and December 31, 2004.

The Company recorded higher interest income in the fiscal year ended December 31, 2005, as compared to the same period in 2004, primarily as a result of a \$0.7 million gain from forward contracts to purchase U.S. Dollars and increases in interest rates.

The Company recorded an interest expense of \$5.3 million in the fiscal year ended December 31, 2005, as compared to \$4.9 million in the same period in 2004, primarily as a result of increases in applicable interest rates.

The management of the Company currently believes that inflation has not had a material impact on the Company's operations.

SELECTED QUARTERLY FINANCIAL DATA

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
(U.S. Dollars in thousands, except per share data)				
Unaudited				
Fiscal Year Ended December 31, 2005				
Revenues	\$ 15,634	\$ 5,827	\$ 7,907	\$ 1,162
Net interest expense	(1,017)	(1,439)	(1,143)	(91)
Net (loss) income	6,728	(2,511)	(10,630)	455
Basic EPS:				
Earnings (Loss) per Class A share ⁽¹⁾	0.33	(0.13)	(0.53)	0.02
Diluted EPS:				
Earnings (Loss) per Class A share	0.30	(0.13)	(0.53)	0.02
(U.S. Dollars in thousands, except per share data)				
Unaudited				
Fiscal Year Ended December 31, 2004				
Revenues	\$ 7,469	\$ 8,181	\$ 8,912	\$ 6,902
Net interest expense	(715)	(1,236)	(2,117)	(222)
Net (loss) income	(811)	284	(2,545)	(15,313)
Basic EPS:				
Earning (Loss) per Class A share ⁽¹⁾	(0.04)	0.01	(0.13)	(0.78)
Diluted EPS:				
Earning (Loss) per Class A share	(0.04)	0.01	(0.13)	(0.78)

⁽¹⁾ After deduction of dividends on the 4% and 6 1/2% Cumulative Convertible Preferred Stock in 2005 and 2004 (in thousands) of \$191 and \$200, respectively.

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See note 17 to the Company Consolidated Annual Statements which describe management decision to correct the disclosure provided by the Statements of Comprehensive Income (Loss) contained in the Company's periodic reports on Form 10-Q for the three months ending March 31, 2005, six months ending June 30, 2005 and nine months ending September 30, 2005.

Fiscal year ended December 31, 2004 compared to fiscal year ended December 31, 2003:

The Company recorded a consolidated net loss of \$18.4 million for the fiscal year ended December 31, 2004, as compared to \$8.8 million gain for the same period in 2003. The decrease in net income is primarily attributable to the increase in losses from impairment of investments and decreases in realized and unrealized gain on investments in marketable securities. The decrease was partially offset by higher income from equity in and translation gains, 2004, as compared to 2003.

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In the fiscal year ended December 31, 2004, the Company recorded \$38.8 million in losses from the impairment of its investments and loans which was comprised primarily of the following losses: MIRS (\$30.0 million), ShellCase (\$3.8 million) and Star Management (\$1.6 million). In the fiscal year ended December 31, 2003, the Company recorded \$13.1 million in losses from the impairment of its investments and loans which was comprised primarily of the following losses: XACCT (\$9.0 million), Carmel (\$2.0 million) and Identify (\$1.3 million).

During the fiscal year ended December 31, 2004, Ampal recorded \$7.9 million of realized and unrealized gains on investments, as compared to \$29.8 million of realized and unrealized gains in the same period in 2003. The gains recorded in 2004 are mainly attributable to the sale of assets by PSINet Europe, one of the holdings of Ampal's investee company, Telecom Partners (TP)(\$2.5 million), (see Investments) and approximately 49% of the Company's holdings in PowerDsine Ltd. (PowerDsine)(\$3.5 million). The remaining shares of PowerDsine were treated as available-for-sale and \$2.9 million were recorded as unrealized gains on marketable securities under, Accumulated Other Comprehensive Loss. The realized and unrealized gains on investments in 2003 were primarily attributable to the gains on the sale of the Company's investment in Granite Hacarmel Investments Ltd. (Granite)(\$20.7 million), Blue Square Israel Ltd. (Blue Square)(\$2.6 million), Alvarion (\$1.4 million), and mutual funds and other securities (\$5.1 million).

During 2003, the Company reduced its holding interest in Granite from 20.4% to 10.5% as a result of a sale of 9.9%. Consequently, the Company's investment in Granite, which was previously accounted for by the equity method, was accounted for as an investment in a trading marketable security. The remaining 10.5% interest in Granite was sold in February 2004.

Equity in earnings of affiliates increased to \$4.0 million for the fiscal year ended December 31, 2004 as compared to \$2.5 million for the fiscal year ended in 2003. In 2003, a loss of \$1.7 million was recorded during the first quarter with respect to the Company's holdings in Granite.

The increase in real estate income and expenses in 2004 as compared to 2003 is primarily attributable to the increase in the tenant occupancy rate in Am-Hal Ltd.

Other income realized by the Company is principally composed of guaranteed dividend payments from Motorola equal to \$7.1 million for the years ended December 31, 2004 and 2003.

The Company recorded lower interest expense in the fiscal year ended December 31, 2004, as compared to the same period in 2003, primarily as a result of repayment of loans.

In the fiscal year ended December 31, 2004, Ampal recorded \$10.2 million of tax benefit which related mainly to the loss from the impairment in our investment in MIRS.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows

On December 31, 2005, cash, cash equivalents and marketable securities were \$62.9 million, as compared with \$68.1 million at December 31, 2004.

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The Company has sources of cash from operations, cash from investing activities and amounts available under credit facilities, as described below. The Company believes that these sources are sufficient to fund the current requirements of operations, capital expenditures, investing activities, dividends on preferred stock and other financial commitments of the Company for the next 12 months. However, to the extent that contingencies and payment obligations described below and in other parts of this Report require the Company to make unanticipated payments, the Company would need to further utilize these sources of cash. In the event of a decline in the market price of its marketable securities, the Company may need to draw upon its other sources of cash, which may include additional borrowing, refinancing of its existing indebtedness or liquidating other assets, the value of which may also decline.

In addition, the shares of Ophir Holdings Ltd. and government debenture notes equal to \$9 million have already been pledged as security for various loans provided to the Company for the purchase of these shares and would therefore be unavailable if the Company wished to pledge them in order to provide an additional source of cash.

Cash flows from operating activities

Net cash provided by operating activities totaled approximately \$43.2 million for the fiscal year ended December 31, 2005, as compared to approximately \$13.1 million provided by the same period in 2004. The change is primarily attributable to (i) the \$19.7 million net proceeds from the sale of securities (\$32.6 million proceeds offset by \$12.9 million invested) as compared to \$23.0 million net proceeds from the sale of securities in 2004, (ii) receipt of a \$21.3 million dividend from MIRS as part of the sale of MIRS to Motorola Communication Israel Ltd. and (iii) the \$4.3 million in dividend payments received from affiliates as compared to \$3.3 million in dividend payments received from affiliates in 2004.

Cash flows from investing activities

Net cash provided by investing activities totaled approximately \$36.7 million for the fiscal year ended December 31, 2005, as compared to approximately \$17.7 million provided by for the same period in 2004. The cash provided by investing activities is primarily attributable to the proceeds in the amount of \$75.4 million from the disposition of MIRS, High-Tech Portfolio, Epsilon Group, Xpert, Modem Art and certain assets of TP. The cash receipts were offset by our approximately \$30 million investment in EMG and a payment of \$9.8 million by Am-Hal Ltd. (Am-Hal), a wholly owned subsidiary of the Company, to acquire and develop real estate for a new project in Tel-Aviv.

Cash flows from financing activities

Net cash used in financing activities was approximately \$73.5 million for the fiscal year ended December 31, 2005, as compared to approximately \$19.1 million of net cash used in financing activities for the fiscal year ended December 31, 2004.

The increase in cash used in financing activities is primarily attributable to the repayment in full of the \$73.1 million loan which was received from Bank Hapoalim Ltd and Bank Leumi Le-Israel Ltd relating to the MIRS investment, the repayment of \$2.5 million of loans by Am-Hal and Ampal which used its own cash to pay down its existing notes payable and debentures in the amount of \$5.3 million. Those effects were offset by Am-Hal Ltd. and its minority partner in the new project which borrowed \$8.8 million to finance the new project (see cash flow from investing activities). In 2004, the Company paid down its notes payable and debentures in the amount of \$18.9 million with cash on hand and by borrowing funds in the amount of \$6.5 million.

Investments

On December 31, 2005, the aggregate fair value of trading and available-for-sale securities were approximately \$38.6 million, as compared to \$50.4 million at December 31, 2004. The decrease in 2005 is attributable to the sale of tradable securities in order to finance the \$30 million investment in EMG.

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- a) In 2005, the Company made the following investments:
1. On December 1, 2005, the Company acquired a 2.0% interest in EMG from Merhav for \$29,960,000. EMG is an Egyptian joint stock company organized in accordance with the Egyptian Special Free Zones system which has been given the right to export natural gas from Egypt to Israel and other locations in the East Mediterranean basin and other countries. (See also Item 7. Related Party Transaction).
 2. An additional investment of \$0.7 million in Fimi Opportunity Fund, L.P. (Fimi).
- b) In 2005, the Company made the following dispositions:
1. On October 3, 2005 the Company, through Ampal Communications L.P., completed the sale to Motorola Israel Ltd. of all of its holdings of MIRS. In connection with the sale of its holdings of MIRS, Ampal Communications L.P. received approximately US \$89 million of total proceeds, composed of US \$67.7 million for the purchase price and an additional US \$21.3 million related to guaranteed dividend payments.
 2. During the third and fourth quarter of 2005, one of the holdings of Ampal's investee companies, TP received proceeds in the amount of \$1.1 million from the sale of all its assets in Grapes Communications N.V./S.A. and from the disposition of its holdings in PSINet Europe B.V.
 3. On September 7, 2005 a third-party Israeli based venture fund and certain of its affiliated companies invested \$2.65 million in the Company's high-tech and communications portfolio. Ampal received \$2.5 million in connection with this transaction. The Company treated this investment as a disposition for accounting purposes and recorded a loss of \$7.3 million (\$4.6 million after taxes).
 4. On August 15, 2005 the Company sold its holdings in Epsilon Investment House Ltd. and Renaissance Investment Company Ltd. for \$2.0 million and recorded a \$1.4 million gain.
 5. On July 11, 2005, the Company sold its holdings in Xpert Ltd. for \$0.8 million and recorded a loss of \$0.2 million.
 6. On March 8, 2005, the Company sold its holdings in Modem Art Ltd. for \$4.4 million and recorded a gain of \$3.3 million.

Related Party transaction

On December 1, 2005, the Company acquired an interest in EMG from Merhav. EMG is an Egyptian joint stock company organized in accordance with the Egyptian Special Free Zones system which has been given the right to export natural gas from Egypt to Israel and other locations in the East Mediterranean basin and other countries. Egyptian natural gas shall reach the Israeli market via an underwater pipeline owned by EMG, which EMG expects to be completed during 2007. Under the terms of the transaction, the Company acquired a 2% beneficial ownership in EMG for a purchase price of \$29,960,000. Additionally, the Company was granted the exclusive right to negotiate to acquire a substantial portion of Merhav's remaining shares of EMG. The Company also has the right for a period of time to require Merhav to repurchase the EMG interest.

Yosef A. Maiman, the chairman of the Company's Board of Directors and the Company's controlling shareholder, is the sole owner of Merhav. The transaction was approved by a special committee of the Board of Directors composed of the Company's independent directors. Houlihan Lokey Howard & Zukin Financial Advisors, Inc. acted as financial advisors to the special committee.

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Debt

Notes and loans payable consist primarily of bank borrowings either in U.S. dollars, linked to the Consumer Price Index in Israel or in unlinked Israel Shekels, with interest rates varying depending upon their linkage provision and mature between 2006-2010.

The Company financed a portion of the \$9.8 million real estate acquisition by Am-Hal, a wholly-owned subsidiary of the Company, which develops and operates luxury retirement centers for senior citizens, through a revolving credit facility from Hapoalim, Phoenix Insurance Company and others. On December 1, 2005, a loan agreement creating the facility was signed between Am-Hal, Phoenix Insurance Company and others. Pursuant to the loan agreement, the lenders granted the Company a revolving credit facility in Israeli Shekels equal to \$12.5 million. The annual interest rate on the loan, which matures in 10 years, is 7.5%. The interest rate and the principal of the loan will be adjusted based on the changes in the Israeli Consumer Price Index. As of December 31, 2005 the Company had drawn \$2.5 million from the facility. As of December 31, 2005 and December 31, 2004 the amounts outstanding under these loans were \$13.5 million and \$7.7 million, respectively. The loans, excluding the Phoenix loan, mature in up to one year and have interest rates range between 5.4% and 7.5%. The Company generally repays these loans with the proceeds received from deposits and other payments from the apartments in Am-Hal facilities. The loans are secured by a lien on Am-Hal's properties. The Company also issued guarantees in the amount of \$3.6 million in favor of tenants of Am-Hal in order to secure their deposits.

The Company also finances its general operations and other financial commitments through bank loans with Hapoalim. The long-term loans in the amount of \$31.3 million mature through 2006-2010.

Other long term borrowings in the amount of \$1.9 million are linked to the Israeli C.P.I and mature between 2006 and 2010 of which an amount of \$1.4 million bears no interest. The remaining \$0.5 million bears an annual interest of 5.7%.

The weighted average interest rates on the balances of short-term borrowings at year-end are as follows: 6.0% on \$15.0 million and 3.5% on \$13.0 million in 2005 and 2004, respectively.

Contractual Obligations	Payments due by period (in thousands)				
	Total	Less than 1 year	1 - 3 years	3-5 years	More than 5 years
Long-Term Debt	\$ 35,406	\$ 10,443	\$ 12,412	\$ 9,521	\$ 3,030
Short-Term Debt	\$ 14,960	\$ 14,960			
Capital Call Obligation ⁽¹⁾	\$ 2,800	\$ 2,800			
Operating Lease ⁽²⁾ Obligation	\$ 6,300	\$ 300	\$ 600	\$ 500	\$ 4,900
Capital Lease Obligation	--	--	--	--	--
Purchase Obligations	--	--	--	--	--
Other Long-Term Liabilities Reflected on the Company's Balance Sheet Under GAAP	--	--	--	--	--
Total	\$ 59,466	\$ 28,503	\$ 13,012	\$ 10,021	\$ 7,930

⁽¹⁾ See note 15(d)

⁽²⁾ See note 15(a)

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As of December 31, 2005, the Company had issued guarantees on certain outstanding loans to its investees and subsidiaries in the aggregate principal amount of \$10.3 million. This includes:

1. \$5.8 million guarantee on indebtedness incurred by Bay Heart (\$3.5 million of which is recorded as a liability in the Company's financial statements at December 31, 2005) in connection with the development of its property. Bay Heart recorded losses in 2005 as a result of decreased rental revenues. There can be no guarantee that Bay Heart will become profitable or that it will generate sufficient cash to repay its outstanding indebtedness without relying on the Company's guarantee.
2. \$3.6 million guarantee to Am- Hal tenants as described above.
3. \$0.9 million guarantee to Galha 1960 Ltd. as described in Item 3 of this Report.

In each of 2005 and 2004, Ampal paid dividends in the amount of \$0.20 and \$0.325 per share on its 4% and 6 ½% Cumulative Convertible Preferred Stocks, respectively. Total dividends paid in each year amounted to approximately \$0.2 million.

Off-Balance Sheet Arrangements

Other than the foreign currency contracts specified below, the Company has no off-balance sheet arrangements.

Foreign Currency Contracts

The Company's derivative financial instruments consist of foreign currency forward exchange contracts to purchase or sell US Dollars. These contracts are utilized by the Company, from time to time, to manage risk exposure to movements in foreign exchange rates. None of these contracts have been designated as hedging instruments. These contracts are recognized as assets or liabilities on the balance sheet at their fair value, which is the estimated amount at which they could be settled based on market prices or dealer quotes, where available, or based on pricing models. Changes in fair value are recognized currently in earnings.

As of December 31, 2005, the Company did not have any open foreign currency forward exchange contracts to purchase or sell U.S. Dollars.

ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

MARKET RISKS AND SENSITIVITY ANALYSIS

The Company is exposed to various market risks, including changes in interest rates, foreign currency rates and equity price changes. The following analysis presents the hypothetical loss in earnings, cash flows and fair values of the financial instruments which were held by the Company at December 31, 2005, and are sensitive to the above market risks.

During the fiscal year ended December 31, 2005, there have been no material changes in the market risk exposures facing the Company as compared to those the Company faced in the fiscal year ended December 31, 2004.

Interest Rate Risks

At December 31, 2005, the Company had financial assets totaling \$21.4 million and financial liabilities totaling \$50.4 million. For fixed rate financial instruments, interest rate changes affect the fair market value but do not impact earnings or cash flows. Conversely, for variable rate financial instruments, interest rate changes generally do not affect the fair market value but do impact future earnings and cash flows, assuming other factors are held constant.

At December 31, 2005, the Company had fixed rate financial assets of \$0.3 million and had variable rate financial assets of \$21.1 million. A ten percent decrease in interest rates would increase the unrealized fair value of the fixed rate assets by approximately \$0.1 million.

At December 31, 2005, the Company had fixed rate debt of \$5.0 million and variable rate debt of \$45.4 million. A ten percent decrease in interest rates would increase the unrealized fair value of the financial debts in the form of the fixed rate debt by approximately \$0.1 million.

The net decrease in earnings for the next year resulting from a ten percent interest rate increase would be approximately \$0.2 million, holding other variables constant.

Exchange Rate Sensitivity Analysis

The Company's exchange rate exposure on its financial instruments results from its investments and ongoing operations in Israel. During 2005, the Company entered into various foreign exchange forward purchase contracts to partially hedge this exposure. At December 31, 2005, the Company didn't have any open foreign exchange forward purchase contracts. Holding other variables constant, if there were a ten percent devaluation of the foreign currency, the Company's cumulative translation loss reflected in the Company's accumulated other comprehensive loss would increase by \$1.2 million, and regarding the statements of income loss a ten percent devaluation of the foreign currency would be reflected in a net decrease in earnings and would be \$2.0 million.

Equity Price Risk

The Company's investments at December 31, 2005, included marketable securities which are recorded at fair value of \$38.6 million, including a net unrealized gain of \$0.4 million. Those securities have exposure to price risk. The estimated potential loss in fair value resulting from a hypothetical ten percent decrease in prices quoted on stock exchanges is approximately \$3.9 million.

ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Ampal-American Israel Corporation:

We have audited the accompanying consolidated balance sheets of Ampal-American Israel Corporation and subsidiaries (the Company) as of December 31, 2005 and 2004, and the related consolidated statements of income (loss), cash flows, changes in shareholders' equity, and comprehensive income (loss) for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of certain subsidiaries, whose revenues included in consolidation constitute approximately 14.5% of total consolidated revenues for the year ended December 31, 2003. Also we did not audit the financial statements of certain affiliated companies, the company's interest in which as reflected in the balance sheets as of December 31, 2005 and 2004 is \$14,001 thousands and \$13,345 thousands, respectively, and the Company's share in excess of profits over losses in a net amount of \$88 thousands, \$1,931 thousands and \$676 thousands for the years ended December 31, 2005, 2004 and 2003, respectively. The financial statements of those subsidiaries and affiliated companies were audited by other independent registered public accounting firms whose reports thereon have been furnished to us and our opinion expressed herein, insofar as it relates to the amounts included for those companies, is based solely on the reports of the other independent registered public accounting firms. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Boards (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of other independent auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other independent registered public accounting firms, the financial statements referred to above present fairly, in all material respects, the financial position of the Company and its subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

Tel Aviv, Israel
March 29, 2005

/s/ KESSELMAN & KESSELMAN CPAs (ISR) A member of
PricewaterhouseCoopers International Limited

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AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF INCOME (LOSS)

	Fiscal Year Ended December 31,		
	2005	2004	2003
(U.S. Dollars in thousands, except per share data)			
REVENUES:			
Equity in earnings of affiliates (Note 11)	\$ 6,666	\$ 4,031	\$ 2,526
Real estate income	9,244	9,020	8,889
Realized gains on investments (Note 2)	--	5,964	--
Realized and unrealized gains on marketable securities	3,203	1,929	29,813
(Loss) gain on sale of real estate rental property (Note 2)	--	(123)	69
Interest income	1,567	590	508
Other Income (note 12)	9,850	10,053	10,009
Total revenues	30,530	31,464	51,814
EXPENSES:			
Interest expense	5,257	4,880	5,531
Real estate expenses	8,651	8,874	8,110
Realized losses on investments (Notes 2)	2,735	--	--
Loss from impairment of investments & real estate (Note 2)	13,984	38,811	13,144
Translation (gain) loss	2,220	(194)	3,061
Other (mainly general and administrative)	10,957	11,806	10,747
Total expenses	43,804	64,177	40,593
(Loss) Income before income taxes	(13,274)	(32,713)	11,221
Provision for income taxes (tax benefits) (Note 10)	(2,849)	(10,198)	434
(Loss) Income after income taxes (tax benefits)	(10,425)	(22,515)	10,787
Minority interests, net	(4,467)	(4,130)	1,940
NET (LOSS) INCOME	\$ (5,958)	\$ (18,385)	\$ 8,847
Basic EPS: (Note 9)			
(Loss) earnings per Class A share	\$ (0.31)	\$ (0.94)	\$ 0.42
Shares used in calculation (in thousands)	19,967	19,841	19,713
Diluted EPS:			
(Loss) earnings per Class A Share	\$ (0.31)	\$ (0.94)	\$ 0.40
Shares used in calculation (in thousands)	19,967	19,841	22,120

The accompanying notes are an integral part of the consolidated financial statements.

**AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS**

	Assets As At	
	December 31, 2005	December 31, 2004
	(U.S. Dollars in thousands)	
Cash and cash equivalents	\$ 24,314	\$ 17,618
Deposits, notes and loans receivable	343	3,534
Investments (Notes 2, 3 and 11):		
Marketable securities (Note 3)	38,575	50,433
Other investments	54,903	127,023
	93,478	177,456
Total investments		
Real estate property, less accumulated depreciation of \$13,907 and \$12,190	70,989	63,191
Other assets (Note 4)	21,780	43,148
TOTAL ASSETS	\$ 210,904	\$ 304,947

The accompanying notes are an integral part of the consolidated financial statements.

**AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS**

	Liabilities and Shareholders' Equity As At	
	December 31, 2005	December 31, 2004
	(U.S. Dollars in thousands except share amounts per share data)	
LIABILITIES		
Notes and loans payable (Note 5)	\$ 50,366	\$ 118,760
Debentures	--	2,036
Deposits from tenants	52,880	52,152
Accounts payable, accrued expenses and others (Note 6)	18,669	26,002
Total liabilities	121,915	198,950
Commitments and Contingencies (note 15)		
Minority interests, net	120	5,984
SHAREHOLDERS' EQUITY (Note 7)		
4% Cumulative Convertible Preferred Stock, \$5 par value; authorized 189,287 shares; issued 114,198 and 124,024 shares; outstanding 110,848 and 120,674 Shares	571	620
6-1/2% Cumulative Convertible Preferred Stock, \$5 par value; authorized 988,055 shares; issued 641,423 and 662,219 shares; outstanding 518,887 and 539,683 shares	3,207	3,311
Class A Stock \$1 par value; authorized 60,000,000 shares; issued 25,826,821 and 25,715,303 shares; outstanding 20,075,782 and 19,883,639 shares	25,827	25,715
Additional paid-in capital	58,252	58,211
Retained earnings	51,223	57,524
Accumulated other comprehensive loss	(19,518)	(14,272)
Treasury stock, at cost	(30,693)	(31,096)
Total shareholders' equity	88,869	100,013
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 210,904	\$ 304,947

The accompanying notes are an integral part of the consolidated financial statements.

AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Fiscal Year Ended December 31,		
	2005	2004	2003
(U.S. Dollars in thousands)			
Cash flows from operating activities:			
Net (loss) income	\$ (5,958)	\$ (18,385)	\$ 8,847
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Equity in earnings of affiliates	(6,666)	(4,031)	(2,526)
Realized and unrealized net gains on investments	(468)	(7,893)	(29,813)
Loss (gain) on sale of real estate rental property	--	123	(69)
Depreciation expense	1,978	2,168	2,173
Amortization income from tenants deposits	(1,876)	(1,944)	(1,577)
Impairment of investments	13,984	38,811	13,144
Minority interests	(4,467)	(4,130)	1,940
Translation (gain) loss	2,220	(194)	3,061
Decrease (Increase) in other assets	14,006	537	(6,944)
(Decrease) increase in accounts payable, accrued expenses and other	6,387	(18,273)	8,753
Investments made in trading securities	(12,868)	(36,811)	(54,411)
Proceeds from sale of trading securities	32,595	59,834	39,370
Dividends received from affiliates	4,335	3,277	5,638
	<u>43,202</u>	<u>13,089</u>	<u>(12,414)</u>
Net cash provided by (used in) operating activities .			
Cash flows from investing activities:			
Deposits, notes and loans receivable collected	2,872	14,935	1,888
Deposits, notes and loans receivable granted	(1,024)	(6,696)	(3,772)
Investments made in:			
Affiliates and others	(30,621)	(6,295)	(1,367)
Proceeds from sale of investments:			
Affiliate Company	3,041	--	19,511
Others	72,315	16,556	--
Return of capital by partnership	--	--	213
Capital improvements	(9,884)	(1,075)	(823)
Acquisition of minority interest	--	--	(481)
Proceeds from sale of real estate property, net	--	236	1,350
	<u>36,699</u>	<u>17,661</u>	<u>16,519</u>
Net cash provided by investing activities			

The accompanying notes are an integral part of the consolidated financial statements.

AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Fiscal Year Ended December 31,		
	2005	2004	2003
(U.S. Dollars in thousands)			
Cash flows from financing activities:			
Notes and loans payable received	\$ 8,869	\$ 6,463	\$ 19,871
Long term loan received by partnership minority	2,050	--	--
Notes and loans payable repaid	(78,875)	(23,655)	(1,934)
Proceeds from exercise of stock options	251	--	--
Debentures repaid	(2,023)	(1,753)	(19,271)
(Distribution) contribution to partnership by minority interests	(3,567)	40	--
Dividends paid on preferred stock	(191)	(200)	(213)
	<u> </u>	<u> </u>	<u> </u>
Net cash used in financing activities	(73,486)	(19,105)	(1,547)
	<u> </u>	<u> </u>	<u> </u>
Effect of exchange rate changes on cash and cash equivalents	281	1,401	457
	<u> </u>	<u> </u>	<u> </u>
Net increase in cash and cash equivalents	6,696	13,046	3,015
Cash and cash equivalents at beginning of year	17,618	4,572	1,557
	<u> </u>	<u> </u>	<u> </u>
Cash and cash equivalents at end of year	\$ 24,314	\$ 17,618	\$ 4,572
	<u> </u>	<u> </u>	<u> </u>
Supplemental Disclosure of Cash Flow Information			
Cash paid during the year:			
Interest	2,535	5,170	5,187
	<u> </u>	<u> </u>	<u> </u>
Income taxes paid	\$ 68	\$ 3,763	\$ 2,053
	<u> </u>	<u> </u>	<u> </u>
Proceeds on trading securities received from realization of an investment	\$ 3,316	\$ 2,267	--
	<u> </u>	<u> </u>	<u> </u>
Supplemental disclosure of non cash operating Activities:			
Dividend in kind from an affiliate	\$ 7,088	\$ --	\$ --
	<u> </u>	<u> </u>	<u> </u>

The accompanying notes are an integral part of the consolidated financial statements.

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AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Fiscal Year Ended December 31,		
	2005	2004	2003
(U.S. Dollars in thousands, except share amounts per share data)			
4% PREFERRED STOCK			
Balance, beginning of year	\$ 620	\$ 660	\$ 697
Conversion of 9,826, 7,928 and 7,439 shares into Class A Stock	(49)	(40)	(37)
Balance, end of year	\$ 571	\$ 620	\$ 660
6-1/2% PREFERRED STOCK			
Balance, beginning of year	\$ 3,311	\$ 3,487	\$ 3,532
Conversion of 20,796, 35,161 and 9,070 shares into Class A Stock	(104)	(176)	(45)
Balance, end of year	\$ 3,207	\$ 3,311	\$ 3,487
CLASS A STOCK			
Balance, beginning of year	\$ 25,715	\$ 25,567	\$ 25,503
Issuance of shares upon conversion of Preferred Stock	112	148	64
Balance, end of year	\$ 25,827	\$ 25,715	\$ 25,567
ADDITIONAL PAID-IN CAPITAL			
Balance, beginning of year	\$ 58,211	\$ 58,143	\$ 58,125
Conversion of Preferred Stock	41	68	18
Balance, end of year	\$ 58,252	\$ 58,211	\$ 58,143
RETAINED EARNINGS			
Balance, beginning of year	\$ 57,524	\$ 76,109	\$ 67,475
Net (loss) income	(5,958)	(18,385)	8,847
Loss from treasury stock reissued for exercised stock option	(152)	--	--
Dividends:			
4% Preferred Stock - \$0.20 per share	(22)	(24)	(26)
6-1/2% Preferred Stock - \$0.325 per share	(169)	(176)	(187)
Balance, end of year	\$ 51,223	\$ 57,524	\$ 76,109

The accompanying notes are an integral part of the consolidated financial statements.

AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Fiscal Year Ended December 31,		
	2005	2004	2003
(U.S. Dollars in thousands, except share amounts per share data)			
TREASURY STOCK:			
4% PREFERRED STOCK			
Balance, beginning and end of year	\$ (84)	\$ (84)	\$ (84)
6-1/2% PREFERRED STOCK			
Balance, beginning and end of year	\$ (1,853)	\$ (1,853)	\$ (1,853)
CLASS A STOCK			
Balance, beginning of year - 5,831,664, 5,831,664 and 5,831,664 shares, at cost	\$ (29,159)	\$ (29,159)	\$ (29,159)
Issuance of 80,625 shares	403	--	--
Balance, end of year - 5,751,039, 5,831, 664 and 5,831,664 shares, at cost	\$ (28,756)	\$ (29,159)	\$ (29,159)
Balance, end of year	\$ (30,693)	\$ (31,096)	\$ (31,096)
ACCUMULATED OTHER COMPREHENSIVE LOSS			
Cumulative translation adjustments:			
Balance, beginning of year	\$ (20,083)	\$ (20,596)	\$ (20,750)
Foreign currency translation adjustments	348	513	154
Balance, end of year	(19,735)	(20,083)	(20,596)
Unrealized gains (losses) on available for sale securities:			
Balance, beginning of year	5,811	2,749	(3,308)
Unrealized (losses) gains, net	(1,472)	3,396	4,772
Sale of available-for-sale securities	(4,122)	(334)	1,285
Balance, end of year	217	5,811	2,749
Balance, end of year	\$ (19,518)	\$ (14,272)	\$ (17,847)
Total Shareholders' equity	\$ 88,869	\$ 100,013	\$ 115,023

The accompanying notes are an integral part of the consolidated financial statements.

AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Fiscal year ended December 31,		
	2005	2004	2003
	(U.S. Dollars in thousands)		
Net (loss) Income	\$ (5,958)	\$ (18,385)	\$ 8,847
Other comprehensive (loss) income, net of tax:			
Foreign currency translation adjustments	348	513	154
Unrealized gain (loss) on securities	(1,472)	3,396	4,772
Sale of available for sale securities	(4,122)	--	--
Other comprehensive income (loss)	(5,246)	3,909	4,926
Comprehensive (loss) income	\$ (11,204)	\$ (14,476)	\$ 13,773

	Fiscal year ended December 31,		
	2005	2004	2003
	(U.S. Dollars in thousands)		
Related tax (expense) benefit of other comprehensive (loss) income:			
Foreign currency translation adjustments	\$ (731)	\$ (71)	\$ (31)
Unrealized gains on securities	\$ 3,012	\$ (1,648)	\$ (2,688)

* See note 1(m)

The accompanying notes are an integral part of the consolidated financial statements.

AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Summary of Significant Accounting Policies

(a) General

- (1) Ampal is a New York corporation founded in 1942. The Company primarily acquires interests in businesses located in the State of Israel or that are Israel-related.
- (2) As used in these financial statements, the term the Company refers to Ampal-American Israel Corporation (Ampal) and its consolidated subsidiaries. As to segment information see note 13.
- (3) The consolidated financial statements are prepared in accordance with generally accepted accounting principals (GAAP) in the United States.
- (4) 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, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(b) Consolidation

The consolidated financial statements include the accounts of Ampal and its controlled and majority owned subsidiaries. Inter-company transactions and balances are eliminated in consolidation.

(c) Translation of Financial Statement in Foreign Currencies

For those subsidiaries and affiliates whose functional currency is other than the US Dollar, assets and liabilities are translated using year-end rates of exchange. Revenues and expenses are translated at the average rates of exchange during the year. Translation differences of those foreign companies financial statements are reflected in the cumulative translation adjustment accounts which are included in accumulated other comprehensive income (loss).

In subsidiaries where the primary currency is the US Dollar, accounts maintained in currencies other than the U.S. Dollar are remeasured in to U.S. Dollars using the representative foreign exchange rate at the balance sheet date. Operational accounts and nonmonetary balance sheet accounts are measured and recorded at the rate in effect at the date of the transaction. The effects of foreign currency remeasurement are reported in current operations.

(d) Foreign Exchange Forward Contracts

The Company s derivative financial instruments consist of foreign currency forward exchange contracts. These contracts are utilized by the Company, from time to time, to manage risk exposure to movements in foreign exchange rates. None of these contracts qualify for hedge accounting. These contracts are recognized as assets or liabilities on the balance sheet at their fair value, which is the estimated amount at which they could be settled based on market prices or dealer quotes, where available, or based on pricing models. Changes in fair value are recognized currently in earnings.

At December 31, 2005, the Company did not have any open foreign currency forward exchange contracts to purchase or sell US Dollars.

(e) Investments

(i) Investments in Affiliates

Investments in which the Company exercises significant influence, generally 20% to 50% owned companies (affiliates), are accounted for by the equity method, whereby the Company recognizes its proportionate share of such companies' net income or loss and in other comprehensive income its proportional share in translation difference on net investments and in other comprehensive income (loss). The Company reduces the carrying value of its investment in an affiliate if an impairment in value of that investment is deemed to be other than temporary.

(ii) Investments in Marketable Securities

Marketable equity securities, other than equity securities accounted for by the equity method, are reported based upon quoted market prices of the securities. For those securities, which are classified as trading securities, realized and unrealized gains and losses are reported in the statements of income (loss). Unrealized gains and losses net of taxes from those securities, that are classified as available-for-sale, are reported as a separate component of shareholders' equity and are included in accumulated other comprehensive income (loss) until realized. Decreases in value determined to be other than temporary on available-for-sale securities are included in the statements of income (loss).

(iii) Cost Basis Investments

Equity investments of less than 20% in non-publicly traded companies are carried at cost. Changes in the value of these investments are not recognized unless an impairment in value is deemed to be other than temporary.

(f) Risk Factors and Concentrations

Financial instruments that subject the Company to credit risk consist primarily of cash, cash equivalents, bank deposits, marketable securities and notes and loans receivable. The Company invests cash equivalents and short-term investments through high-quality financial institutions. The Company's management believes that the credit risk in respect of these balances is not material.

The company performs on going credit evaluation of its receivables allowance for doubtful accounts.

(g) Real Estate Property

The assets are recorded at cost, depreciating these costs over the expected useful life of the related assets.

Real-Estate property of a subsidiary, which existed at the time of the subsidiary's acquisition by the company, are included at their fair value as that date.

The Company applies the provisions of SFAS No. 144 Accounting for the Impairment or Disposal of Long-Lived assets (SFAS 144). SFAS 144 requires that long-lived assets, to be held and used by an entity, be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Under SFAS 144, if the sum of the expected future cash flows (undiscounted and without interest charges) of the long-lived assets is less than the carrying amount of such assets, an impairment loss would be recognized, and the assets are written down to their estimated fair values.

(h) Leasehold improvements

Fixed assets leased by the companies under capital leases are classified as the companies' assets and are recorded, at the inception of the lease, at the lower of the asset's fair value or the present value of the minimum lease payments (not including the financial component). Leasehold improvements are amortized by the straight-line method over the term of the lease, which is shorter than the estimated useful life of the improvements.

(i) Income Taxes

The Company applies the asset and liability method of accounting for income taxes, whereby deferred taxes are recognized for the tax consequences of temporary differences by applying estimated future tax effects of differences between financial statements carrying amounts and the tax bases of existing assets and liabilities. Deferred tax assets are created to the extent management believes that it is more likely than not that it will be utilized, otherwise a valuation is provided for those assets that do not qualify under this term.

Deferred income taxes are not provided on undistributed earnings of foreign subsidiaries adjusted for translation effect totaling approximately \$29.5 million in 2004 and \$0 in 2005, since such earnings are currently expected to be permanently reinvested outside the United States. If the earnings were not considered permanently invested, the Company would have paid approximately \$10.3 million in 2004 and \$0 in 2005 in deferred income taxes.

Income taxes are provided on equity in earnings of affiliates, gains on issuance of shares by affiliates and unrealized gains on investments. Ampal's foreign subsidiaries file separate tax returns and provide for taxes accordingly.

(j) Revenue Recognition

Rental income is recorded over the rental period. Revenues from services provided to tenants and country-club subscribers are recognized ratably over the contractual period or as services are performed. Guaranteed dividend payments from Motorola are recorded in the statement of income (loss) over the guaranteed period (see also note 2(b)). Revenue from amortization of tenant deposits is calculated at a fixed periodic rate based on the specific terms in the occupancy agreement signed with the tenants.

(k) Cash Equivalents

Cash equivalents are short-term, highly liquid investments that have original maturities of three months or less and that are readily convertible to cash.

(l) Earning (loss) per share (EPS)

Basic and diluted net earning (loss) per share are presented in accordance with SFAS No. 128 "Earnings per share" (SFAS No. 128), and as from 2004, but with retroactive effect, with EITF 03-06 "participating securities and the two-class method under FAS 128", for all periods presented. In 2005 and 2004, all outstanding stock options and preferred shares have been excluded from the calculation of the diluted loss per share because all such securities are anti-dilutive for these periods presented. Also, participating 4% Convertible Preferred Stock were not taken into account in the computation of the basic EPS for those years since its shareholders do not have contractual obligation to share in the losses of the Company. In 2003, the basic EPS was computed using the two-class method. The implementation of EITF 03-06 to prior periods resulted in immaterial change (less than \$0.01) in the basic EPS for 2003. The total number of common shares related to outstanding options and preferred shares excluded from the calculations of diluted net loss per share was 2,024,500 and 2,064,500 for the years ended December 31, 2005 and 2004, respectively. As to data used in the per share computation see Note 9.

(m) Comprehensive Income

SFAS No. 130, Reporting Comprehensive Income, (SFAS No. 130) established standards for the reporting and display of comprehensive income (loss), its components and accumulated balances in a full set of general purpose financial statements. The Company's components of other comprehensive income (loss) are net income (losses), income (loss) from selling available for sale investments, net unrealized gains or losses on investments held as available for sale and foreign currency translation adjustments, which are presented net of income taxes. Comprehensive income in the consolidated statements of comprehensive income (loss) in the years 2004 and 2003 does not include amounts for realized gain on available for sale securities, as the amounts are not material.

(n) Employee Stock Based Compensation

The Company accounts for all employee stock options plans under APB Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations. Accordingly, the compensation cost relating to stock options is charged on the date of grant of such options, to shareholders' equity, under deferred compensation, and it thereafter amortized by the straight line method and charged against income over vesting period. No compensation costs were incurred in the years ended December 31, 2005, 2004 and 2003, because the exercise price on the date of grant equals fair value of the stock.

SFAS No. 123 Accounting for Stock-Based Compensation (SFAS No. 123) as amended by SFAS 148 established a fair value-based method of accounting for employee stock options or similar equity instruments and encourages adoption of such method for stock compensation plans. However, it also allows companies to continue to account for those plans using the accounting treatment prescribed by APB No. 25. The Company has elected to continue accounting for employee stock option plans according to APB No. 25 and accordingly discloses pro forma data assuming the Company had accounted for employee stock option grants using the fair value based method as defined in SFAS No. 123.

If compensation cost for the options under the plans in effect been determined in accordance with SFAS No. 123, the Company's net income (loss) and EPS would have been reduced as follows:

		Fiscal Year Ended December 31,		
		2005	2004	2003
(In thousands, except per share data)				
Basic EPS:				
Net (loss) income:	As reported	\$ (5,958)	\$ (18,385)	\$ 8,847
Less - stock based compensation expense Determined under fair value method		(874)	(569)	(496)
	Pro forma	(6,832)	(18,954)	8,351
	As reported ⁽¹⁾	\$ (0.31)	\$ (0.94)	\$ 0.42
	Pro forma ⁽¹⁾	\$ (0.35)	\$ (0.97)	\$ 0.40

Fiscal Year Ended December 31,		
2005	2004	2003
(In thousands, except per share data)		

Diluted EPS:

As reported	\$	(0.31)	\$	(0.94)	\$	0.40
Pro forma	\$	(0.35)	\$	(0.97)	\$	0.38

⁽¹⁾After deduction of accrued Preferred Stock Dividend (in thousands) of \$191 and \$200 and \$213, for the years 2005, 2004 and 2003, respectively.

Under SFAS No. 123, the fair value of each option is estimated on the date of grant using the Black Scholes option-pricing model with the following weighted average assumptions for 2005, 2004 and 2003, respectively: (1) expected life of options of 5 years; (2) dividend yield of 0%; (3) volatility ranging from 46% to 60%; and (4) risk-free interest rate ranging from 3.3% to 4.08%.

(o) Treasury stock

These shares are presented as a reduction of shareholders' equity at their cost to the Company.

(p) Recently Issued Accounting Pronouncements

For 123R (Revised 2004) Share Based Payment

In December 2004, the Financial Accounting Standards Board (FASB) issued the revised Statement of Financial Accounting Standards (FAS) No. 123, Share-Based Payment (FAS 123R), which addresses the accounting for share-based payment transactions in which the Company obtains employee services in exchange for (a) equity instruments of the Company or (b) liabilities that are based on the fair value of the Company's equity instruments or that may be settled by the issuance of such equity instruments. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the SEC's interpretation of FAS 123R.

FAS 123R eliminates the ability to account for employee share-based payment transactions using APB Opinion No. 25 Accounting for Stock Issued to Employees, and requires instead that such transactions be accounted for using the grant-date fair value based method. This Statement will be effective as of the beginning of the first interim period after June 15, 2005 (January 1, 2006 for the Company). Early adoption of FAS 123R is encouraged. This Statement applies to all awards granted or modified after the Statement's effective date. In addition, compensation cost for the unvested portion of previously granted awards that remain outstanding on the Statement's effective date shall be recognized on or after the effective date, as the related services are rendered, based on the awards' grant date fair value as previously calculated for the pro-forma disclosure under FAS 123.

The Company estimates that the cumulative effect of adopting FAS 123R, as of its adoption date by the Company (January 1, 2006), based on the awards outstanding as of December 31, 2005, will not be material. This estimate does not include the impact of additional awards, which may be granted, or forfeitures, which may occur subsequent to December 31, 2005 and prior to the adoption of FAS 123R.

The Company expects that upon the adoption of FAS 123R, the Company will apply the modified prospective application transition method, as permitted by the Statement. Under such transition method, upon the adoption of FAS 123R, the Company's financial statements for periods prior to the effective date of the Statement will not be restated.

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The Company expects, based on the awards outstanding as of December 31, 2005, that this statement will have an estimated effect of \$0.8 million on its financial position and results of operations in 2006.

FAS 154 - No accounting Changes and Error Corrections - a replacement of APB Opinion No. 20 and FASB Statement No. 3

In June 2005, the Financial Accounting Standards Board issued FAS No. 154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No.3". This Statement generally requires retrospective application to prior periods financial statements of changes in accounting principle. Previously, Opinion No. 20 required that most voluntary changes in accounting principle were recognized by including the cumulative effect of changing to the new accounting principle in net income of the period of the change. FAS 154 applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. This Statement shall be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005 (Year 2006 for the Company). We do not expect the adoption of this statement will have a material impact on our results of operations, financial position or cash flow.

(q) Reclassifications

Certain comparative figures have been reclassified to conform to the current year presentation.

Note 2 Acquisitions, Dispositions and Impairments

(a) In 2005, the Company made the following investments:

1. On December 1, 2005 the Company acquired a 2% interest in EMG from Merhav. EMG is an Egyptian joint stock company organized in accordance with the Egyptian Special Free Zones system which has been given the right to export natural gas from Egypt to Israel and other locations in the East Mediterranean basin and other countries. Egyptian natural gas shall reach the Israeli market via an underwater pipeline owned by EMG. Under the terms of the transaction, the Company acquired a 2% beneficial ownership in EMG for a purchase price of \$29,960,000. Additionally, the Company was granted the exclusive right to negotiate to acquire a substantial portion of Merhav's remaining shares of EMG. The Company also has the right for a period of time to require Merhav to repurchase the EMG interest.

Yosef A. Maiman, the chairman of the Company's Board of Directors and the Company's controlling shareholder, is the sole owner of Merhav. The transaction was approved by a special committee of the Board of Directors composed of the Company's independent directors. Houlihan Lokey Howard & Zukin Financial Advisors, Inc. acted as financial advisors to the special committee.

2. Additional investment of \$0.7 million in Fimi Opportunity Fund, L.P. (Fimi).
3. A loan to Bay Heart Ltd. of \$0.9 million, a shopping mall.

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(b) In 2005, the Company made the following dispositions:

1. During the third and fourth quarter of 2005, one of the holdings of Ampal's investee companies, TP received proceeds at the amount of \$1.1 million from selling all its assets in Grapes Communications N.V./S.A. and its holdings in PSINet Europe B.V.
2. On October 3, 2005 the Company, through Ampal Communications L.P., completed the sale to Motorola Israel Ltd. of all of its 25% holdings of MIRS pursuant to the Agreement. In connection with the sale of its holdings of MIRS, Ampal Communications L.P. received approximately US \$89 million of total proceeds, composed of US \$67.7 million for the purchase price and an additional US \$21.3 million related to guaranteed dividend payments. During the third quarter of 2005, the Company recorded a \$13.3 million loss from impairment relating to this investment.
3. On September 7, 2005 a third-party Israeli based venture fund and certain of its affiliated companies invested \$2.65 million in the Company's high-tech and communications portfolio. Ampal received \$2.5 million in connection with this transaction. The Company treated this investment as a disposition for accounting purposes and recorded a loss of \$7.3 million (\$4.6 million after taxes).
4. On August 15, 2005 the Company sold its holdings in Epsilon Investment House Ltd. and Renaissance Investment Company Ltd. for \$2.0 million and recorded a \$1.4 million gain.
5. On July 11, 2005, the Company sold its holdings in Xpert Ltd. for \$0.8 million and recorded a loss of \$0.2 million.
6. On March 8, 2005, the Company sold its holdings in Modem Art Ltd. for \$4.4 million and recorded a gain of \$3.3 million.

(c) In 2005, the Company recorded loss from impairment of investments and loan of \$14.0 million as follows:

1. MIRS Ltd. (\$13.3 million)
2. Shiron Ltd. (\$0.6 million)
3. Other loans (\$0.1 million)

(d) In 2004, the Company made investments aggregating \$6.3 million, as follows:

1. The Company invested EUR 4.9 million (approximately US\$5.8 million) in Telecom Partners Limited Partnership, a newly formed entity that will serve as a platform for investments in the telecommunication industry predominantly outside of Israel. Ampal holds 33.3% of TP which currently holds investments in two European telecom service providers: PSINet Europe B.V. (PSINet) and Grapes Communications N.V./S.A.
2. A loan of \$0.2 million to ShellCase, the principal business of which is the packaging process of semiconductor chips.
3. An investment of \$0.3 million in Fimi Opportunity Fund, L.P. (Fimi).

(e) In 2004, the Company made the following dispositions:

1. On February 19, 2004, Ampal sold its holdings in XACCT Technology Ltd. for \$3.8 million.

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2. During May 2004, the Company sold 49% of its holdings in PowerDSine Ltd. for approximately \$7.4 million.
 3. During the third quarter of 2004, PSInet, one of the holdings of Ampal's investee company, TP, sold all its assets to large telecommunications providers. Following the sale, a portion of the proceeds was distributed to TP, of which Ampal received \$7.1 million and recorded a gain of \$2.5 million in connection with this transaction. The remaining carrying value is \$1.2 million.
- (f) In 2004, the Company recorded loss from impairment of investments of \$38.8 million as follows:
1. MIRS Ltd. (\$30 million)*
 2. Star Management of Investment (\$1.6 million)
 3. Courses Investment in Technology Ltd. (\$0.3 million)
 4. VisionCare Ophthalmic Technologies (\$0.5 million investment)
 5. ShellCase Ltd. (\$3.8 million)
 6. Identify Solutons Ltd. (\$0.7 million)
 7. Xpert Integrated Systems Ltd. (\$1.7 million)
 8. Peptor Ltd. (\$0.2 million).

* Management determined that a reduction in the carrying value of MIRS by \$30 million is appropriate at the time due to the then existing relationship with Motorola.

- (g) In 2003, the Company made investments aggregating \$ 1.8 million, as follows:
1. An additional investment of \$0.9 million in ShellCase Ltd. The company holds an approximate 13.84% equity interest in ShellCase Ltd.
 2. An additional investment of \$0.3 million in Star Management of Investment No. II (2000) L.P., a venture capital fund which focuses on investment in communication, Internet, software and medical devices.
 3. An investment of \$0.2 million in Fimi Opportunity Fund, L.P.
 4. A loan of \$0.1 million to Shiron Ltd., a developer and manufacturer of two-way satellite communications products.
 5. A loan to Netformx Ltd. of \$0.2 million, a developer of network design tools.
 6. A loan to Bay Heart Ltd. of \$0.1 million, a shopping mall.
- (h) During 2003, the Company, which previously held a 20.4% interest in Granite, sold 9.9% of its holding for \$19.5 million. Consequently, the Company's investment in Granite, which was previously accounted for by the equity method, was accounted for as an investment in trading marketable securities. (The remaining holding in Granite was sold in 2004).

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(i) In 2003, the Company recorded loss from impairment of investments of \$13.1 million as follows:

1. XACCT Technologies Ltd. (XACCT) (\$9.0 million investment).
2. Carmel Container Ltd. (\$2.0 million).
3. Identify Solution Ltd. (\$1.3 million investment).
4. Cute Ltd. (\$0.2 million loan).
5. Real estate in Migdal Haemek (\$0.6 million).

Note 3 Investments in Marketable Securities

The Company classifies investments in marketable securities as trading securities or available-for-sale securities.

(a) Trading Securities

The cost and market values of Trading securities at December 31, 2005 and 2004 are as follows:

	Cost	Unrealized Gains	Market Value
(U.S. Dollars in thousands)			
2005	\$ 36,316	\$ 71	\$ 36,387
2004	\$ 43,353	\$ 2,012	\$ 45,365

(b) Available-For-Sale Securities

The cost and market values of available-for-sale securities consisting of marketable securities only at December 31, 2005 and 2004 are as follows:

	Cost	Unrealized Gains	Market Value
(U.S. Dollars in thousands)			
2005	\$ 1,855	\$ 333	\$ 2,188
2004	\$ 2,164	\$ 2,904	\$ 5,068

Note 4 Other Assets

The balance of Other Assets as of December 31, 2005 and 2004, is composed of the following items:

	As of December 31,	
	2005	2004
(U.S. Dollars in thousands)		
Deferred tax assets	\$ 15,681	\$ 23,023
Income receivables	480	14,987
Account receivable-trade	1,132	1,094
Deferred expenses	1,424	353
Leasehold improvements	2,595	2,931
Others	468	760
	\$ 21,780	\$ 43,148

Note 5 Notes and Loans Payable

Notes and loans payable consist primarily of bank borrowings either in U.S. dollars, linked to the Consumer Price Index in Israel or in unlinked Israel Shekels with interest rates varying depending upon their linkage provision and mature between 2006 and 2010.

The Company financed a portion of the \$9.8 million real estate acquisition by Am-Hal, a wholly-owned subsidiary of the Company, which develops and operates luxury retirement centers for senior citizens, through a revolving credit facility from Hapoalim, Phoenix Insurance Company and others. On December 1, 2005, a loan agreement creating the facility was signed between Am-Hal, Phoenix Insurance Company and others. Pursuant to the loan agreement, the lenders granted the Company a revolving credit facility in Israeli Shekels equal to \$12.5 million. The annual interest rate on the loan, which matures in 10 years, is 7.5%. The interest rate and the principal of the loan will be adjusted based on the changes in the Israeli Consumer Price Index. As of December 31, 2005 the Company had drawn \$2.5 million from the facility. As of December 31, 2005 and December 31, 2004 the amounts outstanding under these loans were \$13.5 million and \$7.7 million, respectively. The loans excluding the Phoenix loan, mature in up to one year and have interest rates range between 5.4% and 7.5%. The Company generally repays these loans with the proceeds received from deposits and other payments from the apartments in Am-Hal facilities. The loans are secured by a lien on Am-Hal's properties and bank accounts. The Company also issued guarantees in the amount of \$3.6 million in favor of tenants of Am-Hal in order to secure their deposits.

The Company also finances its general operations and other financial commitments through bank loans with Hapoalim. The long-term loans in the amount of \$31.3 million mature through 2006-2010.

Other long term borrowings in the amount of \$1.9 million are linked to the Israeli C.P.I and mature between 2006 and 2010, of which an amount of \$1.4 million bears no interest. The remaining \$0.5 million bears an annual interest of 5.7%.

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The weighted average interest rates on the balances of short-term borrowings at year-end are as follows: 6.0% on \$15.0 million and 3.5% on \$13.0 million in 2005 and 2004, respectively.

Payments due by period:

	(US. Dollars in thousands)				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-Term Debt	\$ 35,406	\$ 10,443	\$ 12,412	\$ 9,521	\$ 3,030
Short--Term Debt	\$ 14,960	\$ 14,960			

Note 6 Accounts payable accrued expenses and others

(a) Composition:

	As of December 31,	
	2005	2004
(U.S. Dollars in thousands)		
Deferred tax liabilities	\$ 3,310	\$ 15,886
Deferred income and accrued expenses	2,283	3,664
Excess of share in losses of affiliate over the investment	3,456	3,342
Related party	5,081	41
Deferred expenses from warrants*	1,300	--
Others	3,239	3,069
	<u>\$ 18,669</u>	<u>\$ 26,002</u>

* As part of the loan agreement between Am-Hal and Phoenix Insurance Company, the lender is granted a warrant to purchase 19.9% (on fully diluted basis) of the issued and paid capital of Am - Hal (the warrant). The warrant is exercisable during a period of 4 years and can be exercised for payment of \$5,960,000. The number of shares under the warrant is adjusted for stock splits or bonus shares, and also adjusted for any new issuances to third parties; in such case the lender's number of shares under the warrant will increase respectively, so as to provide the lender with 19.9% of the outstanding shares after the issuance to a third party. The exercise price for the additional shares (19.9% of the shares issued to the third party) will be equal the price paid by such third party. Also if there is a public offering in a price less than the exercise price of the warrant, the exercise price of the warrant will be adjusted to represent the price in the public offering discounted by 15%. The warrant can only be exercised for the full 19.9% there can be no partial exercise at any time. The value of the warrant was estimated at approximately \$1.3million and recorded as deferred expenses (Note 4). No amortization is recorded in the reported period, since it is immaterial.

(b) Accrued severance liabilities

Israeli labor laws and agreements require payment of severance pay upon dismissal of an employee or upon termination of employment in certain other circumstances. Ampal severance pay liability in Israel, which reflects the undiscounted amount of the liability as if it was payable at each balance sheet date, is calculated based upon length of service and the latest monthly salary (one month's salary for each year worked).

The Company's liability for severance pay pursuant to Israeli law is partly covered by insurance policies. The accrued severance pay liability of \$ 0.8 million, net of deposits made to insurance policies of \$ 0.5 million, is included in accounts payable, accrued expenses and other liabilities.

Severance pay net increase (decrease) was approximately (\$37,800), \$21,000, and \$134,000 in 2005, 2004, and 2003, respectively.

The Company expects that the payments relating to future benefits to its employees upon their retirement at normal retirement age in the next 10 years will be immaterial. These payments are determined based on recent salary rates and do not include amounts that might be paid to employees that will cease working with the Company, before their normal retirement age or amount paid to employees that their normal retirement age extends beyond the year 2015.

Note 7 Shareholders Equity

Capital Stock

The 4% and 6-1/2% preferred shares are convertible into five and three shares of Class A Stock, respectively. At December 31, 2005, a total of 2,375,500 shares of Class A Stock are reserved for issuance upon the conversion of the Preferred Stock and the exercise of 2,024,500 options.

The 4% and 6-1/2% Preferred Stock are preferred as to dividends on a cumulative basis. Additional dividends out of available retained earnings, if declared, are payable on an annual non-cumulative basis as a percentage of par value as follows:

- (i) up to 4% on Class A Stock, then
- (ii) on 4% Preferred Stock and Class A Stock ratably.

Preferred shares are non-voting, unless dividends are in arrears for three successive years. At December 31, 2005, there are no dividends in arrears.

Note 8 Stock Options

In March 1998, the Board approved a Long-Term Incentive Plan (1998 Plan) permitting the granting of options to all employees, officers, directors and consultants of the Company and its subsidiaries to purchase up to an aggregate of 400,000 shares of Class A Stock. The 1998 plan was approved by the majority of the Company's shareholders at the June 19, 1998, annual meeting of shareholders. The plan remains in effect for a period of ten years. As of December 31, 2005, 30,000 options of the 1998 Plan are fully vested and outstanding.

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On February 15, 2000, the Stock Option Committee approved a new Incentive Plan (2000 Plan), under which the Company has reserved 4 million shares of Class A Stock, permitting the granting of options to all employees, officers and directors. The 2000 Plan was approved by the Board of Directors of Ampal (the Board) at the meeting held on March 27, 2000 and was approved by a majority of the Company's shareholders at the June 29, 2000 annual meeting of shareholders. The plan remains in effect for a period of ten years. As of December 31, 2005, 1,994,500 options under the 2000 Plan are outstanding.

The options granted under the 1998 Plan and the 2000 Plan (collectively, the Plans) may be either incentive stock options, at an exercise price to be determined by the Stock Option Compensation Committee (the Committee) but not less than 100% of the fair market value of the underlying options on the date of grant, or non-incentive stock options, at an exercise price to be determined by the Committee. The Committee may also grant, at its discretion, restricted stock, dividend equivalent awards, which entitle the recipient to receive dividends in the form of Class A Stock, cash or a combination of both and stock appreciation rights, which permit the recipient to receive an amount in the form of Class A Stock, cash or a combination of both, equal to the number of shares of Class A Stock with respect to which the rights are exercised multiplied by the excess of the fair market value of the Class A Stock on the exercise date over the exercise price. The options granted under the plans were granted either at market value or above.

Under each of the Plans, all granted but unvested options become immediately exercisable upon the occurrence of a change in control of the Company. On April 25, 2002, the controlling shareholder of the Company, Rebar Financial Corp. sold all of its stock in the Company to Y.M. Noy Investments Ltd., accordingly, the 329,000 outstanding options granted under the Plans were immediately exercisable.

As of December 31, 2005, 2,375,500 options under both Plans are available for future grant.

Transactions under both Plans were as follows:

The options granted under the plans vest in equal installment every three months, except that a portion of the options may vest on an accelerate basis upon the achievement of certain performance criteria.

	Fiscal Year Ended December 31, 2005	
Options	Weighted Average Exercise Price	
(In thousands, except per share data)		
Outstanding at beginning of year	2,064	\$ 3.39
Granted at market price	135	\$ 3.69
Forfeited/Expired	(175)	\$ 3.85
Outstanding at end of year	2,024	\$ 3.37
Exercisable at end of year	1,044	\$ 3.29
Weighted average grant date fair value of options granted		\$ 1.68
Weighted average remaining contractual life		7.72

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	Fiscal Year Ended December 31, 2004	
Options	Weighted Average Exercise Price	
(In thousands, except per share data)		
Outstanding at beginning of year	1,396	\$ 3.46
Granted at market price	886	\$ 3.49
Forfeited/Expired	(218)	\$ 4.22
Outstanding at end of year	<u>2,064</u>	<u>\$ 3.39</u>
Exercisable at end of year	<u>678</u>	<u>\$ 3.43</u>
Weighted average grant date fair value of options granted		<u>\$ 1.89</u>
Weighted average remaining contractual life		<u>8.40</u>

	Fiscal Year Ended December 31, 2003	
Options	Weighted Average Exercise Price	
(In thousands, except per share data)		
Outstanding at beginning of year	2,852	\$ 14.77
Granted at market price	58	\$ 3.69
Forfeited/Expired	(1,514)	\$ 24.78
Outstanding at end of year	<u>1,396</u>	<u>\$ 3.46</u>
Exercisable at end of year	<u>500</u>	<u>\$ 3.83</u>
Weighted average grant date fair value of options granted		<u>\$ 2.13</u>
Weighted average remaining contractual life		<u>8.20</u>

Note 9 Earnings (Loss) Per Class A Share

A reconciliation between the basic and diluted EPS computations for net earnings is as follows:

	Fiscal Year Ended December 31, 2005		
	(Loss)	Shares	Per Share Amounts
	(In thousands, except per share data)		
Basic and diluted EPS ⁽²⁾			
Net (loss) attributable to Class A Stock	\$ (6,149) ⁽¹⁾	19,967	\$ (0.31)
	_____	_____	_____
	Fiscal Year Ended December 31, 2004		
	(Loss)	Shares	Per Share Amounts
	(In thousands, except per share data)		
Basic and diluted EPS ⁽²⁾			
Net (loss) attributable to Class A Stock	\$ (18,585) ⁽¹⁾	19,841	\$ (0.94)
	_____	_____	_____
	Fiscal Year Ended December 31, 2003		
	Income	Shares	Per Share Amounts
	(In thousands, except per share data)		
Basic EPS:			
Net income attributable to Class A Stock	\$ 8,355 ⁽¹⁾⁽³⁾	19,713	\$ 0.42
	_____	_____	_____
Diluted EPS:			
Net income attributable to Class A Stock	\$ 8,847	22,120	\$ 0.40
	_____	_____	_____

(1) After deduction of Preferred Stock dividends (in thousands) of \$191, \$200 and \$213 in 2005, 2004 and 2003, respectively.

(2) Options to purchase 2,024,500 and 2,064,500 shares of common stock were outstanding as of December 31, 2005 and 2004, respectively, and they were not included in the computation of diluted EPS because of their anti-dilutive effect.

(3) After allocation of net income to the participating 4% Cumulative Convertible Preferred Stock.

Note 10 **Income Taxes**

	Fiscal Year Ended December 31,		
	2005	2004	2003
(U.S. Dollars in thousands)			
The components of current and deferred income tax expense (benefit) are:			
Current:			
Federal	\$ -	\$ -	\$ 275
Foreign	-	1,472	13
Deferred:			
State and local	3	-	-
Federal	(2,955)	(20,404)	5,202
Foreign	103	8,734	(5,056)
Total	\$ (2,849)	\$ (10,198)	\$ 434

The domestic and foreign components of income (loss) before income taxes are:

Domestic	\$ (14,046)	\$ (29,286)	\$ 2,316
Foreign	772	(3,427)	8,905
Total	\$ (13,274)	\$ (32,713)	\$ 11,221

A reconciliation of income taxes between the statutory and effective tax is as follows:

Federal income tax (benefit) at 34%	\$ (4,513)	\$ (11,123)	\$ 3,815
Taxes on foreign loss below U.S. rate	(12,796)	(806)	(3,817)
Changes in valuation allowance	14,639	2,304	281
Other	(179)	(573)	155
Total effective tax: 22%, 31%, and 4%	\$ (2,849)	\$ (10,198)	\$ 434

	As of December 31,	
	2005	2004
Deferred tax assets:		
The components of deferred tax assets and liabilities are as follows:		
Net operating loss and capital loss carryforwards	\$ 35,925	\$ 25,439
Unrealized losses on investments	1,132	4,321
Foreign tax credits carryforwards	5,456	5,456
Total deferred assets	42,513	35,216
Valuation allowance	(26,832)	(12,193)

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	As of December 31,	
	_____	_____
Net deferred tax assets	15,681	23,023
Deferred tax liabilities:		
Tax on equity in earnings of affiliates	2,470	3,356
Cost basis of investment greater than tax bases	-	10,877
Other	840	1,653
Total deferred tax liability	3,310	15,886
Net deferred tax assets	\$ 12,371	\$ 7,137

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As of December 31, 2005, valuation allowance is provided against tax benefits on foreign net operating loss carryforwards of \$26.8 million.

As of December 31, 2005, the Company has foreign tax credits of \$5.5 million that will expire in the years 2009 through 2014.

As of December 31, 2005, the Company has U.S. Federal net operating loss carryforwards of approximately \$29.5 million that will expire in the years 2021 through 2024. The utilization of net operating loss carryforwards may be subject to substantial annual limitations if there has been a significant change in ownership. Such a change in ownership, as described in Section 382 of the Internal Revenue Code, may substantially limit the Company's utilization of the net operating loss carryforwards.

Note 11 Investments in Affiliates

The companies accounted for by the equity method and the Company's share of equity in those investees are:

	As of December 31,	
	2005	2004
	%	%
Bay Heart Limited	37	37
Carmel Containers Systems Limited	21.8	21.8
Coral World International Limited	50	50
CUTe Ltd.	--	20
Epsilon Investment House Ltd.	--	20
Hod Hasharon Sport Center (1992) Limited Partnership	50	50
Ophir Holdings	42.5	42.5
Ophirtech Ltd.	--	42.5
Renaissance Investment Company Ltd.	--	20
Trinet Investment in High-Tech Ltd.	37.5	37.5
Trinet Venture Capital Ltd.	50	50

Combined summarized financial information for the above companies is as follows:

	Fiscal Year Ended December 31,		
	2005	2004	2003
	(U.S. Dollars in thousands)		
Revenues	\$ 140,197	\$ 129,091	\$ 119,323
Gross profit	30,918	22,200	22,201
Net income	15,803	8,184	9,858

	As of December 31,	
	2005	2004
	(U.S. Dollars in thousands)	
Property and equipment	\$ 65,931	\$ 80,927
Other assets	134,700	173,579

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	As of December 31,	
	<u> </u>	<u> </u>
Total assets	\$ 200,631	\$ 254,506
	<u> </u>	<u> </u>
Total liabilities, including bank borrowings	\$ 143,217	\$ 162,430
	<u> </u>	<u> </u>

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Note 12 Other Income.

Other revenues for each of the years ended December 31, 2005, and 2004 include accrual of guaranteed dividend payments from Motorola relating to the investment in MIRS of \$ 7.1 million and \$2.2 million from member subscription in the Country Club for 2005 (2004 \$2.2 million).

Note 13 Operating Segments Information

SFAS 131 Disclosure about Segments of an Enterprise and Related Information establishes annual and interim reporting standards for an enterprise's operating segments and related disclosures about its products, services, geographic areas and major customers. Segment information presented below results primarily from operations in Israel.

	Fiscal Year Ended December 31,		
	2005	2004	2003
	(U.S. Dollars in thousands)		
Revenues:			
Finance	\$ 12,475	\$ 16,379	\$ 38,368
Real estate income	9,244	8,897	8,958
Leisure-time	2,208	2,233	2,037
Intercompany adjustments	(63)	(76)	(75)
	<u>23,864</u>	<u>27,433</u>	<u>49,288</u>
Equity in earning of affiliates	6,666	4,031	2,526
	<u>30,530</u>	<u>31,464</u>	<u>51,814</u>
Total	\$ 30,530	\$ 31,464	\$ 51,814
Equity in Earnings (losses) of Affiliates:			
Finance	\$ 106	\$ 1,523	\$ 358
Real estate rental	5,448	590	2,813
Leisure-time	1,112	1,122	967
Others	--	796	(1,612)
	<u>6,666</u>	<u>4,031</u>	<u>2,526</u>
Total	\$ 6,666	\$ 4,031	\$ 2,526
Interest Income:			
Finance	\$ 1,586	\$ 613	\$ 538
Intercompany adjustments	(19)	(23)	(30)
	<u>1,567</u>	<u>590</u>	<u>508</u>
Total	\$ 1,567	\$ 590	\$ 508
Interest Expense:			
Finance	\$ 4,278	\$ 4,246	\$ 4,875
Real estate rental	836	540	605
Leisure-time	162	117	82
Intercompany adjustments	(19)	(23)	(31)
	<u>5,257</u>	<u>4,880</u>	<u>5,531</u>
Total	\$ 5,257	\$ 4,880	\$ 5,531

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Fiscal Year Ended December 31,

Pretax Operating (Loss) Income:			
Finance	\$ (20,472)	\$ (36,192)	\$ 9,765
Real estate rental	287	(963)	(1,299)
Leisure-time	245	411	229
	<u>(19,940)</u>	<u>(36,744)</u>	<u>8,695</u>
Equity in earning of affiliates	6,666	4,031	2,526
	<u>6,666</u>	<u>4,031</u>	<u>2,526</u>
Total	\$ (13,274)	\$ (32,713)	\$ 11,221
	<u>(13,274)</u>	<u>(32,713)</u>	<u>11,221</u>
Income (Benefit) Tax Expense:			
Finance	\$ (2,970)	\$ (10,558)	\$ 422
Real estate rental	63	334	--
Leisure-time	58	26	12
	<u>58</u>	<u>26</u>	<u>12</u>
Total	\$ (2,849)	\$ (10,198)	\$ 434
	<u>(2,849)</u>	<u>(10,198)</u>	<u>434</u>
Net Income:			
Finance	\$ (17,396)	\$ (24,111)	\$ 9,701
Real estate rental	5,672	(707)	1,514
Leisure-time	1,299	1,507	1,184
Others	--	796	(1,612)
	<u>(10,425)</u>	<u>(22,515)</u>	<u>10,787</u>
Minority interest, net	(4,467)	(4,130)	1,940
	<u>(4,467)</u>	<u>(4,130)</u>	<u>1,940</u>
Total	\$ (5,958)	\$ (18,385)	\$ 8,847
	<u>(5,958)</u>	<u>(18,385)</u>	<u>8,847</u>
Total Assets for year end:			
Finance	\$ 118,458	\$ 225,577	\$ 274,948
Real estate rental	76,117	64,128	67,577
Leisure-time	17,568	17,426	16,100
Intercompany adjustments	(1,239)	(2,184)	(4,258)
	<u>210,904</u>	<u>304,947</u>	<u>354,367</u>
Total	\$ 210,904	\$ 304,947	\$ 354,367
	<u>210,904</u>	<u>304,947</u>	<u>354,367</u>
Investments in Affiliates for year end:			
Finance	\$ 8,360	\$ 3,389	\$ 3,499
Real estate rental	(3,456)	10,987	8,662
Leisure-time	15,066	14,479	13,395
	<u>19,970</u>	<u>28,855</u>	<u>25,556</u>
Total	\$ 19,970	\$ 28,855	\$ 25,556
	<u>19,970</u>	<u>28,855</u>	<u>25,556</u>
Capital Expenditures:			
Finance	\$ --	\$ 5	\$ 246
Real estate rental	9,794	774	425
Leisure-time	90	296	152
	<u>9,884</u>	<u>1,075</u>	<u>823</u>
Total	\$ 9,884	\$ 1,075	\$ 823
	<u>9,884</u>	<u>1,075</u>	<u>823</u>

Fiscal Year Ended December 31,

Depreciation, Amortization and Impairment:			
Finance	\$ 14,039	\$ 38,984	\$ 13,723
Real estate rental	(160)	(111)	(117)
Leisure-time	207	162	134
Total	\$ 14,086	\$ 39,035	\$ 13,740

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Corporate office expense is principally applicable to the financing operation and has been charged to that segment above. Revenues and pretax operating (loss) income above exclude equity in (losses) earnings of affiliates.

The real estate rental segment consists of rental property owned in Israel and the United States leased to unrelated parties, and operations of Am-Hal Ltd., a wholly-owned subsidiary which owns and operates a chain of senior citizens facilities located in Israel.

The leisure-time segment consists of Coral World International Limited (marine parks located around the world) and Country Club Hod Hasharon Sport Center and Kfar Saba, the Company's 51%-owned subsidiary located in Israel.

Note 14 Disclosures about Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

(a) Cash and Cash Equivalents

For cash and cash equivalents, the carrying amount is a reasonable estimate of fair value (see Note 1(k)).

(b) Deposits, Notes and Loans Receivable

The fair value of these deposits, notes and loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

(c) Investments

For financial instruments with maturities between 91 days and 1 year, and all marketable securities, the carrying amount is a reasonable estimate of fair value.

(d) Financial Instruments

The fair value of the financial instruments included in other assets, accounts payable, and accrued expenses presented at a fair value.

(e) Commitments

Due to the relatively short term of commitments discussed in Note 15, the contract value is considered to be at fair value.

(f) Financial Assets and Financial Liabilities

The fair value of notes and loans payable, deposits payable and debentures outstanding is estimated by discounting the future cash flows using the current rates offered by lenders for similar borrowings with similar credit ratings and for the same remaining maturities.

	As of December 31,			
	2005		2004	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
(U.S. Dollars in thousands)				
Financial assets:				
Cash and cash equivalents	\$ 24,314	\$ 24,314	\$ 17,618	\$ 17,618
Deposits, notes and loans receivable	343	343	3,534	3,525
Investments	38,575	38,575	50,433	50,433
	<u>\$ 63,232</u>	<u>\$ 63,232</u>	<u>\$ 71,585</u>	<u>\$ 71,576</u>

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As of December 31,

Financial liabilities:

Notes and loans payable	\$ 50,366	\$ 50,362	\$ 118,760	\$ 117,743
Debentures outstanding	-	-	2,036	2,036
	\$ 50,366	\$ 50,362	\$ 120,796	\$ 119,779

Note 15 **Commitments and Contingencies**

- (a) The combined minimum annual lease payments on Ampal's corporate office and its subsidiary Country Club Kfar Saba Ltd. in 2005 were \$ 0.3 million. The lease of the corporate offices expires in 2009 and the Kfar Saba lease expires in 2038. In the years 2006-2010, the combined annual lease payments on those premises will be in an aggregate amount of \$ 1.4 million, and thereafter, an amount totaling \$4.9 million.
- (b) AM-Hal provided a lien to Bank Hapoalim on AM-Hal properties in Rishon Le Zion and Hod Hasharon to guarantee a loan of \$10.4 million.
- (c) The Company has issued guarantees on bank loans to its investees and subsidiaries totaling \$10.3 million as follows:
 - (1) The Company provided a \$3.6 million guarantee to AM Hal tenants.
 - (2) The Company provided a \$5.8 million guarantee on indebtedness incurred by Bay Heart.
 - (3) The Company provided a \$0.9 million guarantee to Galha (1960) Ltd, for the payment of the Company's subsidiary of a final judgment, if entered against the Company's subsidiary. (See below)
- (d) The Company made a commitment to invest \$2.8 million in Star II (2000 L.P.).
- (e) Legal Proceedings:

Ampal Communications L.P.

1. On May 10, 2004, Ampal Communications L.P., a limited partnership controlled by Ampal and in which Ampal holds a 75% equity interest, filed a claim in the Tel-Aviv District Court against Motorola Communications Israel Ltd., Motorola Israel Ltd., Elisha Yanai, Peter Brum, Rami Guzman, Nathan Gidron, Shimon Tal and MIRS Communications Ltd. (collectively, the Defendants), for injunctive and declaratory relief as described below. The claim is in connection with the exploitation by the defendants of Ampal Communications' minority rights by virtue of its 33% holding in MIRS Communications Ltd.

Ampal Communications L.P. requested the Court to issue relief as follows:

- A. Declaring that the business of MIRS Communications Ltd. is conducted in such a way as to be prejudicial to the rights of Ampal Communications L.P. as a minority share holder;
- B. Appointing an appraiser to conduct a valuation of MIRS Communications Ltd. and Ampal Communications L.P.'s holdings therein, which will encompass a review of the way MIRS Communications Ltd. conducts its business, including a review of the related party transactions between MIRS Communications Ltd. and Motorola Israel Ltd. and/or any other of the Defendants;
- C. Instructing each of the Defendants to acquire and purchase from Ampal Communications L.P. the shares it holds in MIRS Communications Ltd. at the highest of the following prices:
 - (1) based on a company valuation of MIRS Communications Ltd. as presented to Ampal Communications L.P. by Motorola prior to the signing of the Share Purchase Agreement for MIRS Communications Ltd.; or

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- (2) based on the amount paid by Ampal Communications L.P. for its share holding in MIRS Communications Ltd. plus linkage to the Israeli consumer index and interest; or
 - (3) based on the company valuation that will be determined by the valuation specified in Section B above, excluding any material negative effect brought about by the Defendants' omissions and/or negligence in their management of MIRS Communications Ltd., all as may be assessed and computed by the appraiser specified in Section B above;
- D. Determining that each of the individual Defendants, as officers in MIRS Communications Ltd., has violated his respective fiduciary obligations towards Ampal Communications L.P. as a minority shareholder in MIRS Communications Ltd.; and
- E. Declaring that the Share Purchase Agreement pursuant to which Ampal Communications L.P. acquired its shareholding in MIRS Communications Ltd. and the Shareholders Agreement in respect thereof, are void.
2. On May 24, 2004 and on May 31, 2004 the Defendants requested the district court to strike out the claim in limine, on the grounds that Ampal had allegedly not paid sufficient fees when filing the claim, and further requested an extension of the time for filing statements of defense until after the district court had reached a decision regarding the request to strike out the claim. Ampal and the Defendants filed various responses and on June 30, 2004, the district court requested the Attorney General to furnish an opinion regarding the Defendants' request before issuing its own decision. On October 11, 2004 the Attorney General furnished its opinion that supported the Defendants' request that Ampal should pay the fees calculated on the basis of the value of the requested remedies in the claim.

On November 10, 2004 Ampal filed its response. The Court also decided that the statements of defense should be filed 10 days after it issues its decision regarding the striking out of the claim.

3. On March 1, 2005, Ampal requested the district court to enter judgment against Peter Brum on the grounds that he failed to file a defense to the Company's claim. On March 15, 2005, the district court granted Ampal's request and entered judgment against Peter Brum. On March 17, 2005, the district court ordered Mr. Brum to acquire and purchase from Ampal the shares it holds in MIRS for a total company valuation of \$ 765,998,000, which is the highest of the prices set forth in the complaint. The litigation with regard to the other defendants is ongoing. Peter Brum, Motorola and MIRS have appealed the district court's judgment on numerous grounds. Ampal has filed responses to the appeal.
4. On August 30, 2005, the Company, through Ampal Communications L.P. entered into a Stock Purchase and Indemnification Agreement, dated as of August 30, 2005, by and among Motorola Israel Ltd., Ampal Communications L.P. and MIRS (the Agreement) to sell Motorola Israel Ltd. all of its holdings of MIRS. In connection with the closing of the transactions contemplated by this Agreement the existing lawsuit among the parties and other relating to MIRS was dismissed.
5. On October 3, 2005 the Company, through Ampal Communications L.P., completed the sale to Motorola Israel Ltd. of all of its holdings of MIRS pursuant to the Agreement. In connection with the sale of its holdings of MIRS, Ampal Communications L.P. received approximately US \$89 million of total proceeds, composed of \$67.7 million for the purchase price and an additional \$ 21.3 million related to guaranteed dividend payments. Approximately \$ 74.0 million of the proceeds was used to repay all outstanding debt to banks incurred in connection with making the MIRS investment, and the Company received US\$ 15.0 million (\$11.0 million after the deduction of minority interest) of net proceeds from the sale.

Galha

On January 1, 2002, Galha (1960) Ltd. (Galha) filed a suit against the Company and other parties, including directors of Paradise Industries Ltd. (Paradise) appointed by the Company, in the Tel Aviv District Court, in the amount of NIS 10,249,609 (\$2.2 million). Galha claimed that the Company, which was a shareholder of Paradise, and another shareholder of Paradise, misused funds that were received by Paradise from an insurance company for the purpose of reconstructing an industrial building owned by Galha and used by Paradise which burnt down. Paradise is currently involved in liquidation proceedings. Ampal issued a guarantee in favor of Galha for the payment of an amount of up to NIS 4,022,085 (\$873,800) if a final judgment against the Company will be given.

On May 26, 2003 the Company and the directors of Paradise appointed by the Company filed a third party claim against Arieh Israeli Insurance Company Ltd., in the Tel Aviv District Court, claiming that, to the extent the court decides that the directors of Paradise appointed by the Company will have to pay any amounts to Galha, Arieh will pay such amounts on behalf of the directors in accordance with the Directors and Officers insurance policy that the Company had at that time with Arieh. Arieh filed a statement of defense and stated that the policy does not cover the claim. At this stage, the Company cannot estimate the impact this claim will have on it.

Note 16 Subsequent Events

None

Note 17 Quarterly Financial Information (Unaudited)

The table below provides the results of comprehensive income (loss) including the sale of available for sale securities. In the previously filed quarterly reports, the item Sale of available for sale securities was not included in the Statement of Comprehensive Income (Loss). The table below reflects the corrected comprehensive income (loss) figures.

Consolidated Statements of Comprehensive Income (loss) is presented for the following periods in 2005:

	Three Months ended March 31, 2005		Six Months Ended June 30, 2005		Nine Months Ended September 30, 2005	
	Previously reported	Restated	Previously reported	Restated	Previously reported	Restated
(U.S. Dollars in thousands)						
Net income (loss)	\$ 6,728	\$ 6,728	\$ 4,217	\$ 4,217	\$ (6,413)	\$ (6,413)
Other comprehensive (loss) income, net of tax:						
Foreign currency translation adjustment	(179)	(179)	(1,383)	(1,383)	408	408
Unrealized gain (loss) on securities	(733)	(733)	(780)	(780)	(573)	(573)
Sale of available for sale securities	-	(4,166)	-	(4,166)	-	(4,166)
Other comprehensive (loss) income	(912)	(5,078)	(2,163)	(6,329)	(165)	(4,331)
Comprehensive income (loss)	\$ 5,816	\$ 1,650	\$ 2,054	\$ (2,112)	\$ (6,578)	\$ (10,744)

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company's management with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective. Notwithstanding the foregoing, a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in the Company's periodic reports.

Internal Control Over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the Company's fourth fiscal quarter that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

MANAGEMENT

The following table sets forth certain information regarding Ampal's directors and executive officers as of March 6, 2006:

Name	Position
Yosef A. Maiman	Chairman of the Board of Directors and Director
Jack Bigio ⁽¹⁾	President, Chief Executive Officer and Director
Leo Malamud ⁽¹⁾	Director
Dr. Joseph Yerushalmi ⁽¹⁾	Director
Yehuda Karni ^{(1) (2) (3)(4)}	Director
Eitan Haber ^{(2) (3)(4)}	Director
Menahem Morag ^{(2) (3)(4)}	Director
Irit Eluz	CFO, Senior Vice President - Finance and Treasurer
Yoram Firon	Vice President-Investments and Corporate Affairs and Secretary
Amit Mantsur	Vice President-Investments
Giora Bar-Nir	Vice President - Accounting and Controller

The numbers listed below, which follow the names of some of the foregoing directors, designate committee membership:

- (1) Member of the Executive Committee of the Board which meets as necessary between regularly scheduled Board meetings and, consistent with certain statutory limitations, exercises all the authority of the Board.
- (2) Member of the Audit Committee of the Board which reviews functions of the outside auditors, auditors' fees and related matters. Mr. Karni is the Chairman of the Audit Committee of the Board.
- (3) Member of the Stock Option and Compensation Committee of the Board.
- (4) Member of the Special Committee of the Board.

In 2005, the Board met seven times and acted 4 times by written consent; the Executive Committee met two times and did not act by written consent; the Audit Committee met five times and did not act by written consent. The Stock Option and Compensation Committee met one time and did not act by written consent. The Special Committee met two times and did not act by written consent. All directors attended more than 75% of the aggregate of (1) the total number of Board meetings held during the period in 2005 for which such individual was a director and (2) the total number of meetings held by all committees of the Board on which such individual served in 2005 (during the period of such service). Each director of the Board is elected for a one year term and serves until his or her successor is duly elected and qualified.

The following sets forth the ages of all of the above-mentioned directors and executive officers, all positions and offices with Ampal or its subsidiaries held by each director and officer and principal occupations during the last five years.

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YOSEF A. MAIMAN, 60, has been the Chairman of the Board of Ampal since April 25, 2002. Mr. Maiman has been President and Chief Executive Officer of Merhav M.N.F. Ltd. (Merhav), one of the largest international project development companies based in Israel, since its founding in 1975. Mr. Maiman is also the Chairman of the Board of Directors of Channel Ten, a commercial television station in Israel, a director of Eltek, Ltd. (Eltek), a developer and manufacturer of printed circuit boards, a member of the Board of Directors of the Middle East Task Force of the New York Council on Foreign Relations and Honorary Consul to Israel from Peru. Mr. Maiman is also member of the Board of Trustees of the Tel Aviv University, Chairman of the Israeli Board of the Jaffee Center for Strategic Studies at Tel Aviv University, a member of the Board of Governors of Ben Gurion University, and the Chairman of the Board of Trustees of the International Policy Institute for Counter Terrorism.

JACK BIGIO, 40 has been the President and Chief Executive Officer of Ampal since April 25, 2002, and a director of Ampal since March 6, 2002. From 1996 until April 2002, Mr. Bigio served as Senior Vice President Operations and Finance of Merhav. Mr. Bigio is also a director of Eltek, a member of the Board of Israel-America Chamber of Commerce & Industry and a member of Young Presidents Organization.

LEO MALAMUD, 54, has been a director of Ampal since March 6, 2002. Since 1995, Mr. Malamud is Senior Vice President of Merhav. Mr. Malamud is also a director of Eltek.

Dr. JOSEPH YERUSHALMI, 68, has been Senior Vice President Head of Energy and Infrastructure Projects of Merhav since 1995. He has been a director of Ampal since August 16, 2002.

YEHUDA KARNI, 77, was a senior partner in the law firm of Firon Karni Sarov & Firon, from 1961 until his retirement in 2000. He has been a director of Ampal since August 16, 2002.

EITAN HABER, 66, was the Head of Bureau for the former Prime Minister of Israel, Yitzhak Rabin, from July 1992 until November 1995. Since 1996, Mr. Haber has been the President and Chief Executive Officer of Geopol Ltd., which represents the Korean conglomerate Samsung Aircraft and Industries in Israel and the Middle East; Kavim Ltd., a production and project development company; Mr. Haber is a member in the Board of Directors of Africa Israel Ltd. Mr. Haber is also a member of various non-profit organizations. He has been a director of Ampal since August 16, 2002.

MENAHEM MORAG, 55, has been a director of Ampal since January 27, 2004. From 1996 to 1999 Mr. Morag was the Head of Finance and Budget at the Israeli Prime Minister's office in Tel Aviv. From 1999 to 2001, Mr. Morag was the Controller and Ombudsman at the Israeli Prime Minister's office in Tel Aviv. From 2001 to 2003, Mr. Morag was the Head of Human Resources Department at the Israeli Prime Minister's office in Tel Aviv. Since, 2003, Mr. Morag has been the Head of the Council of the Pensioners Association of the Israeli Prime Minister's office in Tel Aviv, director in Palram Industries since 2004 and since 2005 he is the CEO of Keren-Shemesh Foundation for the Encouragement of Young Entrepreneurs.

IRIT ELUZ, 39, has been the Chief Financial Officer and Senior Vice President Finance and Treasurer since October 2004. From May 2002 through October 2004 Ms. Eluz was Chief Financial Officer and Vice President Finance and Treasurer. From January 2000 through April 2002, Ms. Eluz was the Associate Chief Financial Officer of Merhav. From June 1995 through December 1999, Ms. Eluz was the Chief Financial Officer of Kamor Group.

YORAM FIRON, 37, has been Secretary and Vice President Investments and Corporate Affairs since May 2002. During the preceding five years, Mr. Firon was a Vice President of Merhav and a partner in the law firm of Firon Karni Sarov & Firon.

AMIT MANTSUR, 36, has been Vice President Investments since March 2003. From September 2000 through December 2002, Mr. Mantsur served at Alrov Group as Strategy & Business Development Manager. From February 1997 through September 2000, Mr. Mantsur was a projects manager at the Financial Advisory Services of KPMG Somekh Chaikin.

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GIORA BAR-NIR, 49, has been Vice-President Accounting and Controller Since October 2004. From March 2002 through October 2004 Mr. Bar-Nir has been the Controller. During the preceding five years, Mr. Bar-Nir was the Controller of the Israeli subsidiaries of Ampal.

AUDIT COMMITTEE

The Company has an Audit Committee of the Board consisting of Messrs. Karni, Haber and Morag, each of whom is an independent director as defined under the rules of the National Association of Securities Dealers, Inc. and the rules promulgated by the Securities and Exchange Commission. The Board has determined that Mr. Morag is an audit committee financial expert for purposes of the rules promulgated by the Securities and Exchange Commission.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires Ampal's executive officers and directors, and persons who own more than 10% of a registered class of Ampal's equity securities, to file with the Securities and Exchange Commission initial statements of beneficial ownership (Form 3), and statements of changes in beneficial ownership (Forms 4 and 5), of Class A Stock of Ampal. To the Company's knowledge, based solely on its review of the copies of such forms received by it, all filing requirements applicable to its executive officers, directors and greater than 10-percent stockholders were complied with.

CODE OF ETHICS

The Company has adopted a code of ethics (as defined in the rules promulgated under the Securities Exchange Act of 1934) that applies to the Company's principal executive officer, principal financial officer, principal accounting officer, or person performing similar functions. A copy of the Company's code of ethics is available on the Company's website at www.ampal.com (the Company's Website).

CODE OF CONDUCT

The Company has adopted a code of conduct that applies to all of the Company's employees, directors and officers. A copy of the code of conduct is available on the Company's Website.

ITEM 11. EXECUTIVE COMPENSATION

Summary Compensation Table

The table below presents information regarding remuneration paid for services to Ampal and its subsidiaries by the executive officers named below during the three fiscal years ended December 31, 2005, 2004 and 2003.

Name and Principal Position	Year	Salaries	Bonus	Other Annual Compensation ⁽⁹⁾	Long-Term Compensation Number of Securities Underlying Options ⁽¹⁰⁾	All Other Compensation (U.S. Dollars) ⁽¹¹⁾
		(U . S . D o l l a r s)				
Yosef A. Maiman ⁽¹⁾⁽¹²⁾ Chairman of the Board	2005	581,613	310,208	299	-	7,282
	2004	606,409	364,604	6,091	-	2,143
	2003	506,849	155,953	25,570	-	2,002
Jack Bigio ⁽²⁾⁽¹²⁾ President and CEO	2005	443,176	208,484	40,257	-	111,235
	2004	420,064	252,564	54,943	280,000	102,131
	2003	257,547	106,189	71,777	-	88,389
Irit Eluz ⁽³⁾⁽¹²⁾ CFO - SVP Finance & Treasurer	2005	242,757	423,599	25,525	-	57,374
	2004	219,980	132,332	32,732	280,000	49,349
	2003	183,959	55,698	39,631	-	42,000
Yoram Firon ⁽⁴⁾⁽¹²⁾ Secretary, Vice President and Corporate Affairs	2005	185,345	107,767	25,771	-	45,346
	2004	159,500	48,674	26,491	190,000	35,086
	2003	133,138	14,063	30,261	-	29,756
Amit Mantsur ⁽⁵⁾ Vice President - Investments	2005	129,915	43,308	13,187	-	32,911
	2004	120,706	51,068	11,491	15,000	31,130
	2003	108,853	-	12,097	58,000	28,335
Shlomo Shalev ⁽⁶⁾⁽⁷⁾⁽⁸⁾ Senior Vice President investment	2005	180,385	96,688	18,930	-	300,601
	2004	188,105	61,145	24,617	30,000	46,803
	2003	167,093	34,254	33,048	-	41,712

(1) Mr. Maiman has been employed by Ampal since April 25, 2002 as Chairman of the Board.

(2) Mr. Bigio has been employed by Ampal since April 25, 2002 as President and CEO.

(3) Ms. Eluz has been employed by Ampal since April 25, 2002.

(4) Mr Firon has been employed by Ampal since April 25, 2002.

(5) Mr. Mantsur has been employed by Ampal since February 2, 2003.

(6) Mr. Shalev served as Senior Vice President Investment from May 21, 2002 until November 30, 2005.

(7) Mr. Shalev retired on November 30, 2005, the amounts include final account settlement.

(8) Mr. Shalev exercised 73,125 options on December 7, 2005.

(9) Consists of amounts reimbursed for the payment of taxes.

(10) Represents the number of shares of Class A Stock underlying options granted to the named executive officers.

(11) Comprised of Ampal (Israel s) contribution pursuant to : (i) Ampal (Israel s) Pension Plan and (ii) Ampal (Israel s) education fund and (iii) use of car and (iv) use of mobile (v) final account settlement.

(12) Eligible to receive an additional payment of up to six months salary (i) in the event of a change of control of the Company and (ii) such executive officer s employment is terminated within six months from the date of the change of control of the Company.

Fiscal Year-End Option Values

	Number of Securities Underlying Unexercised Options at Fiscal Year End 2005		Unrealized Value of In-the-Money Options (U.S. Dollars)	
	Exercisable	Unexercisable	Exercisable	Unexercisable
Yosef A. Maiman	203,125	46,875	\$ 633,750	\$ 146,250
Jack Bigio	191,875	238,125	\$ 625,250	\$ 822,750
Irit Eluz	133,781	224,719	\$ 443,998	\$ 780,923
Yoram Firon	103,156	155,344	\$ 339,898	\$ 538,823
Amit Mantsur	43,625	29,375	\$ 160,264	\$ 106,256

Option Grants In Last Fiscal Year

No stock options were granted to purchase our Class A Stock to our named executive officers during fiscal year ended December 31, 2005.

Other Benefits

Ampal previously maintained a money purchase pension plan (Pension Plan) for all full-time employees of Ampal except non-resident aliens outside the United States. Pursuant to the cessation of the Company's U.S. operations, the Ampal-American Israel Corporation Money Purchase Pension Plan and the Ampal-American Israel Corporation Savings Plan were terminated effective December 31, 2004.

Compensation of Directors

Directors of Ampal (other than Mr. Maiman and Mr. Bigio) received \$1,500 per Board meeting attended. The Chairman of the Board receives \$2,000. Directors of Ampal also receive the same amount for attendance at meetings of committees of the Board, provided that such committee meetings are on separate days and on a day other than the day of a regularly scheduled Board meeting.

On October 28, 2004, the Board formed a Special Committee of the Board composed of Mr. Yehuda Karni, Mr. Eitan Haber and Mr. Menahem Morag, each of whom is an independent director.

The Board appointed the Special Committee of independent directors to consider alternatives available to the Company to maximize shareholder value. The Special Committee was formed in response to a suggestion from Mr. Yosef A. Maiman, Chairman of the Board and controlling stockholder, that he is reviewing his alternatives with regard to his investment in the Company.

In connection with the formation of this Special Committee, the Company entered into an Indemnification and Compensation Agreement with each of Messrs. Karni, Haber and Morag. In consideration for serving as a member of the Special Committee, each director shall receive from the Company a fee of \$35,000 payable in seven equal monthly installments beginning on October 28, 2004. Each director shall also be entitled to receive from the Company a fee of \$1,500 per each meeting of the Special Committee he attends. In addition, the Company has agreed to indemnify and hold harmless each Director with respect to his service on, and any matter or transaction considered by, the Special Committee to the fullest extent authorized or permitted by law. A copy of the form of this Indemnification and Compensation Agreement is attached as Exhibit 10j to this annual report on Form 10-K.

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The following table sets forth certain information regarding stock options granted to purchase our Class A Stock to our directors during the three fiscal years ended December 2005, 2004 and 2003.

	2005	2004	2003
Jack Bigio (1)	-	280,000	-
Eitan Haber (2)	45,000	-	-
Yehuda Karni (2)	45,000	-	-
Menahem Morag (3)	45,000	15,000	-

(1) Since March 6, 2002.

(2) Since August 16, 2002 .

(3) Since March 24, 2004.

Stock Option Plan

In March 1998, the Board approved a Long-Term Incentive Plan (1998 Plan) permitting the granting of options to all employees, officers, directors and consultants of the Company and its subsidiaries to purchase up to an aggregate of 400,000 shares of Class A Stock. The 1998 Plan was approved by a majority of the Company s shareholders at the June 19, 1998 annual meeting of shareholders. The 1998 Plan remains in effect for a period of ten years. As of December 31, 2005, 30,000 options of the 1998 Plan are outstanding.

On February 15, 2000, the Stock Option Committee approved a new Incentive Plan (2000 Plan), under which the Company has reserved 4 million shares of Class A Stock, permitting the granting of options to all employees, officers and directors. The 2000 Plan was approved by the Board of Directors at a meeting held on March 27, 2000 and was approved by a majority of the Company s shareholders at the June 29, 2000 annual meeting of shareholders. The 2000 Plan remains in effect for a period of ten years. As of December 31, 2005, 1,994,500 options of the 2000 Plan are outstanding.

The options granted under the 1998 Plan and the 2000 Plan (collectively, the Plans) may be either incentive stock options, at an exercise price to be determined by the Stock Option and Compensation Committee (the Committee) but not less than 100% of the fair market value of the underlying options on the date of grant, or non-incentive stock options, at an exercise price to be determined by the Committee. The Committee may also grant, at its discretion, restricted stock, dividend equivalent awards, which entitle the recipient to receive dividends in the form of Class A Stock, cash or a combination of both and stock appreciation rights, which permit the recipient to receive an amount in the form of Class A Stock, cash or a combination of both, equal to the number of shares of Class A Stock with respect to which the rights are exercised multiplied by the excess of the fair market value of the Class A Stock on the exercise date over the exercise price. The options granted under the Plans were granted either at market value or above.

Under each of the Plans, all granted but unvested options become immediately exercisable upon the occurrence of a change in control of the Company. On April 25, 2002, the controlling shareholder of the Company, Rebar Financial Corp., sold all of its stock in the Company to Y.M. Noy Investments Ltd. Accordingly, all options granted but unvested under the Plans were immediately exercisable.

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The Company accounts for all plans under APB Opinion No. 25, under which no compensation costs were incurred in the years ended December 31, 2003, 2004 and 2005. If compensation cost for the options under the above Plans had been determined in accordance with SFAS No. 123, the Company's net income (loss) would have been (\$6,832) million, (\$18,954) million and \$8,351 million, for the years 2005, 2004 and 2003, respectively.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The current members of the Stock Option and Compensation Committee are Mr. Yehuda Karni, Mr. Eitan Haber and Mr. Menahem Morag, none of whom is an officer or employee or former officer or employee of the Company. During 2005, no executive officer of the Company served on the Stock Option and Compensation Committee, or the Board of Directors of another entity whose executive officer(s) served on the Company's Stock Option and Compensation Committee of the Board of Directors.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Plan category	Equity Compensation Plan Information ⁽¹⁾		
	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	2,024,500	3.37	2,375,500 ⁽²⁾
Equity compensation plans not approved by security holders	N/A	N/A	N/A
Total	2,024,500	3.37	2,375,500

(1) All information provided as of December 31, 2005.

(2) The number of securities remaining available for future issuance under 1998 Plan is 370,000. The number of securities remaining available for future issuance under 2000 Plan is 2,005,500.

PRINCIPAL SHAREHOLDERS OF AMPAL

The following table sets forth information as of March 6, 2006, as to the holders known to Ampal who beneficially own more than 5% of the Class A Stock, the only outstanding series of voting securities of Ampal. For purposes of computation of the percentage ownership of Class A Stock held by such stockholders set forth in the table, conversion of any 4% Cumulative Convertible Preferred Stock (the 4% Preferred Stock) and 6 1/2% Cumulative Convertible Preferred Stock (the 6 1/2% Preferred Stock) owned by such beneficial owner has been assumed, without increasing the number of shares of Class A Stock outstanding by amounts arising from possible conversions of convertible securities held by shareholders other than such beneficial owner. As of March 6, 2006, there were 20,157,772 (not including treasury shares) shares of Class A Stock of Ampal outstanding. In addition, as of March 6, 2006, there were 501,227 non-voting shares of 6 1/2% Preferred Stock outstanding (each convertible into 3 shares of Class A Stock) and 110,296 non-voting shares of 4% Preferred Stock outstanding (each convertible into 5 shares of Class A Stock).

Security Ownership of Certain Beneficial Owners

Name and Address of Beneficial Owner	Title of Class	Number of Shares and Nature of Beneficial Ownership	Percent of Outstanding Shares of Class A Stock
Y.M. Noy Investments Ltd., of 33 Havazelet Hasharon St., Herzliya, Israel	Class A Stock	11,750,132 ⁽¹⁾	58.29%
Yosef A. Maiman Y.M. Noy Investments Ltd., of 33 Havazelet Hasharon St., Herzliya, Israel	Class A Stock	11,968,882 ⁽¹⁾⁽²⁾	58.74%
Ohad Maiman Y.M. Noy Investments Ltd., of 33 Havazelet Hasharon St., Herzliya, Israel	Class A Stock	11,750,132 ⁽¹⁾	58.29%
Noa Maiman Y.M. Noy Investments Ltd., of 33 Havazelet Hasharon St., Herzliya, Israel	Class A Stock	11,750,132 ⁽¹⁾	58.29%

(1) Consists of 11,750,132 shares of Class A Stock held directly by Y.M. Noy Investments Ltd. Yosef A. Maiman owns 100% of the economic shares and one-third of the voting shares of Y.M. Noy Investments Ltd.. In addition, Mr. Maiman holds an option to acquire the remaining two-thirds of the voting shares of Y.M. Noy Investments Ltd. (which are currently owned by Ohad Maiman and Noa Maiman, the son and daughter, respectively, of Mr. Maiman).

(2) Includes 218,750 shares of Class A Stock underlying options which are currently exercisable by Mr. Maiman.

Security Ownership of Management

The following table sets forth information as of March 6, 2006 as to each class of equity securities of Ampal or any of its subsidiaries beneficially owned by each director and named executive officer of Ampal listed in the Summary Compensation Table and by all directors and named executive officers of Ampal as a group. All ownership is direct unless otherwise noted. The table does not include directors or named executive officers who do not own any such shares:

Name	Number of Shares and Nature of Beneficial Ownership of Class A Stock	Percent of Outstanding Shares of Class A Stock
Yosef Maiman	11,968,882 ⁽¹⁾⁽²⁾	58.74%
Jack Bigio	236,250 ⁽²⁾	1.16%
Irit Eluz	173,688 ⁽²⁾	*
Yoram Firon	131,187 ⁽²⁾	*
Amit Mantsur	48,187 ⁽²⁾	*
Leo Malamud	131,250 ⁽²⁾	*
Dr. Joseph Yerushalmi	87,500 ⁽²⁾	*
Eitan Haber	18,750 ⁽²⁾	*
Yehuda Karni	18,750 ⁽²⁾	*
Menahem Morag	13,126 ⁽²⁾	*
All Directors and Executive Officers as a Group	12,827,570 ⁽²⁾	60.44%

* Represents less than 1% of the class of securities.

(1) Attributable to 11,750,132 shares of Class A Stock held directly by Y.M. Noy Investments Ltd. See Security Ownership of Certain Beneficial Owners. In addition, this represents 218,750 shares underlying options for Yosef Maiman which are presently exercisable.

(2) Represents shares underlying options which are presently exercisable or exercisable in 60 days.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The Audit Committee of Ampal has the duty and responsibility of approving all transactions between Ampal, on the one hand, and any officer, director, or affiliate thereof, on the other hand, or in which any officer, director or affiliate has a material interest. Under the rules promulgated by Nasdaq, the Audit Committee must review and approve all transactions between Ampal on the one hand and any officer, director or principal shareholder of Ampal on the other hand. The Audit Committee considers and evaluates potential related party transactions from time to time, including co-investment opportunities and other types of transactions. The Audit Committee has the authority to engage independent legal, financial and other advisors.

On December 1, 2005, the Company, through Merhav Ampal Energy Ltd., a wholly-owned subsidiary of the Company, entered into an agreement (the Agreement) with Merhav M.N.F. Ltd. (Merhav) for the purchase from Merhav of a portion of its interest in EMG.

Under the terms of the transaction, the Company acquired the beneficial ownership of 1,200 shares of EMG's capital stock, representing a 2% beneficial ownership in EMG. The purchase price for the shares was \$29,960,000. Additionally, the Company was granted the exclusive right to negotiate to acquire a substantial portion of Merhav's remaining shares of EMG. The Company also has the right for a period of time to require Merhav to repurchase the EMG interest.

Yosef A. Maiman, the Chairman of the Board and the Company's controlling shareholder, is the sole owner of Merhav. Because of the foregoing relationship, the Special Committee, which is identical in composition to the Audit Committee, negotiated and approved the transaction. Houlihan Lokey Howard & Zukin Financial Advisors, Inc. acted as financial advisors to the Special Committee.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

AUDIT FEES. The fees of Kesselman & Kesselman (Kesselman) fees for professional services rendered for the audit of the Company s annual financial statements for the fiscal years ended December 31, 2005 and December 31, 2004 and reviewing the financial statements included in the Company s quarterly reports on Form 10-Q were \$266,000 and \$267,000, respectively.

TAX FEES. Kesselman s tax fees for the fiscal years ended December 31, 2005 and December 31, 2004, were \$209,000 and \$100,000, respectively.

ALL OTHER FEES Kesselman s fees for other services for the fiscal years ended December 31, 2005 and December 31, 2004, were \$236,000 and \$42,800, respectively.

All of the services provided by our principal accounting firm described above under the captions Audit Fees , Tax Fees and All Other Fees were approved by our Audit Committee. The Audit Committee has determined that the rendering of professional services described above by Kesselman is compatible with maintaining the auditor s independence.

Audit Committee Pre-Approval Policies

The Company s Audit Committee Charter provides that the Audit Committee shall approve in advance all audit services and all non-audit services provided by the independent auditors based on policies and procedures developed by the Audit Committee from time to time. The Audit Committee will not approve any non-audit services prohibited by applicable SEC regulations or any services in connection with a transaction initially recommended by the independent auditor, the purpose of which may be tax avoidance and the tax treatment of which may not be supported by the Internal Revenue Code and related regulations.

Our Audit Committee requires that our independent auditor, in conjunction with our Chief Financial Officer, be responsible for seeking pre-approval for providing services to us and that any request for pre-approval must inform the Audit Committee about each service to be provided and must provide detail as to the particular service to be provided.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as a part of this report:

	<u>Page Reference</u>
(1) Financial Statements and Supplementary Data	
Ampal-American Israel Corporation and Subsidiaries	
<u>Report of Independent Registered Public Accounting Firm</u>	31
<u>Consolidated Statements of Income for the years ended December 31, 2005, 2004 and 2003</u>	32
<u>Consolidated Balance Sheets as of December 31, 2005 and 2004</u>	33-34
<u>Consolidated Statements of Cash Flows for the years ended December 31, 2005, 2004 and 2003.</u>	35-36
<u>Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2005, 2004 and 2003</u>	37-38
<u>Consolidated Statements of Comprehensive Income for the years ended December 31, 2005, 2004 and 2003</u>	39
<u>Notes to Consolidated Financial Statements</u>	40-62
Supplementary Data:	
<u>Selected quarterly financial data for the years ended December 31, 2005 and 2004</u>	24

(2) Financial Statement Schedules

(i) Schedule of Representative Rates of Exchange between the U.S. Dollar and New Israeli Shekel for three years ended December 31, 2005

**Representative Rates of Exchange
Between the U.S. Dollar and the New Israeli Shekel
For the Three Years Ended December 31, 2005**

The following table shows the amount of New Israeli Shekels equivalent to one U.S. Dollar on the dates indicated:

	2005	2004	2003
March 31	4.361	4.528	4.687
June 30	4.574	4.497	4.312
September 30	4.598	4.482	4.441
December 31	4.603	4.308	4.379

(ii) Consolidated financial statements filed pursuant to Rule 3-09 of Regulation S-X

Granite Hacarmel Investments Limited and Subsidiaries

Report of Certified Public Accountants

Consolidated Balance Sheets as at December 31, 2003 and 2002

Consolidated Statements of Income for the years ended December 31, 2003, 2002 and 2001

Consolidated Statements of Shareholders' Equity for the years ended December 31, 2003, 2002 and 2001

Consolidated Statements of Cash Flows for the years ended December 31, 2003, 2002 and 2001

Notes to Consolidated Financial Statements

Ophir Holdings Ltd.

Report of Certified Public Accountants

Consolidated Balance Sheets as at December 31, 2005 and 2004

Consolidated Statements of Income for the years ended December 31, 2005, 2004 and 2003

Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2005, 2004 and 2003

Consolidated Statements of Cash Flows for the years ended December 31, 2005, 2004 and 2003

Notes to Financial Statements

Ophirtech Ltd.

Report of Certified Public Accountants

Consolidated Balance Sheets as at December 31, 2005 and 2004

Consolidated Statements of Income for the years ended December 31, 2005, 2004 and 2003

Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2005, 2004 and 2003

Consolidated Statements of Cash Flows for the years ended December 31, 2005, 2004 and 2003

Notes to Financial Statements

(iii) Reports of Other Certified Public Accountants filed pursuant to Rule 2-05 of Regulation S-X:

AM-HAL Ltd.
Bay Heart Ltd.
Carmel Container Systems Ltd.
Coral World International Limited
Epsilon Investment House Ltd.
Hod Hasharon Sport Center Ltd.
Hod Hasharon Sport Center (1992) Limited Partnership
Renaissance Investment Co. Ltd.

Exhibit 2 Plan of Acquisition, Reorganization, Arrangement, Liquidation or Succession

- 2a. Purchase and Sale Agreement, dated January 5, 1998, between Ampal Communications, Inc. and Motorola Communications Israel Ltd. (Includes as Exhibit A the form of Partnership Agreement between Ampal Communications, Inc. and Motorola Communications Israel Ltd. and as Exhibit B the form of Shareholders Agreement between Ampal Communications, Inc. and Motorola Communications Israel Ltd.) (Filed as Exhibit 2 to a Current Report on Form 8-K, dated February 5, 1998, and incorporated herein by reference, File No. 0-538.)
- 2b. Amendment, dated January 22, 1998, to (i) Purchase and Sale Agreement, dated January 5, 1998, between Ampal Communications, Inc. and Motorola Communications Israel Ltd., (ii) Partnership Agreement between Ampal Communications, Inc. and Motorola Communications Israel Ltd. and (iii) form of Shareholders Agreement between Ampal Communications, Inc. and Motorola Communications Israel Ltd. (Filed as Exhibit 2a to a Current Report on Form 8-K, dated February 5, 1998, and incorporated herein by reference, File No. 0-538.)

Exhibit 3 Articles of Incorporation and By-Laws

- 3a. Amended and Restated Certificate of Incorporation of Ampal-American Israel Corporation, dated May 28, 1997. (Filed as Exhibit 3a. to Form 10-Q, for the quarter ended June 30, 1997 and incorporated herein by reference, File No. 0-5380).
- 3b. By-Laws of Ampal-American Israel Corporation as amended, dated February 14, 2002 (incorporated by reference to Exhibit 3b. of Ampal's Form 10-K filed on March 27, 2002).

Exhibit 4 Instruments Defining the Rights of Security Holders, Including Indentures

- 4a. Form of Indenture dated as of November 1, 1984. (Filed as Exhibit 4a. to Registration Statement No. 2-88582 and incorporated herein by reference).
- 4b. Form of Indenture dated as of May 1, 1986. (Filed as Exhibit 4a. to Pre-Effective Amendment No. 1 to Registration Statement No. 33-5578 and incorporated herein by reference).

Exhibit 10 Material Contracts

- 10a. Agreement, dated March 22, 1993, between the Investment Company of Bank Leumi, Ltd., and Ophir Holdings Ltd., Mercazim Investments Ltd., Diur B.P. Ltd. and Mivnat Holdings Ltd. (Filed as Exhibit 10.4 to Pre-Effective Amendment No. 1 to Registration Statement No. 33-51023 and incorporated herein by reference).
- 10b. Agreement, dated March 30, 1994, between Poalim Investments Ltd., Ampal (Israel) Ltd. and Ampal Industries (Israel) Ltd. (Translation). (Filed as Exhibit 10l, to Form 10-K for the fiscal year ended December 31, 1994 and incorporated herein by reference, File No. 0-538).
- 10c. Loan Agreement, dated April 27, 1998, between Bank Hapoalim Ltd. and Ampal Communications Limited Partnership (Filed as Exhibit 10.1 to Report on Form 10-Q for the quarter ended June 30, 1998, File No. 0-538).
- 10d. Form of Loan Agreement between Ampal Communications Limited Partnership and Bank Leumi Le-Israel B.M. Filed as Exhibit 10.2 to Report on Form 10-Q for the quarter ended June 30, 1998, File No. 0-538).
- 10e. Sale and Purchase Agreement, dated November 8, 2000, between Ampal Realty Corporation and Second 800 LLC. (filed as Exhibit 10I to Form 10-K for the fiscal year ended December 31, 2002, File No. 000-00538).
- 10f. The Company's 1998 Long-Term Incentive Plan (filed as Exhibit A to the Company's Proxy Statement for the 1998 Annual Meeting of Shareholders).*
- 10g. The Company's 2000 Incentive Plan (filed as an exhibit to the Company's Proxy Statement for the 2000 Annual Meeting of Shareholders).*
- 10h. Amendment to the Company's 1998 Long Term Incentive Plan adopted by the Board of Directors on February 14, 2002.* (Filed as Exhibit 10h to the report on Form 10K. Filed on March 27, 2003)
- 10i. Amendment to the Company's 2000 Incentive Plan adopted by the Board of Directors on February 14, 2002.* (Filed as Exhibit 10i to the report on Form 10K. Filed on March 27, 2003).
- 10j. Compensation and Indemnification Agreement, dated as of December 13, 2004, between Ampal-American Israel Corporation and each of Mr. Yehuda Karni, Mr. Eitan Haber and Mr. Menachem Morag. (Filed as Exhibit 10j to the report on Form 10K. Filed on March 15, 2005).
- 10k. Stock Option Cancellation Agreement, dated as of November 30, 2004, between Ampal-American Israel Corporation and Dafna Sharir. (Filed as Exhibit 10k to the report on Form 10K. Filed on March 15, 2005).
- 10l. Omnibus Agreement, dated as of December 1, 2005, between Merhav Ampal Energy Limited and Merhav (M.N.F.) Limited.

* Management contract, compensatory plan or arrangement.

Exhibit 11 Statement re Computation of Earnings Per Share

Exhibit 12 Statement re Computation of Ratios

Exhibit 21 Subsidiaries of the Registrant

Exhibit 23 Consents of Experts and Counsel:

23.1	Brightman Almagor & Co., Certified Public Accountants A member firm of Deloitte Touche Tohmatsu	E-23.1
23.2	Kesselman & Kesselman CPAs (Isr) A member of PricewaterhouseCoopers International Limited	E-23.2
23.3	Brightman Almagor & Co., Certified Public Accountants A member firm of Deloitte Touche Tohmatsu	E-23.3
23.4	Kost Forer Gabbay & Kasierer Member of Ernst & Young Global	E-23.4
23.5	Kesselman & Kesselman CPAs (Isr) A member of PricewaterhouseCoopers International Limited	E-23.5
23.6	Fahn, Kanne & Co. Certified Public Accountants (Isr.)	E-23.6
23.7	Kost Forer Gabbay & Kasierer Member practice of Ernst & Young Global	E-23.7
23.8	Somekh Chaikin, Certified Public Accountants (Isr.)	E-23.8
23.9	Somekh Chaikin, Certified Public Accountants (Israel)	E-23.9
23.10	Somekh Chaikin, Certified Public Accountants (Israel)	E-23.10
23.11	Kesselman & Kesselman CPAs (Isr) A member of PricewaterhouseCoopers International Limited	E-23.11
23.12	Kesselman & Kesselman CPAs (Isr) A member of PricewaterhouseCoopers International Limited	E-23.12
23.13	Kost Forer Gabbay & Kasierer Member practice of Ernst & Young Global	E-23.13

Exhibit 31.1 Certification of Jack Bigio pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31.2 Certification of Irit Eluz pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 32 Certification of Jack Bigio and Irit Eluz pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 29th day of March, 2006.

AMPAL-AMERICAN
ISRAEL CORPORATION

BY: /S/ JACK BIGIO

Jack Bigio, Chief Executive Officer and
President (Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on March 24, 2004.

<u>Signatures</u>	<u>Title</u>	<u>Date</u>
/s/ YOSEF A. MAIMAN Yosef A. Maiman	Chairman of the Board of Directors	March 29, 2006
/s/ JACK BIGIO Jack Bigio	President & CEO - Director	March 29, 2006
/s/ LEO MALAMUD Leo Malamud	Director	March 29, 2006
/s/ DR. JOSEPH YERUSHALMI Dr. Joseph Yerushalmi	Director	March 29, 2006
/s/ YEHUDA KARNI Yehuda Karni	Director	March 29, 2006
/s/ EITAN HABER Eitan Haber	Director	March 29, 2006
/s/ MENAHEM MORAG Menahem Morag	Director	March 29, 2006
/s/ IRIT ELUZ Irit Eluz	CFO, Senior Vice President - Finance and Treasurer (Principal Financial Officer)	March 29, 2006
/s/ GIORA BAR - NIR Giora Bar-Nir	VP Accounting & Controller (Principal Accounting Officer)	March 29, 2006

**Granite Hacarmel Investments Limited
and its Subsidiaries**

Financial Statements

as at December 31, 2003

Granite Hacarmel Investments Limited and its Subsidiaries

Financial Statements December 31, 2003

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-2-

Somekh Chaikin

REPORT OF INDEPENDENT PUBLIC ACCOUNTING FIRM

**THE SHAREHOLDERS OF
GRANITE HACARMEL INVESTMENTS LIMITED**

We have audited the accompanying consolidated balance sheets of Granite Hacarmel Investments Limited and its subsidiaries (the Company) as of December 31, 2003 and 2002, and the related consolidated statements of income, shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2003. These consolidated financial statements are the responsibility of the Company's Board of Directors and of its Management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statement of the following affiliates:

Nitzba Holdings 1995 Ltd. (Nitzba), a 10 percent owned investee company, in respect to which the Company's investment was NIS 75,400 thousands as of December 31, 2003 and the Company's equity in its losses was NIS 9,900 thousands for the year then ended. Those financial statements were prepared on the basis of generally accepted accounting principles in Israel (Israeli GAAP).

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L.D.I. Leasing Dynamics International Ltd. (LDI), a 25 percent owned investee company, in respect to which the Company's investment was NIS 9,200 thousands and NIS 9,900 thousands as of December 31, 2003 and 2002, respectively and the Company's equity in its losses was NIS 700 thousand and 1,000 thousands for the years ended December 31 2003 and 2002, respectively. Those financial statements were prepared on the basis of Israeli GAAP.

Oganim Beyarok Ltd (Oganim), a 50 percent owned investee company, in respect to which the Company's excess of accumulated losses over the cost of investments was NIS 300 thousands and NIS 140 thousands as of December 31, 2003 and 2002, respectively and the Company's equity in its losses was NIS 1,000 thousand and NIS 2,300 thousands for the years ended December 31, 2003 and 2002, respectively. Those financial statements were prepared on the basis of Israeli GAAP with reconciliation from Israeli GAAP to generally accepted accounting principles in the United States (U.S. GAAP).

The financial statements of the affiliates referred above were audited by other auditors whose reports thereon were furnished to us, and our opinion, insofar as it relates to the amounts included for Nitzba and LDI, before conversion to U.S. GAAP and to Oganim for both Israeli GAAP and conversion to U.S GAAP, is based solely on the said reports of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards, including standards prescribed by the Auditors Regulation (Manner of Auditor's Performance) 1973 and in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). 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 Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

We believe that our audits (which include procedures relating to the adjustments to convert information with respect to Nitzba and LDI as reported under Israeli GAAP to amounts reported under generally accepted accounting principles in the United States) provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the years, in the three-year period ended December 31, 2003 in conformity with accounting principles generally accepted in Israel.

Accounting principles generally accepted in Israel vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature of such differences is presented in Note 32 to the consolidated financial statements.

As explained in Note 2, the above mentioned consolidated financial statements are stated in values adjusted for the changes in the general purchasing power of the Israeli currency, in accordance with opinions of the Institute of Certified Public Accountants in Israel.

As discussed in Note 28.B.2 to the financial statements there are few claims against consolidated companies which the court has been asked to recognize as class actions and other claims against consolidated companies claiming that their agreements with their customers are restrictive trade arrangements.

Somekh Chaikin
Certified Public Accountants (Israel)

Haifa Israel, March 25, 2004

Consolidated balance sheets as at December 31

Adjusted to NIS of December 2003

		2003	2002
	Note	NIS thousands	NIS thousands
Current assets			
Cash and cash equivalents	5	7,479	33,249*
Marketable securities		2,927	17,265
Trade receivables	6	965,614	1,017,645*
Other receivables	6	71,737	125,388*
Receivables for work in progress	6	14,443	17,068
Inventories	7	195,842	213,579
Affiliated company designated for sale	8	12,516	-
		<u>1,270,558</u>	<u>1,424,194</u>
Non-current inventories	7	<u>110,981</u>	<u>117,786</u>
Investments, loans and long-term receivables			
Affiliated companies and other investments	8	130,504	160,413*
Long-term loans and receivables	9	129,837	130,123*
		<u>260,341</u>	<u>290,536</u>
Fixed assets, net	10	<u>1,186,561</u>	<u>1,220,507</u>
Other assets	11	<u>209,049</u>	<u>149,577*</u>
		<u>3,037,490</u>	<u>3,202,600</u>

* Reclassified

The notes to the financial statements are an integral part thereof.

Consolidated balance sheets as at December 31

Adjusted to NIS of December 2003

		2003	2002
	Note	NIS thousands	NIS thousands
Current liabilities			
Credit from banks and others	12	1,322,402	1,125,784
Trade payables	13	189,090	185,852*
Other payables	14	195,788	180,035
		<u>1,707,280</u>	<u>1,491,671</u>
Long-term liabilities			
Long-term loans	15	720,083	923,945*
Customers deposits	16	58,102	61,050
Liabilities for severance pay, net	17	22,835	28,861
Deferred taxes	26	68,585	63,620
		<u>869,605</u>	<u>1,077,476</u>
Minority interests		<u>8,133</u>	<u>7,774</u>
Collateral, commitments and contingent liabilities	28		
Shareholders equity	19	<u>452,472</u>	<u>625,679</u>
		<u>3,037,490</u>	<u>3,202,600</u>

* Reclassified

Prof. I. Borovich Chairman of the Board _____

A. Sagis President and Chief Executive Officer _____

J. Frohlich Executive Vice President and Chief Financial Officer _____

Date of approval of statements: March 25, 2004

The notes to the financial statements are an integral part thereof.

Granite Hacarmel Investments Limited and its Subsidiaries

Consolidated statements of income for the year ended December 31

Adjusted to NIS of December 2003

		2003	2002	2001
	Note	NIS thousands		
Sales		4,263,369	4,274,194	4,030,096
Less: Government imposts		1,376,296	1,380,089	1,338,992
Net sales	20	2,887,073	2,894,105	2,691,104
Cost of sales	21	2,127,117	2,134,658	2,047,482
Gross profit		759,956	759,447	643,622
Selling and marketing expenses	22	500,843	480,784	400,227
General and administrative expenses	23	154,012	109,968*	90,056*
		654,855	590,752	490,283
Income from operations		105,101	168,695	153,339
Financing expenses, net	24	(130,505)	(85,137)	(75,622)
Other (expenses) income, net	25	(62,167)	(23,830)	9,825
		(192,672)	(108,967)	(65,797)
(Loss) Income before taxes on income		(87,571)	59,728	87,542
Taxes on income	26	9,628	(28,109)*	(36,270)*
(Loss) Income after taxes on income		(77,943)	31,619	51,272
Company's share in results of affiliated companies, net		(17,189)	(5,184)	5
Minority interest in the results of subsidiaries		(914)	(2,268)	(1,761)
Net (loss) income for the year		(96,046)	24,167	49,516

Net (loss)earnings per NIS 1 par value of ordinary shares (in NIS):	19			
Primary and diluted (loss) income		<u>(0.7)</u>	<u>0.17</u>	<u>0.36</u>
Number of shares of NIS 1 par value each used in the calculation (in thousands)		<u>137,770</u>	<u>138,381</u>	<u>138,720</u>

* Reclassified

The notes to the financial statements are an integral part thereof.

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Granite Hacarmel Investments Limited and its Subsidiaries

Consolidated statements of changes in shareholders equity

Adjusted to NIS of December 2003

	Share capital	Premium on shares	Less Company shares held by a subsidiary	Dividend declared subsequent to balance sheet date	Retained earnings	Total
	NIS thousands					
Balance as at January 1, 2001	269,295	274,365	(3,603)	-	143,001	683,058
Changes in 2001:						
Net income for the year	-	-	-	-	49,516	49,516
Dividend paid	-	-	-	-	(124,944)	(124,944)
Acquisition of Company s shares by a subsidiary	-	-	(280)	-	-	(280)
Balance as at December 31, 2001	269,295	274,365	(3,883)	-	67,573	607,350
Changes in 2002:						
Net income for the year	-	-	-	-	24,167	24,167
Dividend declared	-	-	-	77,009*	(77,009)*	-
Acquisition of Company s shares by a subsidiary	-	-	(5,838)	-	-	(5,838)
Balance as at December 31, 2002	269,295	274,365	(9,721)	77,009	14,731	625,679

Changes in 2003:

Net loss for the year	-	-	-	-	(96,046)	(96,046)
Dividend paid	-	-	-	(77,161)	-	(77,161)
Erosion of dividend paid	-	-	-	152	(152)	-
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Balance as at December 31, 2003	269,295	274,365	(9,721)	-	(81,467)	452,472
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

*Reclassified

The notes to the financial statements are an integral part thereof.

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Granite Hacarmel Investments Limited and its Subsidiaries

Consolidated statements of cash flows for the year ended December 31

Adjusted to NIS of December 2003

	<u>2003</u>	<u>2002</u>	<u>2001</u>
	NIS Thousands		
	<u> </u>	<u> </u>	<u> </u>
Cash flows from operating activities			
Net (loss) income	(96,046)	24,167	49,516
Reconciliations required to present cash flows from operating activities (A)	232,622	118,362	123,350
	<u> </u>	<u> </u>	<u> </u>
Net cash provided by operating activities	136,576	142,529	172,866
	<u> </u>	<u> </u>	<u> </u>
Cash flows from investing activities			
Acquisition of fixed assets	(102,357)	(112,890)	(99,600)
Proceeds from the sale of fixed assets	12,274	12,750	4,745
Proceeds from the sale of investments in companies presented by equity method	-	20	-
Investments in long-term loans	(17,195)	(53,267)*	(9,760)
Collection of long-term loans	73,460	29,574	22,196
Investments in other assets and deferred expenses	(51,123)	(33,365)	(36,990)
Acquisition of affiliated companies' shares	(646)	(1,617)*	(10,999)
Sale of marketable securities, net	19,436	2,594	914
Investments in companies carried at cost	(77)	(72)	-
Acquisition of subsidiary's shares	-	(17,423)	(71,548)
Investment in capital note of affiliated company	-	(6,114)	-
Acquisition of initially consolidated companies(B)	138	(2,434)	(426,726)
Proceeds from the sale of a previously consolidated company (C)	-	(5,480)	(5)
	<u> </u>	<u> </u>	<u> </u>
Net cash used in investing activities	(66,090)	(187,724)	(627,773)
	<u> </u>	<u> </u>	<u> </u>
Cash flows from financing activities			
Dividend paid	(77,161)	-	(124,944)
Dividend to minority shareholders in subsidiaries	(555)	(893)	(1,613)

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Short-term credit from banks and others, net	107,946	(221,810)	61,973
Receipt of long-term loans	10,492	371,277	548,974
Repayment of long-term loans	(137,298)	(85,629)	(3,054)
Deposits received from customers	2,170	1,452	2,518
Deposits refunded to customers	(1,850)	(873)	(1,027)
Repayment of debentures	-	(14,249)	(14,672)
Acquisition of Company's shares by subsidiary	-	(5,838)	(280)
Proceeds from the issuance (redemption) of capital note	-	(615)	652
Net cash (provided by) used for financing activities	(96,256)	42,822	468,527
(Decrease) increase in cash and cash equivalents	(25,770)	(2,373)	13,620
Cash and cash equivalents at beginning of year	33,249	35,622	22,002
Cash and cash equivalents at end of year	7,479	33,249*	35,622

* Reclassified

The notes to the financial statements are an integral part thereof.

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Granite Hacarmel Investments Limited and its Subsidiaries

Consolidated statements of cash flows for the year ended December 31

Adjusted to NIS of December 2003

	2003	2002	2001
	NIS Thousands		
(A) Reconciliations required to present cash flows from operating activities			
Income and expenses not requiring cash flows			
Depreciation and amortization, net	128,820	118,773	100,803
Deferred taxes, net	(31,396)	(10,987)*	9,108*
(Decrease) increase in liabilities for severance pay, net	(7,478)	(8,527)	14,151
Minority interest in income of subsidiaries	914	2,268	1,761
Group's share in undistributed losses of affiliated companies, net	17,492	6,597	2,129
Capital (gains) losses	(1,408)	9,404	427
Erosion of long-term loans, debentures and capital notes issued	5,044	(8,983)	1,987
Erosion of loans granted	(267)	(5,346)	(3,624)
(Increase) decrease in value of marketable securities, net	(5,098)	8,143	(8,068)
Erosion and write-off of customers deposits	(3,268)	(3,835)	821
Decrease in value of investments in affiliated company and other companies, net	3,347	20,014	5,850
Decrease in value of fixed assets	35,480	-	-
Gain from decrease in percent ownership in an affiliated company	-	(629)	-
Loss (profit) from the sale of investments in subsidiary	-	21	(151)
Changes in assets and liabilities:	26,199	(74,520)*	112,904*

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Decrease (increase) in trade receivables, notes and long-term checks for collection and receivables for work in progress

Decrease (increase) in other receivables	17,912	(23,462)	(36,909)
Decrease (increase) in inventories and non-current inventories	24,542	68,343	(2,839)
Increase (decrease) in trade payables	939	20,530*	(46,823)*
Increase (decrease) in other payables	20,848	558	(28,177)
	<u>232,622</u>	<u>118,362</u>	<u>123,350</u>

(B) Acquisition of initially consolidated companies

Working capital (excluding cash and cash equivalents)	19,216	(3,363)	(141,246)
Fixed assets	(17,431)	(1,384)	(404,436)
Long-term liabilities, net	-	15	62,943
Investment in affiliated company	(1,647)	2,812	-
Goodwill created at the time of acquisition	-	(514)	(881)
Minority rights on the date of the acquisition	-	-	56,894
	<u>138</u>	<u>(2,434)</u>	<u>(426,726)</u>

(C) Proceeds from the sale of investment in a previously consolidated company

Working capital (excluding cash and cash equivalents)	-	(7,314)	(1,373)
Fixed and other assets	-	2,526	431
Long-term (liabilities) receivables, net	-	(343)	117
Goodwill	-	-	267
Minority rights on date of sale	-	(328)	402
Capital (loss) gain from sale of investment in subsidiary	-	(21)	151
	<u>-</u>	<u>(5,480)</u>	<u>(5)</u>

* Reclassified

The notes to the financial statements are an integral part thereof.

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Granite Hacarmel Investments Limited and its Subsidiaries

Consolidated statements of cash flows for the year ended December 31

Adjusted to NIS of December 2003

(D) Non-cash items:

	2003	2002	2001
	NIS Thousands		
Conversion of trade receivables to long-term loans	13,294	16,823	2,725
Acquisition of fixed assets against suppliers credit	2,247	356	1,318

Acquisition of other assets on credit	-	3,775	9,049
	<u> </u>	<u> </u>	<u> </u>
Minority interest in dividend declared by subsidiary	-	65	364
	<u> </u>	<u> </u>	<u> </u>

The notes to the financial statements are an integral part thereof.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 1 -

General

A. Granite Hacarmel Investments Ltd. (hereinafter: the Company) (Public Company 520037177) and its subsidiaries are engaged mainly in the following branches:

1. Purchasing locally and importing fuel products and liquefied petroleum gas (lpg), their marketing and distribution, among public filling stations and to others.
2. The production and marketing of paints, coatings, chemicals and other related products.
3. Engineering planning, construction and operation of plants and systems for water enhancement and desalination.
4. Investment in real estate for rent.
5. Participation in oil and gas exploration.

B. In these financial statements -

1. **Subsidiaries** Companies, including partnerships, whose statements are directly or indirectly consolidated with those of the Company.
2. **Proportionally consolidated subsidiaries** Companies, including partnerships or joint ventures, whose statements are directly or indirectly partially consolidated with those of the Company
3. **Affiliated companies** Companies, including partnerships, excluding subsidiaries and/or proportionally consolidated subsidiaries, where the Company's investment in them is included, directly or indirectly in its financial statements by the equity method.
4. **Investee companies** Subsidiaries or proportionally consolidated subsidiaries or affiliated companies.
5. **Group** The Company and its investee companies.
6. **Related Parties** Within the meaning of Pronouncement 29 of the Institute of Certified Public Accountants in Israel.
7. **Interested Parties** - Within the meaning of sub-paragraph 1 of the definition of Interested party in the Corporation as per paragraph 1 of the Securities Law.
8. **Controlling Parties** Within the meaning of the Securities Regulations (Presentation of Transactions between a Corporation and Controlling Party in its Financial Statements)

1996.

9. **Index** The consumer price index as published by the Central Bureau of Statistics.
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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 2 - Reporting rules and accounting principles

A. Principles of adjustment and consolidation of financial statements

1. Financial statements in adjusted values

- a. The Company and the companies in the Group prepare their financial statements on the basis of the historical cost convention adjusted for changes in the general purchasing power of the shekel
- b. The adjusted values of the non-monetary assets do not necessarily represent the value of those assets in the market or to the business, but only their cost adjusted for changes in the purchasing power of the shekel.
- c. The term "cost" in these financial statements means adjusted cost unless stated otherwise.
- d. All the comparative data for previous periods (including the amounts of monetary items) are presented after being adjusted to the index of the end of the current reporting period.

2. Balance Sheet

- a. Non-monetary items have been adjusted for changes in the consumer price index since their acquisition or creation until the balance sheet month. The items treated as non-monetary items are mainly fixed assets and accumulated depreciation thereon, investments carried at cost, inventories which are not inventories of fuel (see Note 2(c).(2)), other assets and amortization thereon, share capital and capital reserves.
 - b. The balance sheet value of the investments in investee companies was determined on the basis of the adjusted statements of those companies.
 - c. Deferred taxes, net, are calculated on the basis of the adjusted data
 - d. Monetary items are presented in the adjusted balance sheet at their nominal value.
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-
-

Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 2 - Reporting rules and accounting principles (contd.)

A. Principles of adjustment and consolidation of financial statements (contd.)

3. Statement of income

Items of the profit and loss have been adjusted to changes in the consumer price index as follows:

- a. Amounts relating to non-monetary items in the balance sheet (such as depreciation and amortization, changes in inventories, prepaid expenses and deferred income, etc) or to provisions included in the balance sheet (such as severance and vacation pay) have been adjusted on the basis of the specific indices in accordance with the adjustment of the corresponding balance sheet item.
- b. Other elements of the statement of income (such as sales, purchases and other current costs) excluding the financing item, net, have been adjusted on the basis of the indices for the months of the relevant transactions.
- c. The financing item expresses financing income and expenses in real terms, the erosion of monetary items during the year, profits and losses from realizing and revaluing marketable securities, and profits and losses from derivative financial instruments.
- d. The share in the results of operations of unconsolidated investee companies and the minority interest in the results of the operations of subsidiaries, were determined on the basis of the adjusted statements of the investee companies.
- e. Current taxes are comprised of payments on account during the year, plus amounts payable as of the balance sheet date (or less amounts claimed as a refund as of the balance sheet date). The payments on account have been adjusted on the basis of the index at the time of each payment, while the amounts to be paid (or claimed as a refund) are included without adjustment. Therefore, current taxes also include an expense resulting from the erosion in the value of the advances on account of the tax from the date of payment to the balance sheet date.
Deferred taxes See Note 2.I. below.

4. Statement of changes in shareholders equity

A dividend declared and actually paid during the year of account has been adjusted on the basis of the index at the time of actual payment. A dividend which was declared/proposed during the year of account and not yet paid as of the balance sheet date has been included without adjustment.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 2 - Reporting rules and accounting principles (contd.)

A. Principles of adjustment and consolidation of financial statements(contd.)

5. Consolidation of financial statements

- a. The Company's consolidated financial statements include the statements of the Company and those of companies under its control. The list of the main companies whose statements are included in the consolidated statements and the ownership share and control therein, appear in an appendix to the financial statements.

Regarding companies initially consolidated, as well as companies consolidated in the past and not included in the consolidation in the year of account see Note 3.

- b. Significant intercompany balances and transactions among consolidated companies and profits from sales between the companies which have not yet been realized outside the Group have been cancelled.
- c. The Company's shares which were acquired by a subsidiary are presented using the treasury stock method.
- d.
 - 1. The excess cost of the Company's investments in subsidiaries not related to specific assets and identified liabilities (goodwill) is included in other assets and depreciated by the straight line method over a period of 10 years. The excess value of assets purchased over and above the cost of the investments in the investee companies is first deducted from intangible assets. The excess negative cost remaining after apportioning it to intangible assets was deducted from non-monetary assets proportionally to the fair value of these assets according to the Company's share. The balance was set-off from the Other assets and amortized by the straight line method over a period of 10 years.
 - 2. Excess cost related to assets and liabilities is recorded in the relevant items in the balance sheet.

B. Investments in Companies

1. Investments in investee companies

- a. Investments in investee companies are presented by the equity method less a provision for a decline in the value when required (see also Note 2(q)). The investee companies including investments in a number of investee companies which are inactive and/or insignificant and which as a result were not consolidated and are presented at cost which does not exceed their fair value.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 2 - Reporting rules and accounting principles (contd.)

B. Investments in Companies (contd.)

1. Investments in investee companies (contd.)

The Company periodically reviews its investments to determine whether any of them have suffered a decline in value which is other than temporary. This review is made when there are indications, including such factors as a decline in share prices on the stock exchange, ongoing losses in investee companies, the business sector in which it operates, the value of goodwill included in the investment and other factors which indicate that the value of such investments may have been adversely affected. The writedown of such investments to their adjusted values which, according to the Company's management, is based on a review of the relevant factors, their importance, and their not being of a temporary nature, is reflected in the statement of income in Other expenses.

- b. Amortization of goodwill - See also Note 2(a)(5) above.
- c. The Company's investments in capital notes of investee companies are presented in the Company's financial statements in accordance with the Securities Regulations (Presentation of Transactions between a Corporation and a Controlling Shareholder therein in the Financial Statements) 1996.
- d. A list of the main investee companies is included in an appendix to the financial statements.

2. **Investments in other companies**

Investments in other companies are included at cost unless there was a decline in their value which is not of a temporary nature (See also Note 2(b)(1)(a) above).

C. Valuation of Inventories

1. Fuel inventories

The main part of the fuel inventories consists of Security inventories.

The Security inventories are held in separate sealed containers and presented as Non-current inventories. The security inventories are stated at cost according to the exchange rate of the dollar (the current rate) or the exchange rate determined by the Fuel Authority if it is lower than the current rate. Regardless, the recovery of the value of the inventories is guaranteed by the State by determining its recovery value based on the exchange rate at the time of the sale.

The commercial inventories are presented at the lower of cost or market. Cost is determined by the first in first out method.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 2 - Reporting rules and accounting principles (contd.)

C. Valuation of Inventories (contd.)

2. Other inventories

- a. Inventories of luboils, spare parts and others are presented at the lower of cost or market. Cost is determined by the moving average method.
- b. Inventories of paints are presented at the lower of cost or market. Costs are determined mainly as follows:
 - Raw and packaging materials - by the moving average method.
 - Finished goods - by a standard price based on calculated production costs which include raw materials, packaging materials, salaries and related expenses and other expenses.
 - Work in progress on the basis of the raw materials plus calculated production costs.
 - Purchased goods by the moving average method.

D. Fixed assets

Fixed assets are presented at cost less accumulated depreciation (cost plus excess costs relating to specific assets). Improvements and refinements are charged to the cost of the assets while maintenance expenses and repairs are charged as incurred to the statement of income. Depreciation is calculated by the straight line method at annual rates based on their estimated useful lives. Capitalization of credit costs see Note 2(n) below.

Annual rates of depreciation are:

	%
Buildings (including temporary buildings and buildings for leasing)	2-10
Machinery and equipment	5-33(mainly 10-15)
Vehicles	15-20
Computers	20-33
Office furniture and equipment	6-20
Leasehold improvements	over the period of lease which does not exceed the economic life of the asset

Excess costs relating to specific assets are depreciated according to the estimated balance of the period of use of the assets to which they relate.

Amortization of leasehold rights are over the period of the lease.

Depreciation of buildings on leased land is over the period of the lease.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 2 - Reporting rules and accounting principles (contd.)

E. Other assets

Other assets are presented at cost and amortized at annual rates from the start of their utilization as follows:

Deferred rental over the period of the lease at equal annual rates.

Goodwill see Note 2(a)(5).

Distribution rights over 20 years or according to the period of the agreement.

Delivery rights over 10 years or according to the period of agreement.

Others over the period of the expected benefit.

F. Foreign currency and linkage

Assets (excluding securities) and liabilities in foreign currency or linked to it, are included at rates of exchange in effect on the balance sheet date.

Assets (excluding securities) and liabilities linked to the consumer price index are included according to the linkage terms applying to each balance.

Data on the consumer price index and rates of exchange:

	Dec. 31, 2003	Dec. 31, 2002	Dec. 31, 2001	% change 2003	% change 2002	% change 2001
Consumer price index- In points	112.95	115.12	108.1	(1.9)	6.5	1.4
Representative rate of exchange of the US dollar	4.379	4.737	4.416	(7.6)	7.3	9.3

G. Marketable securities

Marketable securities held as short term investments are presented on the basis of their realizable value on the stock exchange as of the balance sheet date.

Marketable securities which are permanent investments are presented at cost less a provision for a decline in their value which is other than a temporary nature (see also Note 2(b)(2) above).

Changes in the value of securities are fully reflected in the statement of income.

H. Provision for doubtful debts

The financial statements include a provision for doubtful debts which adequately reflect, according to management's evaluation, the loss inherent in debts whose collection is in doubt. The provision for doubtful debts includes specific provisions. Management, in determining the adequacy of provisions, considered, inter alia, information available regarding the financial condition of customers, the extent of their operations and an evaluation of the collateral received from them.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 2 - Reporting rules and accounting principles (contd.)

I. Deferred taxes

The companies in the Group apportion taxes as a result of temporary differences. Temporary differences are differences between the value for tax purposes of assets and liabilities and their book value. The said apportionment is made on account of differences relating to assets whose usage or expense are recognized for tax purposes.

The balance of deferred taxes (asset or liability) is calculated by the liability method at tax rates which are expected to be in effect when the deferred taxes will be utilized, using tax rates and tax laws which were legislated or whose legislation was completed as of the balance sheet date.

The main factors in respect of which deferred taxes have not been calculated are:

1. Amounts of adjustment for the changes in the purchasing power of the shekel relating mainly to buildings and private vehicles according to rules set forth by the Institute of Certified Public Accountants in Israel.
2. Investments in investee companies, as it is the Company's intention to hold these investments rather than sell them.
3. Tax benefits receivable for timing differences where the possibility of realizing the benefit is uncertain.

J. Recognition of revenues

1. Sales of products - revenues from the sales of products are recorded at the time of delivery to customers with the transfer of the main risks and benefits related to the ownership of the product sold.
2. Rental income - rental income is recorded over the period of the agreement proportionally to the relevant period.
3. Income from work in progress - in accordance with Accounting Standard No. 4, income from work in progress is recorded using the percentage of completion method.
The periodic reporting of income and costs deriving from building projects encompasses the full turnover, including those for which at the time of the report, it is not possible to estimate their expected profit, but for which it is possible to determine the anticipated repayment of the costs already incurred. In such instances, the full amount of such costs incurred are posted to the statements of income against revenues up to the amount of the said cost (hereinafter: Zero profit margin).
In those cases where a loss is expected from a project a full provision for the expected loss as of the project's completion is recorded.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 2 - Reporting rules and accounting principles (contd.)

K. Provision for linkage differences on customers deposits

Supergas, a subsidiary, is obligated by law to pay customers who terminate their gas purchasing agreement an amount equal to the latest approved deposit authorized by the Ministry of Industry and Trade, plus linkage differences from the date of the last approval until the actual payment date. The liability, included on the basis of the present value is determined according to the actual liability as mentioned above. The provision for this liability is made on a present value basis.

L. Earnings per share

Earnings per share is calculated in accordance with Pronouncement 55 of the Institute of Certified Public Accountants in Israel. In calculating the primary earnings per share, the convertible securities issued by the Company were taken into account if there is a likelihood of their conversion or realization in accordance with the tests set forth in the Pronouncement. In calculating diluted earnings per share, convertible securities issued by the Company and its investee companies which were not included in calculating the primary earnings per share were taken into account, provided that their conversion or realization does not result in an increase in earnings per share (anti-dilutive effect).

M. Use of estimates

In preparing the financial statements in accordance with generally accepted accounting principles, management applies estimates and evaluations which affect the reported amounts of assets and liabilities, the disclosure regarding contingent assets and liabilities and also the amounts of income and expenses recorded in the reporting period. Actual results may differ from these estimates.

N. Capitalization of credit costs

The Company capitalizes credit costs in accordance with Accounting Standard No. 3 which relates to capitalization of credit costs. According to this Standard, specific credit costs and non-specific credit costs should be capitalized to eligible assets. The credit costs which are non-specific are capitalized to that investment or that part of it which was not financed by specific credit, while applying a rate which is a weighted average of the cost for those sources of financing whose costs were not capitalized on a specific basis.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 2 - Reporting rules and accounting principles (contd.)

O. Presentation of transactions between the Company and a controlling party

Transactions between the Company and a controlling party in the Company are presented according to the Securities Regulations (Presentation of Transactions between a Company and a Controlling Party in the Financial Statements) 1996.

P. Derivative financial instruments

Forward currency transactions derivative financial instruments not for hedging purposes are presented in the balance sheet at their fair value. Changes in fair value are posted to the financing item in the statement of income. Results of derivative financial instruments which are intended for hedging are posted to the statement of income concurrently with posting the results of the hedged item.

Q. Decline in value of assets

The Company adopted Accounting Standard No. 15 Decline in the Value of Assets (hereinafter: the Standard). The Standard sets forth procedures which the Company must implement in order to ensure that the assets in its consolidated balance sheet (to which the Standard applies), will not be presented at an amount exceeding their recoverable value, which is the higher of the net selling price and the usage

value (the present value of the expected cash flows expected to result from the use of an asset and its realization). The Standard applies to all assets in the consolidated balance sheet excluding tax assets and monetary assets (apart from monetary assets which are investments in investee companies that are not subsidiaries). In addition the Standard stipulates the rules of presentation and disclosure regarding assets whose value declined. Where the value of an asset in the consolidated balance sheet exceeds its recoverable amount, the Company recognizes a loss from the decline in the value in the amount of the difference between the book value of the asset and its recoverable amount. The loss recognized will be cancelled only if there are changes in the estimates used in determining the recoverable amount of the asset from the last date in which the loss from the decline in value was recognized.

In September 2003, the Israeli Accounting Standards Board published Clarification No. 1 regarding the accounting treatment for a decline in the value of an investment in an investee company which is not a subsidiary (hereinafter: the Clarification). The Clarification stipulates that during periods subsequent to the period in which the provision for the decline in the value of an investee company which is not a subsidiary was first recorded, the investment in the investee company must be presented at the lower of the recoverable amount and the amount of the investment using the equity method, where the recoverable amount is calculated for every reporting period in which there are indications that there is a change in the recoverable amount.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 2 - Reporting rules and accounting principles (contd.)

R. Environmental costs

Current operating and maintenance costs of facilities used to prevent pollution of the environment and expected provisions for costs relating to restoring the environment, resulting from current operations or past operations, are charged to the statement of income. The costs of establishing facilities to prevent environmental pollution, which increase the life or efficiency of a facility or reduce or prevent environmental pollution, are charged to the cost of the fixed assets and depreciated according to the depreciation policy of the Company.

S. Disclosure of the effects of new accounting standards during the period prior to their implementation

- a. In October 2001, the Israel Accounting Standards Board published the following two Standards:
- (1) Accounting Standard No. 12 regarding The discontinuance of adjustment of financial statements . According to this standard the adjustment of financial statements for the effect of changes in the general purchasing power of the Israeli currency will be discontinued as of January 1, 2003. In December 2002 the Israeli Accounting Standards Board published Accounting Standard No. 17 which stipulated that the implementation of Accounting Standard No. 12 will be postponed to January 1, 2004. Therefore, the adjustment of financial statements will be discontinued as of January 1, 2004. The Company will continue to prepare adjusted statements according to Pronouncement 36 of the Institute of Certified Public Accountants in Israel until December 31, 2003. The adjusted amounts included in the financial statements as of December 31, 2003 will serve as a starting point for nominal financial reporting beginning January 1, 2004. Implementation of Accounting Standard No. 12 is liable to have significant effects on the business results reported by the Company. The extent of the effects depends on the rates of inflation, the composition of assets and the sources of the Company's financing.
 - (2) Accounting Standard No. 13 regarding The effects of changes in the rates of exchange of foreign currency . The standard deals with the translation of transactions in foreign currency and the translation of financial statements of foreign operations for their inclusion in the reporting corporation's financial statements. The Standard replaces the provisions of clarifications 8 and 9 to Pronouncement 36 of the Institute, which will be cancelled when Accounting Standard No. 12 described above, goes into effect.

Management estimates that the implementation of the Standard will not have a significant effect on the Company's financial condition and on the results of its operations.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 2 - Reporting rules and accounting principles (contd.)

T. Disclosure of effects of new accounting standards during the period prior to their implementation (contd.)

3. In March 2004, the Israel Accounting Standard Board published Accounting Standard No. 20 which relates to the period of amortizing goodwill (hereinafter: the Standard). The Standard stipulates that goodwill will be amortized over its expected useful life in a methodical manner. The period of amortization should reflect the best estimate of the period in which future economic benefits should result to the entity. The period of amortization is not to exceed 20 years from the date of its first recognition. The Standard will apply to financial statements for periods beginning on January 1, 2004 or thereafter.
- The change in the period of amortization of goodwill balances as of January 1, 2004 will be treated as a change in a prospective estimate (from here on). Balances of goodwill as mentioned, will be amortized in a methodical manner over the balance of the period remaining to complete the said amortization period.
- In the Company's management's opinion implementation of the new Standard will not have a significant effect on the Company's financial condition and on its results of operations.

Note 3 - Consolidated financial statements

Initially consolidated companies

During the current year the financial statements of Kleeson Holdings (1999) Ltd. were consolidated for the first time.

Following are amounts included in the consolidated financial statements (prior to the increase in the rate of holding the company was presented by the equity method).

	Date of acquisition of control	December 31, 2003 and the period from the acquisition up to the above date
NIS thousands		
Balance sheet		
Cash and cash equivalents	138	51
Working capital (excluding cash and cash equivalents), net	(19,216)	(19,467)
Fixed assets, after deducting accumulated depreciation	17,431	17,492
Investment in affiliated company	(1,647)	-
Statement of income		
Expenses and costs	-	(131)

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 4 - Accounting with the Fuel Authority and government control in the energy sector - Sonol

1. Amounts due to or from the Fuel Authority, the government agency responsible for supervision of the fuel market in Israel, to the extent still provisional, are included in the accounts each year according to estimates prepared by Sonol Israel Ltd.'s management (hereinafter: Sonol), a subsidiary, based on past experience. Differences arising as a result of changes in the estimates are reflected in the results of the period of account in which they are determined.
2. All the costs and expenses related to the holding of Security inventories, are fully recoverable from the government. Costs of holding Commercial inventories are on Sonol's account with all the attendant risks.
3. The sales prices of 95 and 96 octane gasoline at the public filling stations are subject to government control.

Note 5 Cash and cash equivalents

Consist of:

	December 31	
	2003	2002
	NIS thousands	
In local currency	5,637	7,916*
In foreign currency**	1,842	25,333
	7,479	33,249

Cash equivalents - bank deposits, whose maturities at the time of the deposit, did not exceed 3 months.

* Reclassified

** Mainly in US dollars.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 6 Trade and other receivables

Consist of:

	December 31	
	2003	2002
	NIS thousands	

(1) Trade receivables:		
Customers open accounts	714,253	761,964*
Income receivable	19,800	18,665*
Checks and notes receivable	204,622	158,715
Credit card companies	100,115	109,894
Current maturities of long-term loans granted	30,204	23,091
Less provision for doubtful debts	(103,380)	(54,684)*
	965,614	1,017,645
(2) Other receivables:		
Fuel Authority	4,212	4,861
Government agencies	424	1,114
Income receivable	963	881
Income tax receivable	4,383	12,085
Employees	1,188	821
Prepaid expenses	10,435	17,274*
Deferred taxes, net**	33,896	31,823*
Current maturities of long-term receivables	-	38,349
Others	16,236	18,180
	71,737	125,388
(3) Receivables for work in progress:		
Income receivable	62,114	63,768
Less receipts on account of work in progress	47,671	46,700
	14,443	17,068

(4) For credit risks see Note 28e.

* Reclassified

** See Note 26

Note 7 Inventories

Consist of:

	December 31	
	2003	2002
NIS thousands		
Crude oil and raw materials	48,184	42,021
Finished goods	234,055	268,593
Auxiliary materials	12,933	14,932
Goods in process	6,574	5,819
Inventory of work in process, net (1)	5,077	-
	306,823	331,365
Less non-current inventories (2)	110,981	117,786
	195,842	213,579
(1) Inventory of work in process	57,879	51,150

Less amount reflected in the statement of income	<u>52,802</u>	<u>51,150</u>
	<u>5,077</u>	<u>-</u>

(2) See Note 2.c.1

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 8 Investee companies and other investments

	December 31	
	2003	2002
	NIS thousands	
Affiliated companies and others:		
<u>Investments in affiliated companies</u>		
Balance of investments as at December 31, 1991	12,575	12,575
Changes as of January 1, 1992:		
Cost of shares**	146,693	146,047*
Share in accumulated net losses	(47,814)	(31,969)*
Write-down of investment	(15,152)	(17,071)
Long-term loans to affiliated companies (1)	11,261	12,392*
Investment in capital notes of affiliated company (2)	6,936	6,114
Classification to current assets (3)	(12,516)	-
Presented in reserve for losses	1,530	145
	<u>103,513</u>	<u>128,233</u>
Investment in shares on the cost basis after write down to recoverable value (4)	26,991	32,180
	<u>130,504</u>	<u>160,413</u>

* Reclassified

** Including goodwill not yet fully amortized:

Original amount	16,281	16,281
Balance	10,150	11,962

Securities listed for trading on the Tel Aviv Stock Exchange:Affiliated companies:

Book value	75,437	83,396
Stock exchange value	28,381	19,796

	<u> </u>	<u> </u>
Companies at cost:		
Book value	<u>3,369</u>	<u>4,294</u>
Stock exchange value	<u>7,580</u>	<u>7,437</u>

- (1) The loans are index linked and bear interest at the rate of 0%-10% with no due date but not prior to January 1, 2005.
- (2) Permanent capital notes issued by a limited partnership are unlinked and non-interest bearing.
- (3) In January 2004, after signing MOU at December 2003, a subsidiary sold all its holdings in an affiliated company.
- (4) In 2003 a provision for a decline in the value of the investments of NIS 5,266 thousand was included. See also Note 25.

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Granite Hacarmel Investments Limited and its Subsidiaries
Notes to the Financial Statements as at December 31, 2003

Note 8 Investee companies and other investments (contd.)
Changes in investment in affiliated companies:

	<u>NIS thousands</u>
Balance as at January 1, 2003	128,233
Changes during the year:	
Investment in shares	646
Investment in capital notes	822
Repayment of loans, net	(1,131)
Initial consolidation of former affiliated company (See Note 3)	1,647
Share in losses, net	(17,189)
Reclassification of writedown of investment in affiliated company to equity losses	1,919
Dividend during the year of report	(303)
Reclassification to current assets	(12,516)
Changes in reserve for the losses	1,385
	<u> </u>
Balance as at December 31, 2003	<u>103,513</u>

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Granite Hacarmel Investments Limited and its Subsidiaries
Notes to the Financial Statements as at December 31, 2003

Note 9 Loans and long-term receivables
A. In consolidated balance sheet comprised as follows:

	December 31	
	2003	2002
NIS thousands		
Loans to customers (1)	141,910	148,775*
Other loans	5,390	1,872*
	<u>147,300</u>	<u>150,647</u>
Less current maturities	30,204	23,091
	<u>117,096</u>	<u>127,556</u>
Other receivables (2)	-	38,349*
Checks and notes for collection	12,741	2,567*
Less current maturities	-	(38,349)
	<u>12,471</u>	<u>2,567</u>
	<u>129,837</u>	<u>130,123</u>
Dates of repayment of loans:		
Current maturities	30,204	
Second year	21,253	
Third year	18,967	
Fourth year	10,825	
Fifth year	9,068	
Sixth year and thereafter or without due date	56,983	
	<u>147,300</u>	

* Reclassified

- (1) December 31, 2003 less provision of NIS 1,624 thousand for the difference between the interest stated in the loan and market interest on the date of granting the credit to the customer.
- (2) Balance of long-term receivables in the Company from the sale of shares of an investee company. According to the sales agreement, the balance of the debt that was linked to the consumer price index, was paid on April 22, 2003. The discount rate of the balance of the debt in 2002 was 6%.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 9 Loans and long-term receivables (contd.)

B. Breakdown of loans according to size of borrowers balances :

December 31, 2003
Number of loans

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Borrowers balances of NIS thousands		Total loans NIS thousands
Up to 1,000	125	18,896
From 1,000 10,000	43	101,372
Over 10,000	2	27,032
	<u>170</u>	<u>147,300</u>

A large part of the loans are covered by rental agreements and long-term supplier agreements in favor of companies in the Group and the companies have the right to offset amounts payable.

C. Linkage terms and interest rates on the loans:

	December 31, 2003						
	Unlinked		Linked to the index		Linked to foreign currency		
Interest rates:	0%	10-20%	0-4%	over 4-10%	0-3%	over 3-5%	Total
	NIS thousands						
Loans to customers	6,335	37	50,365	35,891	35,171	14,111	141,910
Others	-	-	159	5,231	-	-	5,390
	<u>6,335</u>	<u>37</u>	<u>50,524</u>	<u>41,122</u>	<u>35,171</u>	<u>14,111</u>	<u>147,300</u>
Less current maturities							<u>30,204</u>
							<u>117,096</u>

D. Regarding credit risks see Note 28.e.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 10 Fixed assets

a. Consist of:

Land and buildings*	Machinery and equipment	Furniture, equipment and computers	Vehicles	Total
---------------------------	-------------------------------	--	----------	-------

NIS thousands

Cost					
Balance at beginning of year	1,234,537	1,384,850	166,216	78,720	2,864,323
Additions**	55,275	40,698	12,936	7,391	116,300
Disposals	(7,173)	(3,121)	(766)	(9,047)	(20,107)
Balance at end of year	1,282,639	1,422,427	178,386	77,064	2,960,516
Accumulated depreciation					
Balance at beginning of year	455,402	1,020,292	115,594	52,528	1,643,816
Depreciation charged**	30,979	52,807	18,763	7,300	109,849
Depreciation on disposals	(103)	(2,422)	(222)	(6,631)	(9,378)
Balance at end of year	486,278	1,070,677	134,135	53,197	1,744,287
Provision for decline in value					
Losses from decline in value, net	(29,752)	(3,013)	-	-	(32,765)
Withdrawals for assets sold	3,097	-	-	-	3,097
Balance at end of year	(26,655)	(3,013)	-	-	(29,668)
Depreciated balance as at Dec. 31, 2003	769,706	348,737	44,251	23,867	1,186,561
Depreciated balance as at Dec. 31, 2002	779,135	364,558	50,622	26,192	1,220,507

* Including leasehold improvements

** Including on behalf of an initially consolidated company (See Note 3).

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Granite Hacarmel Investments Limited and its Subsidiaries**Notes to the Financial Statements as at December 31, 2003****Note 10 Fixed assets (contd.)**

- b. Land and buildings include buildings on land leased by capital leasing at a cost of NIS 327,617 thousand for various original periods of 49-98 years ending in the years 2004-2072. Land and buildings costing NIS 282,624 thousand have not yet been registered in the name of the Company or in subsidiaries in the Land Registry Office. The main reason for the lack of registration is that the land settlement and subdivision procedures have not yet been completed.

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Land and buildings include buildings on leased land and leasehold improvements to rented property having a cost of NIS 20,359 thousand and a depreciated cost of NIS 10,365 thousand. The terms of the leases were for original periods of 4 to 25 years.

- c. Financing expenses of NIS 5,458 thousand for loans and credit used to finance the construction of fixed assets were charged to the cost of these assets.
- d. Regarding collaterals see Note 28.

Note 11 Other assets

Consist of:

	Depreciated balance	
	December 31	
	2003	2002
	NIS thousands	
Other assets		
Leasing and deferred rental	31,612	31,560*
Goodwill in subsidiaries	15,035	17,360*
Concessions for oil and gas exploration (1)	915	4,698
Delivery and filling station operation rights	69,829	42,388*
Distribution rights	19,431	21,374
Others (2)	21,015	14,841*
	157,837	132,221
Long-term deferred taxes (See Note 26)	51,212	17,356
	209,049	149,577

(1) See also Notes 25 and 31.a.

(2) After writeoff in the amount of NIS 2,715 thousand

* Reclassified

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 12 - Credits from banks and other credit provided

Details of linkage and interest rates:

	December 31, 2003				December 31, 2002			
	Unlinked	Linked to the index	Linked to foreign currency	Total	Unlinked	Linked to the index	Linked to foreign currency	Total
	5.7%-9.4%	4.6%-6.5%	2.4%-4.2%		6.3%-13.1%	4%-7.2%	2.5%-3.1%	
	NIS thousands				NIS thousands			
Overdrafts	1,345	-	-	1,345	12,936	-	-	12,936
Short-term loans	922,812	-	179,401	1,102,213	773,143	-	202,860	976,003

Current maturities of long-term loans	22,752	194,314	744	217,810	-	134,851	856	135,707
Total credit from banks	946,909	194,314	180,145	1,321,368	786,079	134,851	203,716	1,124,646
Credit from others	-	1,034	-	1,034	-	1,138	-	1,138
	946,909	195,348	180,145	1,322,402	786,079	135,989	203,716	1,125,784

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Granite Hacarmel Investments Limited and its Subsidiaries

Financial Statements December 31, 2003

Note 13 Trade payables

The liabilities include NIS 2,932 thousand balances of related and interested parties (2002 NIS 36,437 thousand). Linkage terms See Note 18.

Note 14 Other payables

Consist of:

	December 31	
	2003	2002
	NIS thousands	
Liabilities to employees and other salary related liabilities	41,757	44,270
Institutions	72,390	70,374
Accrued expenses	44,860	34,346
Income tax payable	19,131	10,215
Deferred taxes	868	1,300
Reserve for losses of affiliated companies	1,530	145
Others	15,252	19,385
	195,788	180,035

Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 15 Long-term liabilities

a. Long-term loans

Consist of:

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		December 31		
		2003	2002	
		NIS thousands		
Rate of interest				
%				
Loans from banks	index linked	4.6-6.5	702,826	828,219
Loans from banks	unlinked	7.6	227,520	223,221
Customers deposits	index linked	-	3,206	3,197
Customers deposits	linked to foreign currency	-	-	88
Loans from banks	linked to foreign currency	2.4	3,317	4,364
Loans from others	index linked	4.5	809	352
Capital notes	unlinked	-	215	211*
		937,893	1,059,652	
Less current maturities		217,810	135,707	
		720,083	923,945	

Maturity dates:

		December 31	
		2003	2002
		NIS thousands	
First year	current maturities	217,810	135,707
Second year		241,437	216,667
Third year		88,697	240,179
Fourth year		55,851	87,494
Fifth year		60,601	54,186
Sixth year and thereafter		269,266	321,570
Without due date		4,231	3,849*
		720,083	923,945
		937,893	1,059,652

Accrued interest is included in current liabilities in other payables .

* Reclassified

Notes to the Financial Statements as at December 31, 2003

Note 15 Long-term liabilities (contd.)

b. In order to obtain the long-term bank credit taken by the Company and Sonol, the Company undertook the following covenants to the main banks providing the credit:

1. Total shareholders' equity plus customers' deposits will not be less than NIS 450 million. The amount is linked to the index of December 1998.
2. The ratio of shareholders' equity plus customers' deposits divided by total assets less Security inventories will not be less than 20%. Subsequent to the balance sheet date it was agreed with the banks to whom the covenants were issued that the ratio will be 17% for a period until March 31, 2005.
3. Maintaining the ratio of total liabilities to the banks and financial institutions (less liabilities for Security inventories) to EBITDA (earnings before interest, taxes, depreciation and amortization) that will not exceed 10 at any time.

On the date of editing the financial statements the Company has complied with the covenants. In addition the Company and certain subsidiaries agreed not to create a specific collateral on its assets (excluding a certain specific existing collateral, and excluding a collateral to finance the acquisition and development of those assets).

Note 16 Customers' deposits

a. The deposits are calculated on the basis of present value at an annual rate of interest of 4%.

b. Customers' deposits include NIS 32,747 thousand (2002 - NIS 36,894 thousand) of linkage differences accrued on these deposits.

Note 17 Liabilities for severance pay, net

Consist of:

	December 31	
	2003	2002
	NIS thousands	
Liabilities for severance pay (a)	14,305	18,387
Less: Funded amounts deposited**	5,012	5,671
	9,293	12,716
Liabilities for early pension (b)*	11,348	13,801
Reserve for redemption of sick leave (c)	2,194	2,344
	22,835	28,861

* Does not include NIS 7,445 thousand (2002 - 8,897 thousand) the current portion of severance pay, net, included in other payables.

** The deposited funded amount can be withdrawn subject to the provisions of the law. Accumulated profits on these funded amounts are included in the statement of income.

Notes to the Financial Statements as at December 31, 2003

Note 17 Liabilities for severance pay, net (contd.)

- (a) The Company's liabilities and those of its investee companies for payments of pension and severance pay are fully covered by provisions for severance pay, deposits in approved pension and severance pay funds and managers' insurance programs. The deposits in the approved pension and severance pay funds and the deposits in managers' insurance programs are not included in the financial statements as they are not controlled by the companies.
- (b) The liabilities for early pension are calculated at the present value of future liabilities for employees who retire. The liabilities are until such time when the employee reaches the age of 65 (women up to the age of 60) and are calculated at a fixed percentage of the maximum pension due to the employee from the pension fund. The discount rate used in calculating the liability is based on the stock exchange discount rate for annual interest charged on index linked amounts, in effect on the date of the employees retirement from the Company.
- Subsequent to the balance sheet date a law was enacted in the Knesset, according to which retirement ages as of April 1, 2004 will be delayed gradually until the age of 67 for men and 62 for women. Against this the Minister of Finance submitted a letter to the chairman of the Finance Committee of the Knesset, according to which an annual fund for severance pay will be provided for those harmed by the implementation of the law, including employers. The Company's management is examining all the financial and legal aspects as a result of the implementation of the law, and its effects on the Company's liabilities.
- (c) According to labor agreements between investee companies and their employees, an employee who retires, is entitled to receive a partial redemption of the unused sick pay subject to a maximum number of sick days. The reserve was prepared in part according to actuarial calculations and in part on the basis of past experience based, inter alia, on a net discount rate (after taking into account the rate of real wage costs) of 3%.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 18 Linkage of monetary balances

	December 31, 2003			December 31, 2002		
	Linked to the index	Linked to foreign currency **	Unlinked ***	Linked to the index	Linked to foreign currency **	Unlinked ***
	NIS thousands			NIS thousands		
Financial assets:						
Cash and cash equivalents	-	1,842	5,637	-	25,333	7,916*
Customers and receivables for						
work in progress	20,249	45,281	914,527	13,649	61,068	959,996*
Other receivables	778	954	25,674	39,170	1,678	35,443*
Investments in loans and capital notes	7,255	-	34	7,197	-	6,114
Long-term loans, net	67,472	41,343	21,022	71,352	50,581	8,190*
	95,754	89,420	966,894	131,368	138,660	1,017,659

Financial liabilities:

Credit from banks and others (excluding current maturities)	1,034	179,401	924,157	1,138	202,860	786,079
Trade payables	2,343	56,100	130,647	-	76,734	109,118*
Other payables	24,524	1,077	160,344	26,674	6,602	136,417
Long-term loans (including current maturities)	706,841	3,317	227,735	831,768	4,452	223,432
Deposits from customers	58,102	-	-	61,050	-	-
	792,844	239,895	1,442,883	920,630	290,648	1,255,046

* Reclassified

** Mainly US dollars

*** Part of which bear interest

Against the excess of liabilities linked to foreign currency totaling NIS 150,500 thousand (2002 NIS 152,100 thousand) Sonol holds inventories of fuel totaling NIS 156,600 thousand (2002 NIS 181,900 thousand), which are mainly Security inventories valued according to changes in the rate of exchange of the dollar as explained in Note 2.c.1.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 19 Share capital

a. Nominal

	Authorized		Issued and paid up*	
	December 31, 2003	December 31, 2002	December 31, 2003	December 31, 2002
	NIS thousands		NIS thousands	
225,000,000 ordinary shares of NIS 1 par value each	225,000	225,000	139,336	139,336

* 139,335,657 ordinary shares

As of December 31, 2003 and 2002 a subsidiary holds 1,565,540 ordinary shares of the Company.

All the shares are listed for trading on the Tel Aviv Stock Exchange.

b. (Loss) Earnings per share

1. Adjusted net (loss) income used in calculating earnings per share is as follows:

For the year ended December 31

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	2003	2002	2001
	NIS thousands		
Net (loss) income per statement of income	(96,046)	24,167	49,516

2. The par value of the shares used for calculating net income per NIS 1 par value of shares:

	For the year ended December 31		
	2003	2002	2001
	NIS thousands par value		
Share capital in calculating primary earning per share	137,770	138,381	138,720

Note 20 Net sales

	For the year ended December 31		
	2003	2002	2001
	NIS thousands		
Commercial operations	2,429,723	2,375,391	2,394,714
Manufacturing operations	439,654	503,281	285,984
Other operations	17,696	15,433	10,406
	2,887,073	2,894,105	2,691,104

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 21 Cost of sales

Consolidated:

a. Consist of:

	For the year ended December 31		
	2003	2002	2001
	NIS thousands		

Fuel products and other materials used*	1,974,209	1,946,807	1,907,459
Wages and outsourcing	42,971	43,081	25,590
Manufacturing expenses	89,439	126,954	104,662
Depreciation and amortization	20,498	17,816	9,771
Total cost of sales	2,127,117	2,134,658	2,047,482
Decrease (increase) in inventories	24,542	68,343	(2,839)

* Financing income (expenses) deriving from the erosion of dollar linked credit used as a source of financing for the acquisition of inventories of fuel included in the Cost of sales (See also Note 2.c.1)

b. Categories according to types of income:

For the year ended December 31

	2003	2002	2001
	NIS thousands		
Commercial operations	1,819,389	1,818,940	1,876,451
Manufacturing operations	298,606	308,187	166,502
Other operations	9,122	7,531	4,529
	2,127,117	2,134,658	2,047,482

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 22 Selling and marketing expenses

Consist of:

For the year ended December 31

2003	2002	2001
NIS thousands		

Wages and salaries	162,731	151,696	125,534
Advertising	25,998	32,872	17,139
Depreciation and amortization	85,294	81,082	78,246
Maintenance of buildings, installations and filling stations	31,728	28,545	28,322
Rent and municipal taxes	105,617	92,117	75,289
Transport and maintenance of commercial vehicles	55,528	52,920	47,220
Other expenses	33,947	41,552	28,477
	500,843	480,784	400,227

Note 23 General and administrative expenses

Consist of:

	For the year ended December 31		
	2003	2002	2001
	NIS thousands		
Wages and salaries	56,790	57,538	45,326
Depreciation and amortization	17,110	18,795	12,323
Consulting, legal and auditing	12,736	12,431	9,260
Provision for doubtful/bad debts	48,954	5,184*	12,884*
Other expenses	18,422	16,020	10,263
	154,012	109,968	90,056

* Reclassified

Note 24 Financing (expenses) income, net

(Expenses) income are derived from:

	For the year ended December 31		
	2003	2002	2001
	NIS thousands		
Long-term liabilities	(58,480)	(44,795)	(33,758)
Marketable securities, net	5,460	(8,143)	(204)
Other receivables and payables	2,379	4,108	10,812
Short-term loans received	(92,540)	(11,380)	(69,358)
Convertible debentures linked to the dollar	-	9	(1,823)
(Loss) gain from forward transactions	(1,308)	972	644
Others, including erosion of other monetary assets and liabilities, net	13,984	(25,908)	18,065
	(130,505)	(85,137)	(75,622)

Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 25 Other (expenses) income, net

Consist of:

	For the year ended December 31		
	2003	2002	2001
	NIS thousands		
Provisions for a decline in the value of fixed and other assets (a)	(35,480)	-	-
Amortization of assets and concessions for prospecting for oil and gas (b)	(12,924)	(9,107)	-
Write-off of investment in affiliated company and on the basis of costs, net	(5,266)	(20,014)	(5,850)
Management fees	1,517	1,114	511
Leasing	673	1,102	1,228
Dividends and shares received	145	469	12,647
(Loss) gain from realizing investment in investee companies	-	(21)	151
Miscellaneous, net (c)	(10,832)	2,627	1,138
	(62,167)	(23,830)	9,825

(a) See also Note 2(q)

(b) See also Note 31(a)

(c) Including expenses and provisions for settling claims and demands.

Note 26 Taxes on income

- A. The Company and most of its subsidiaries are assessed under the Income Tax Law (Adjustments for Inflation) 1985, hereinafter the Adjustments Law, in effect from the 1985 tax year which introduced the measurement of results for tax purposes in real terms. The various adjustments required by the above law should result in taxation based on real income. Nevertheless, the adjustment of nominal income according to the tax Laws is not always identical to the inflationary adjustment pursuant to the Pronouncements of the Institute of Certified Public Accountants. As a result, differences arise between the adjusted income according to the financial statements and the adjusted income for income tax purposes.

In the financial statements for 2003 the Company implemented the law as written and took into account the negative rate of change of the index in calculating the tax provision.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 26 Taxes on income (contd.)

B. Amendments to the Income Tax Ordinance and the Land Betterment Tax Law

1. In March 2002 the Knesset passed Amendment No. 50 to the Land Taxation Law (Land betterment, selling and purchasing) (hereinafter: the Amendment) which came into effect on November 7, 2001 (hereinafter: the effective date).
The Amendment stipulates, inter alia, that upon the sale of a right in real estate or a transaction in a land association, the Company will be liable for tax at a rate of 36% on the real betterment created up to the effective date and 25% on the betterment created after the effective date where the allocation is linear according to the ratio of the periods. In addition , the amendment stipulates land betterment tax discounts on transactions carried out during 2002 and 2003 and an exemption from sales tax on land purchased after the starting date. Furthermore , the new provisions were enacted for the purpose of calculating the tax from the sale of shares in a land association and other provisions were added for the purpose of facilitating certain transactions in real estate such as the temporary provisions regarding replacements, sale of options, combination transactions, vacating and building.
2. On July 24, 2002 the Knesset passed the Law for the Amendment of the Income Tax Ordinance (Amendment No. 132) 2002 and in December 2002 an amendment to the said Law was passed (hereinafter: the Tax Reform) which became effective as of January 1, 2003. Within the framework of the Tax Reform the basis for taxation in Israel was changed, to a personal basis from a territorial / geographic basis. As of January 1, 2003, an Israel resident will be subject to his tax on his total global income.
3. The main provisions of the tax reform likely to affect Israeli resident companies are:
 - a. The source rules source rules have been set forth to determine the location where income is derived.
 - b. A controlled foreign corporation (CFC) - rules have been issued according to which, in certain cases, Israeli shareholders will be taxed on theoretical dividends for passive undistributed income from a foreign resident company under their control
 - c. The offsetting of losses from abroad restrictions have been issued regarding offsetting losses from abroad.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 26 Taxes on income (contd.)

B. The amendments to the Income Tax Ordinance and the Land Betterment Tax Law (contd.)

- d. Tax credit within this framework, special provisions have been made to provide a credit to an Israeli company who paid foreign tax on income from abroad and is subject to company tax.
- e. Capital gains The rate of tax on capital gains from non-negotiable assets was reduced from 36% to 25% (linear according to the ratio of periods), excluding capital gains on marketable securities in a company as reflected in the Adjustments Law.
- f. Regarding individuals and companies to which the Adjustments Law does not apply, tax was imposed on capital gains and interest from securities traded on the stock exchange in Israel and abroad at lower tax rates of 10%, 15% or 25% regarding an individual and companies not subject to the Adjustments Law and whose income is not considered to be business income. In addition, the definition of foreign securities was changed in such a way that a security issued by an Israeli company is not considered to be a foreign security.

- g. Cancellation of the seven years restriction regarding the utilization of capital losses carried forward (applicable to losses incurred in 1996 and thereafter).
- h. Transfer prices general provisions were issued requiring reporting on international transactions between related parties according to market conditions. These provisions will come into effect when regulations are issued (no regulations have yet been issued).

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Granite Hacarmel Investments Limited and its Subsidiaries
Notes to the Financial Statements as at December 31, 2003

Note 26 Taxes on income (contd.)
C. Deferred taxes
For the following items:

	Depreciable fixed assets	Deductions and losses transferable for tax purposes	Liabilities for severance pay, net	Other	Total
	NIS thousands				
Balance as at January 1, 2002	(69,362)	295	24,709	17,069*	(27,289)
Changes in 2002:					
Current	(438)	3,060	(7,322)	15,687*	10,987
Addition for company initially consolidated	-	462	36	63	561
Balance as at December 31, 2002	(69,800)	3,817	17,423	32,819	(15,741)
Changes in 2003:					
Current	(1,013)	17,092	(2,807)	18,124	31,396
Balance as at December 31, 2003	(70,813)	20,909	14,616	50,943	15,655

The deferred taxes are presented in the balance sheets as follows:

December 31	
2003	2002
NIS thousands	

In current assets	33,896	31,823*
In current liabilities	(868)	(1,300)
In other assets and deferred expenses, net	51,212	17,356
In long-term liabilities	(68,585)	(63,620)
	<u>15,655</u>	<u>(15,741)</u>

* Reclassified

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 26 Taxes on income (contd.)

D. The provision in the statement of income consists of: expense (income):

For the year ended December 31

	2003	2002	2001
	NIS thousands		
Current taxes including erosion of advance tax payments	20,889	40,797	27,326
Deferred taxes, net	(31,396)	(10,987)*	9,108*
	<u>(10,507)</u>	<u>29,810</u>	<u>36,434</u>
Taxes on account of previous years	879	(1,701)	(164)
	<u>(9,628)</u>	<u>28,109</u>	<u>36,270</u>

E. Final assessments

The Company, Sonol and Supergas received final assessments through the 1999 tax year. The assessments for these companies were completed in 2002 within the framework of a compromise with the Tax Authorities. The net effect, part of which results from timing differences, was included in financial results for 2002. Sprint Motors Ltd. received final tax assessments through 1998. All other companies in the Group, have final tax assessments within the framework of Section 145(a)(2) Income Tax Ordinance (Statute of Limitations) through years 1997 and 1998.

F. Losses, deductions and additional tax for the purpose of tax to be carried forward to future years.

Losses for tax purposes of the Company and its subsidiaries to be carried forward to future years, as of the balance sheet date reached an adjusted amount of NIS 99,000 thousand.

The balances of losses and deductions carried forward to following years are index linked - in accordance with the Adjustments Law mentioned in (a) above.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 26 Taxes on income (contd.)

G. Reconciliation between the theoretical tax on pre-tax adjusted income and the provision for tax included in the statements

	For the year ended December 31		
	2003	2002	2001
	NIS thousands		
Statutory tax rates	36%	36%	36%
Theoretical tax per applicable tax rates	(31,526)	21,502*	31,515*
Differences in definition of capital, assets and expenses for tax purposes and others, net (1)	21,108 ⁽¹⁾	8,096*	4,856*
Erosion of advance tax payments	(89)	212	63
Taxes on account of previous years	879	(1,701)	(164)
	<u>(9,628)</u>	<u>28,109</u>	<u>36,270</u>

(1) Including NIS 9,770 thousand for losses and deductions on which no deferred taxes were apportioned

* Reclassified

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 27 Segment reporting

Segment reporting by products and services:

The accounting principles applied in the segment reporting are in accordance with those adopted for the purpose of preparing and presenting the Company's consolidated financial statements.

For the year ended December 31, 2003

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	Fuel and gas	Paint and chemicals	Others	Consolidated
NIS thousands				

Profit and loss data:

Income

Net external sales	2,400,768	380,310	105,995	2,887,073
Sales within segments	-	-	-	-
Total sales	2,400,768	380,310	105,995	2,887,073

Results

Segment results	83,040	31,697	6,267	121,004
Unallocated expenses				(15,903)
Income from operations				105,101
Financing expenses				(137,980)
Financing income				7,475
Other expenses, net				(62,167)
Taxes on income				9,628
Minority interest in results of subsidiaries				(914)
Share in results of affiliated companies, net	(717)		(16,472)	(17,189)
Net loss				(96,046)

Additional information

Segment assets	2,017,859	590,939	191,523	2,800,321
Investments by the equity method	9,725	-	93,788	103,513
Unallocated assets				133,656
Total consolidated assets				3,037,490
Segment liabilities	256,994	102,603	51,160	410,757
Unallocated liabilities				2,166,128
Total consolidated liabilities				2,576,885
Capital investments	127,521	8,008	5,728	
Depreciation and amortization	80,786	21,928	6,990	

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 27 Segment reporting (contd.)

For the year ended December 31, 2002

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	Fuel and Gas	Paint and chemicals	Others	Consolidated
NIS thousands				

Profit and loss data:

Income

Net external sales	2,390,410	395,649	108,046	2,894,105
Sales within segments	-	-	-	-
Total sales	2,390,410	395,649	108,046	2,894,105

Results

Segment results	140,991*	42,217	(527)	182,681
Unallocated expenses				(13,986)
Income from operations				168,695
Financing expenses				(89,268)
Financing income				4,131
Other expenses, net				(23,830)
Taxes on income				(28,109)*
Minority interest in results of subsidiaries				(2,268)
Share in results of affiliated companies, net	(318)	750	(5,616)	(5,184)
Net loss				24,167

Additional information

Segment assets	2,071,957*	630,926	225,280	2,928,163
Investments by the equity method	8,982	12,515	106,736	128,233
Unallocated assets				146,204
Total consolidated assets				3,202,600
Segment liabilities	253,856	83,415	45,526	382,797
Unallocated liabilities				2,186,350
Total consolidated liabilities				2,569,147
Capital investments	99,377	16,175	31,912	
Depreciation and amortization	88,688	22,152	7,286	

* Reclassified

Granite Hacarmel Investments Limited and its Subsidiaries
Notes to the Financial Statements as at December 31, 2003

Note 27 Segment reporting (contd.)

For the year ended December 31, 2001

	Fuel and Gas	Paint and chemicals	Others	Consolidated
	NIS thousands			
Profit and loss data:				
Income				
Net external sales	2,446,189	187,406	57,509	2,691,104
Sales among segments	-	-	-	-
Total sales	2,446,189	187,406	57,509	2,691,104
Results				
Segment results	*138,563	14,031	10,115	162,709
Unallocated expenses				(9,370)
Income from operations				153,339
Financing expenses				(78,631)
Financing income				3,009
Other expenses, net				9,825
Taxes on income				(36,270)*
Minority interest in results of subsidiaries				(1,761)
Share in results of affiliated companies, net	(928)	-	933	5
Net loss				49,516

* Reclassified

Granite Hacarmel Investments Limited and its Subsidiaries
Notes to the Financial Statements as at December 31, 2003

Note 28 Collateral, commitments and contingent liabilities**A Floating and fixed charges**

In consolidated balance sheet:

	Dec. 31, 2003	
	NIS thousands	Secured by
Bank overdrafts	1,345	Floating charge on current assets of main investee companies and on non-current inventories of a subsidiary.
Short-term loans from banks	1,102,213	Charge on the shares of some of the investee companies and on current assets, non-current inventories and on other assets and on the land owned by some of the investee companies.
Long-term loans from banks	933,663	Charge on the shares of some of the investee companies. Floating charge on current assets and on non-current inventories of some of the main investee companies, a charge on rights in land owned by an investee company and a fixed charge on some of the fixed assets of some of the investee companies (see Note 15b, and paragraph C2(a)).
Investment grants	590	Current and floating charge on a portion of of the fixed assets of subsidiaries.
Rights of affiliated company	-	A first mortgage on all the rights of an investee company in an affiliated company in order to secure 50% of the credit totaling NIS 75 million provided to the affiliated company.

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Granite Hacarmel Investments Limited and its Subsidiaries**Notes to the Financial Statements as at December 31, 2003****Note 28 Collateral, commitments and contingent liabilities (contd.)****B. Contingent liabilities and claims****1. Indemnification and insurance of officers**

A special general meeting of the Company approved:

- a. Providing indemnity in advance for all eligible directors and senior officers in the Company and its subsidiaries, in the past, present and future, as of January 1, 1995. The undertaking to indemnify is limited to types of events and amounts as detailed in the resolution passed.
- b. Providing an exemption in advance to all eligible directors and senior officers in the Company and subsidiaries from total liability due to damage as a result of the violation of the obligation to act judiciously in regard to the Company.
- c. Liability insurance of directors and senior officers in the Company and subsidiaries, in the past, present and future as of January 1, 1995. Accordingly the Company insured the liability of directors and senior officers for a total amount of 10 million US dollars.

2. Pending litigation

- a. Sonol is involved in four claims filed against it by IDF invalids, operators of filling stations, who received the operating rights within the framework of an arrangement between the invalids and the rehabilitation department of the Ministry of Defense, the Israel Lands Administration and the fuel companies:

1. One claim (from 1996) is for a declarative ruling on the invalidity of agreements between the operator and Sonol on the contention that they are restraint of trade agreements prohibited under the Law for Restrictive Trade Practices. The operator's claim was rejected by the court. The operator filed an appeal to the Supreme Court in which he contests the factual findings and the legal conclusions. The appeal was referred to mediation which was unsuccessful. Therefore, the appeal will be heard. The Supreme Court combined the hearings of this claim together with a number of similar claims filed against another fuel company and even requested the Attorney General to join the proceedings and express his stand on the questions in principle arising therefrom. (To provide a complete picture: In cases of similar claims against another fuel company, divergent rulings were handed down. In one, the operator's contentions were accepted, and in another they were rejected. Appeals were filed with the Supreme Court against these rulings). In the opinion of the company's management, based on the opinion of its legal counsel, it is not possible to determine at this stage what the Attorney General's position and the outcome of the appeal will be. The ruling regarding this claim will affect the legal proceedings in other claims in which IDF invalids are involved.
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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 28 Collateral, commitments and contingent liabilities (contd.)

B. Contingent liabilities and claims (contd.)

2. Pending litigation (contd.)

2. Another IDF invalid operating a filling station in 1999 submitted a suit to receive declarative relief on the contention that the series of agreements between him and Sonol were restraint of trade agreements and therefore null and void. In addition the plaintiff request to declare that the agreement to appoint an operator includes discriminatory conditions in a standard contract and that Sonol be required to pay an amount of approximately NIS 2 million and this due to the excessive prices he claims Sonol charged him over years. The case is at the stage of presenting proof. In the company's management's opinion, based on the opinion of its legal advisors, the ruling in this case as far as it relates to the claims of a restraint of trade arrangement, will be the same as the above claim. If the claim that the agreements are invalid due to their being restraint of trade arrangements is not accepted, then the chance of Sonol's defense as far as it relates to the financial claim against Sonol, are reasonable or even good. Sonol sued the operator for the non-payment of a debt and for breach of agreement between them and informed him of the cancellation of the agreement and of his appointment as the operator of the station.
3. An additional IDF invalid, operator of a filling station, whose eviction from the station he operates is being demanded by Sonol, due to his not paying for products purchased, filed a counterclaim in 2003 claiming an amount of approximately NIS 2.5 million both from Sonol and another fuel company, contending restraint of trade and discriminatory conditions in a standard contract. In the company's management's opinion, based on the opinion of its legal advisors, Sonol's defense prospects in all aspects relating to the claim of a binding restraint of trade agreement are good in view of the verdict in the claim described in paragraph 1 above.
4. Other operators, heirs of an IDF invalid, filed a claim in September 2003 against Sonol in which they claimed both declarative relief claiming that the series of

agreements between the parties is a restraint of trade agreement and that the terms of the engagement have discriminatory or restrictive terms in a standard agreement, and also a financial claim for NIS 15 million. Due to the early stages of the claim it is not yet possible to assess its prospects.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 28 Collateral, commitments and contingent liabilities (contd.)

B. Contingent liabilities and claims (contd.)

2. Pending litigation (contd.)

b. Sonol is involved in a number of claims filed against it (not by IDF invalids) on the contention of a restraint of trade agreement:

1. In the years 1993-1995 three claims were filed against a formerly affiliated company and against its shareholders, which included Sonol. The total claims amount to approximately NIS 65 million for the sale of fuel pursuant to restrictive practices (as the plaintiffs allege) among the fuel companies. In the opinion of the company's management, based on the opinion of its legal advisors, Sonol and the formerly affiliated company, have sound defenses against the claims and they will not bear any additional costs over and above those already provided due to any remaining doubt.

2. In 1999, an agency of Sonol, which also operates stations on its behalf, filed a claim against Sonol asking for declarative and monetary relief. The agency claims that the agreement in effect with Sonol, in regard to one of the stations is a restraint of trade arrangement, and is also a uniform contract with discriminatory provisions and as thus void. In addition the agency is asking that the station be freed under the terms of the arrangement with the Controller of Restrictive Trade Practices, and is, therefore, requesting declaratory relief from the court regarding the cancellation of rights granted Sonol to the land on which the station is located, including leasehold and other proprietary rights. The agency is also asking that Sonol be required to pay approximately NIS. 17 million on account of the inflated prices which Sonol is alleged to have charged over the years. It should be noted that Sonol filed a monetary counterclaim against the same agency in the amount of approximately NIS. 20 million on account of amounts due from the agency from the purchase of fuel products.

At this time, the company's management, based on the opinions of its legal counsel is unable to assess the defense prospects in regard to the alleged restrictive agreement. Should the district court rule in favor of this claim, there is also a risk that the court will accept the monetary claim against Sonol (which, even in such case, the amount of claim is by all accounts exaggerated). If the agency's claim of a restrictive agreement is not accepted by the court, the prospects of the monetary claim against Sonol, are weak.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 28 Collateral, commitments and contingent liabilities (contd.)**B. Contingent liabilities and claims (contd.)****2. Pending litigation (contd.)**

3. In 2000, the operators of one of Sonol's filling stations, against whom Sonol filed a claim in the district court in Tel-Aviv, instituted legal proceedings against Sonol. The operators requested a declarative judgement stating that inasmuch as a filling station operated by them was to be freed under the terms of the arrangement reached between the fuel companies and the Controller of Restrictive Trade Practices, the contractual relationships between them and Sonol should be related to as having been terminated. It was also claimed that all agreements between the plaintiffs and Sonol be considered restrictive agreements and, thereby, cancelled. In addition, the above operators are claiming an amount of approximately NIS 16 million from Sonol, alleging having paid exorbitant prices on account of the fuel products they purchased, and maintaining that inasmuch as the contractual arrangements between them and Sonol have been terminated as claimed in the other proceeding, Sonol had no right to charge such prices. In the opinion of Sonol's legal counsel defense prospects are good. At this stage, the company's management, based on the opinion of its legal counsel, are unable to determine the defense prospects regarding the claim of a restrictive agreement. If this claim by the station operators is accepted there is a risk that the financial claim against Sonol will also be accepted (even though, in such a case, the amount of the claim is exaggerated). Should the above claim regarding a restrictive agreement not be accepted, the prospects of the financial claim against Sonol will be weak.
4. In the year 2000, former operators of a filling station filed a monetary claim against Sonol in the amount of approximately NIS 4 million on account of alleged exorbitant prices paid for fuel products purchased from Sonol, maintaining that the contractual arrangements between them and Sonol have been cancelled and/or terminated, being restrictive arrangements. At this time, the company's management, based on the opinions of its legal counsel, are of the opinion that Sonol's defense claims, although difficult to assess, are not insignificant. The matter was referred to mediation which was unsuccessful and, therefore, the case will be heard before the court.
5. In December, 2001 filling station operators filed a claim in court against Sonol asking for declarative relief, by granting them rights in the station, preventing Sonol from terminating the agreement appointing them as the station operators and integrally connecting theirs and Sonol's rights to the station. Furthermore, they asked the court to be recognized as protected tenants regarding the station. In addition, they asked the court to declare the agreements between them and Sonol to be a restrictive trade arrangement and to order Sonol to sell them fuel products at free market conditions and prices. The station operators are also asking for an amount of approximately NIS. 5 million, claiming that as a result of a restrictive trade arrangement, Sonol charged them prices in excess of those they would have paid in the free market, and alternatively, claiming that Sonol acted in a prejudiced way against them by charging them higher prices than those which it sells to other operators and agents. Sonol submitted its defense and, also filed a counterclaim for the eviction of the station operators. In the opinion of the company's legal counsel, Sonol has a sound defense albeit, at this time, they are unable to predict the defense prospects

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Granite Hacarmel Investments Limited and its Subsidiaries**Notes to the Financial Statements as at December 31, 2003****Note 28 Collateral, commitments and contingent liabilities (contd.)****B. Contingent liabilities and claims (contd.)**

2. Pending litigation (contd.)

regarding the claim of a restrictive trade arrangement. If the claim to nullify the agreements on the grounds that they are a restrictive trade arrangement is not accepted, then, on the basis of the facts and information submitted to legal counsel stating, inter-alia, that the station and agency in question purchased fuel products at similar prices as those paid by other filling stations of the same type within the Sonol network of stations and other agencies, then in the opinion of the company's management, based on the opinion of its legal counsel, Sonol's defense prospects as they relate to the financial claim are reasonable.

6. Following the filing of a claim against Dan Cooperative for Public Transportation Ltd (Dan) in the amount of NIS. 1.6 million for the return of equipment loaned to Dan by Sonol for the construction of an internal filling station, in accordance with an agreement signed between Dan, Sonol, Paz Oil Company Ltd., Delek the Israel Fuel Corporation Ltd. and Sonol, Dan, in June 2002, submitted a counterclaim in the magistrate's court in Tel-Aviv in the amount of NIS. 10 million. In its counterclaim, Dan contends that the agreement signed with the three fuel companies is illegal and, being a restrictive arrangement entered into as a result of the companies taking advantage of their monopolistic power, is therefore, null and void. Dan maintains that during the period between 1980-1989 when it purchased fuel products from the fuel companies, it paid exorbitant prices in amounts totalling NIS. 15 million. However, due to the cost of the court fee, its counterclaim was submitted in an amount of NIS. 10 million, all against sonol, although Sonol's share of this claim amounts to approximately NIS. 2 million. In the opinion of the company's management, based on the opinion of its legal counsel, Sonol's defense prospects are more favorable than those of the plaintiffs.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 28 Collateral, commitments and contingent liabilities (contd.)

B. Contingent liabilities and claims (contd.)

2. Pending litigation (contd.)

7. In February 2003, the operators of another filling station submitted a claim for declarative relief according to which the agreement between it and Sonol was a restrictive trade arrangement, and that the station should have been released within the framework of the arrangement between the fuel companies and the Controller of the Restrictive Trade Practices. In addition it was claimed that the agreement is a uniform contract and includes discriminatory conditions. The plaintiffs requested approval to divide the relief in such a way that after the requested declarative orders are issued, they will be able to claim compensation from Sonol for loss of profits, violations and other injustices. Sonol filed a defense claim and a counterclaim in which it asks for the eviction of the operators from the station and a monetary claim of NIS 1 million. The parties are engaged in arbitration proceedings. In the opinion of the Company's management, based on the opinion of its legal counsel, at this stage it is not possible to assess the prospects of the claim, although Sonol's counterclaim is well founded.
8. During 2003 the operator of a filling station filed a claim for declarative relief, claiming that its agreement with Sonol is a restrictive trade arrangement and also filed a financial claim for NIS 2.4 million. In view of the early stages of this claim it is not yet possible to estimate its chances.
- c. In February 2000 a motion was filed against Sonol, together with Paz Oil Company Ltd. and Delek the Israel Fuel Corporation Ltd. to allow a class action relating to the alleged collusion in the price fixing of gasoil to consumers. This claim, after being updated and, if allowed as a class action, will amount to approximately NIS. 244 million, of which Sonol's share is approximately NIS. 57 million. Sonol rejects the claim outright and, in the opinion of the company's management, based on the opinion of its legal counsel, chances are reasonable to good that it will not be allowed as a class action.

d. Additional claims filed against Sonol are:

1. Pi Gilloth Petroleum Terminals and Pipeline Ltd. filed a monetary claim against the Petroleum Products Pipeline Ltd. and the fuel companies Sonol, Paz and Delek and Dor for a total amount of NIS 8 million. The plaintiff contends that, by law, it was entitled to a payment from the defendants for storing fuel products in its storage and transfer tanks it owns in its Ashdod installation. The total amount claimed from Sonol is approximately NIS 1 million. The claim has been forwarded to arbitration. In the opinion of the Company's management, based on the opinion of its legal counsel, prospects are favorable that the claim will be rejected.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 28 Collateral, commitments and contingent liabilities (contd.)

B. Contingent liabilities and claims (contd.)

2. Pending litigation (contd.)

2. Petroleum Infrastructures Ltd. filed a monetary claim in a summary procedure for a total amount of NIS 2.7 million against Paz, Delek and Sonol on account of the netting of the said amount by the defendants under the pretext that the gasoil stored by the plaintiff on their behalf was, at some stage, deleted from its records. The amount claimed from Sonol is NIS 0.7 million. In the opinion of the Company's management, based on the opinion of its legal counsel, Sonol's defense prospects are good.
3. Claims were filed by groups of greenhouse owners against Sonol, Oil Refineries Ltd., Paz, Delek and Alon, claiming that damage was caused to them in an amount of NIS 11.4 million (Sonol's share is NIS 7.3 million) due to the use of defective light fuel manufactured by the Oil Refineries Ltd. and sold to them by the fuel companies. In the opinion of the Company's management, Sonol has a sound defense against this claim and is covered under the terms of a product liability policy.
4. In August, 2001 Petroleum and Energy Infrastructures Ltd. and Oil Products Pipeline Ltd. (plaintiffs) filed a claim in the amount of NIS 7 million against Sonol and two other fuel companies. According to the plaintiffs, who are engaged in the pumpover of fuel products through a network of pipelines, they also serve as a clearing house for the defendants whereby the defendants sell and buy the excess/shortage of amounts of fuel that have accumulated. The plaintiffs claim that Sonol and others unlawfully netted amounts from payments due to them, thus causing them financial losses. The amount claimed from Sonol is approximately NIS 1.3 million on the grounds of unlawful enrichment. The parties were referred to arbitration. In the opinion of its legal counsel, inasmuch as the claim is at an early stage, it is difficult to assess its prospects. Nevertheless Sonol has good defense claims.
5. In 2000, an operator of a filling station submitted a claim against Sonol in an amount of NIS 3 million for commission differences due him on account of prior years. The claim was filed following the filing of an eviction claim by Sonol against the station operator. In the opinion of the company's management, based on the opinion of its legal counsel, the prospects of the claim against it succeeding are weak.
6. In April 2001 Sonol filed a series of claims against four of its station operators for their eviction from all four stations and also for the recovery of a debt in the amount of NIS 9.5 million. The defendants claimed that Sonol entered into a new agreement with them which granted them the right to continue operating the stations for an additional period, and simultaneously, the station operators filed a counter claim for damages in the amount of

NIS. 10 million.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 28 Collateral, commitments and contingent liabilities (contd.)**B. Contingent liabilities and claims (contd.)****2. Pending litigation (contd.)**

In November 2002, the Tel-Aviv magistrate's court ruled in favor of Sonol for the defendants' eviction, and the stations were returned to Sonol. The mutual monetary claims have not yet been heard by the court. In the opinion of the Sonol's management, based on its legal counsel, the prospects in regard to the claim against Sonol are weak, while, on the other hand, Sonol's prospects are high regarding its claim against the station operators.

7. A ruling issued in October 2002 by the Jerusalem district court rejected, within the framework of a third party notice, all the claims to repay an investment in public filling stations submitted by the owners of various public filling stations against Sonol. The claim against Sonol amounted to NIS 43 million. An appeal has been filed with the Supreme Court against the verdict. In the opinion of the company's legal counsel, the prospects of the appeal are not high.

e. Supergas is involved in class and other actions as follows:

1. In April 1999 a claim in the amount of NIS 8 million was filed against Supergas and four other gas companies, in the Tel Aviv district court by several consumers pursuant to Regulation 29 of the Civil Procedures Law, and after its amendment, additional grounds were added pursuant to the Law for the Protection of the Consumer and the claim stood at an amount of only NIS 4.9 thousand for so-called violation of the gas companies' obligation to conduct periodic inspections of the gas equipment in the possession of consumers and for selling a product while misleading consumers, causing damage, loss of convenience and harm to safety, while endangering the lives of consumers. The plaintiffs request that the court order the defendant gas companies to carry out the periodic inspections, to pay them compensation for the above amount - approximately NIS 0.8 thousand per plaintiff - and/or to give a declarative order stipulating that the plaintiffs are entitled to a refund of the amounts that they paid to the defendants from the date agreements were entered into and additional similar orders. In addition, the plaintiffs requested the court to consider the claim as a class action. The court approved, only partially, the filing of a class action for declarative relief only, under the Consumer Protection Law, regarding the responsibility of the gas companies to refund to their customers amounts paid by them for periodic examinations which were not made, retroactive to the date of the engagement with each consumer. The court rejected the claim for monetary relief and other relief against the gas companies. In April 2003 the district court ruled that it is not possible to approve the class action pursuant to Regulation 29 of the Civil Proceedings Regulations, and this as the result of a verdict by the Supreme Court regarding Regulation 29. Recently, the parties issued notices on their behalf regarding the ramifications of the district court's ruling on the procedures for the application for a right of appeal. In addition, the plaintiffs filed a request for a separate right to appeal on their behalf regarding the above decision not to approve the claim as a class action based on Regulation 29.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 28 Collateral, commitments and contingent liabilities (contd.)

B. Contingent liabilities and claims (contd.)

2. Pending litigation (contd.)

In the opinion of its legal counsel, Supergas has good grounds for appeal both on the factual and legal points of view. In the opinion of the company's management, the provision included in Supergas' books for any possible exposure, if at all, due to the unclear situation, is sufficient.

2. In June, 2001, a claim was filed in the Tel Aviv district court against Supergas, together with a request that the claim be recognized as a class action, in the amount of NIS. 131 million. Concurrently, Supergas was informed of two additional claims filed against two other gas companies and to which Supergas was included on a formal basis only. The plaintiffs claim they are Supergas customers of central gas and contend, inter-alia, that Supergas and other gas companies unlawfully charge their customers a periodic fixed charge which was not agreed upon in contracts signed between them and Supergas. Therefore, they contend that Supergas should refund the amounts paid and, in addition, should make an appropriate compensatory payment in a manner as to be determined by the court.
In a preliminary hearing, the court decided that the three claims and the request to approve them as class actions, submitted against Supergas and two other gas companies will be heard jointly. In the opinion of the company's management, based on the opinion of its legal counsel, and on information available at this time, Supergas' prospects of success seem greater than those of the plaintiffs.
3. In December 2003, a claim in the amount of at least NIS 1 billion was filed against Supergas and also against Pazgas, Amisragas and Dorgas, together with a request that the claim be recognized as a class action, claiming that between the years 1994 and 2003 restrictive trade arrangements were in force in the private and the commercial gas markets. The company submitted its response to the request rejecting it outright. The claim is not accompanied by any firm evidence supporting its contentions, and has serious flaws and, therefore, the company's management believes, based on the opinion of its legal counsel, that its prospects are poor.
4. In September 2003, the Controller of Restrictive Trade Practices informed Supergas of its intention to issue an indictment against the company for violations of the Law for Restrictive Trade Practices. A draft letter of indictment was attached regarding the four gas companies and those who were their managers at that period, claiming that they participated in restrictive trade arrangements. Supergas was asked to voice its contentions in a hearing procedure. Supergas responded and its representatives met with representatives of the Restrictive Trade Practices Authority to present its contentions. All Supergas' managers at that time deny outright any participation in restrictive trade arrangements. To date, no indictment has been filed.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 28 Collateral, commitments and contingent liabilities (contd.)

B. Contingent liabilities and claims (contd.)

2. Pending litigation (contd.)

5. Investigations are being carried out against Supergas by the Israel Police and the Ministry of Energy regarding the death of a customer resulting from the emission of poisonous gas from gas heaters. No recommendation has yet been received from the Israel police or the district attorney's office.

f. In November, 2002, a claim for declarative relief was filed against a limited partnership, in which the Company holds a 35% interest, claiming that a project constructed and managed by the limited partnership was illegally taken from a resource project written by the plaintiffs while they were students working on their master's degree in business administration. According to the plaintiffs, the research project included a business plan and feasibility studies to be used in constructing a similar project and that use of their research project in building the project constitutes unjust enrichment, the theft of proprietary secrets, breach of trust and a breach of contractual liability. In February 2003, the limited partnership submitted its defense denying outright, all the contentions of the plaintiffs and noting the main differences existing between the outline proposed in the plaintiffs work and the outline in the venture as actually planned and constructed, which reinforce the conclusion that no use was made of the plaintiffs' work. In July 2003, the plaintiffs submitted their response to the defense in which they disagree with part of the defense's contentions. In the opinion of the limited partnership's management, based on the opinion of its legal counsel, the partnership has a sound defense against the claim.

g. Additional claims (most of them legal) in the normal course of business have been filed against subsidiaries and affiliated companies.

In the opinion of the Company's management, the provisions made to cover the results of the claims detailed above are sufficient.

h. For additional claims against Sonol and Supergas, see below Note 31 - Subsequent events.

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Granite Hacarmel Investments Limited and its Subsidiaries**Notes to the Financial Statements as at December 31, 2003****Note 28 Collateral, commitments and contingent liabilities (contd.)****C. The subsidiaries have commitments and liabilities on the balance sheet date as follows:****1. Commitments for investments:**

	<u>NIS thousands</u>
Acquisition of fixed assets	116,770
Supply of fuel, oil and equipment (delivery January - December 2004)	572,701
Executing projects	64,380
Rental and leasing of stations, installations and buildings from agents according to signed agreements*	1,296,618
Leasing and rental of a computer and peripheral equipment for a period of up to a year	4,183
Automobile operating lease agreements**	9,768
Amounts payable for management services (See Note 30b).	4,204
Amounts payable for consulting services (See Note 30b).	368

* Following are dates of payment of the rental and leasing liabilities:

2004	104,670
2005	95,813
2006	90,908
2007	84,997

2008	81,085
2009 and thereafter	839,145
	<hr/>
	1,296,618
	<hr/>

** Following are the dates of payment of liabilities for operating lease agreements for vehicles:

2004	5,522
2005	3,277
2006	969
	<hr/>
	9,768
	<hr/>

2. Commitments for investments:

- a. In 1998 a subsidiary entered into a joint venture for the construction of a building project on jointly owned land. Construction, which began in September 2000 will include, inter alia, a 27 story office building covering an area of approximately 27,000 sq. meters and underground parking facilities.
- Simultaneously, an agreement was signed between the partners in the joint venture and a bank for financial escort over the construction period. In return, the subsidiary pledged its rights in the land and future receipts from the project to the lending bank.
- As of date of the financial statements the subsidiary had not yet utilized the project financing put at its disposal.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 28 Collateral, commitments and contingent liabilities (contd.)

C. The subsidiaries have commitments and liabilities on the balance sheet date as follows: (contd.)

2. Commitments for investments: (contd.)

- b. On September 30, 2001, an agreement was signed between the Company and Naspen Ltd., a member of the Baran Group Ltd., whereby the parties to the agreement will invest, in equal shares, in a new company, Oganim Beyarok Ltd. (50% each), which will engage in Israel and globally in leasing land and masts for the construction of antennas for communications equipment (TM Tower Management). Granite will invest up to approximately 5 million US dollars in accordance with the agreement. As of the balance sheet, the Company invested an amount of NIS 2.9 million.
- c. A subsidiary constructed a water treatment plant which it has undertaken to operate for a period of 10 years.
- d. Subsidiaries have agreements to pay royalties for know-how purchased as a percentage of the sales of certain products. In the past three years a yearly amount of approximately NIS 1 million was paid.
- e. Via Maris Desalination Ltd.
(1) A consortium of companies in which the Company is a member, was awarded a tender for the desalination of seawater. For this purpose the consortium formed a company, Via Maris Desalination Ltd. (hereinafter: Via Maris). The Company's share in Via Maris is 26.5%.

In October 2002 Via Maris signed an agreement with the State of Israel (hereinafter: Concession Agreement) which was approved by the Finance Committee of the Knesset, to plan, finance, construct, operate and maintain a seawater desalination plant having an annual capacity of 30 million cubic meters under the BOO (build, own and operate) method (hereinafter- the Project).

The concession agreement is for a period of 24 years and 11 months and includes the period of construction (hereinafter- Concession Period). During the concession period Via Maris is obligated to construct a desalination plant with an annual production capacity of 30 million cubic meters. In return, Via Maris will be entitled to receive a fixed payment for providing available desalination capacity and a variable payment for the quantities of water actually desalinated. The quantity of water to be desalinated will be determined yearly on the basis of an annual program prepared by Via Maris and approved by the Desalination Administration according to a formula detailed in the concession agreement. The water that Via Maris will supply to the State must meet the quality requirements stipulated in the concession agreement

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 28 Collateral, commitments and contingent liabilities (contd.)

C. The subsidiaries have commitments and liabilities on the balance sheet date as follows: (contd.)

2. Commitments for investments: (contd.)

The shareholders of Via Maris provided a performance guarantee to the State of Israel in the amount of NIS 35 million, of which the Company's share is approximately NIS 9.3 million. At the time the financing agreements with the banks will be approved by the Desalination Administration, the shareholders will increase their guarantee to NIS 92.5 million of which the Company's share will be approximately NIS 24.5 million. Total guarantees that the Company provided Via Maris as of the balance sheet amounts to NIS 9.8 million.

In accordance with the provisions of the concession agreement, Via Maris is required, inter alia, to complete most of the planning and licensing stages of the project and to obtain most of the licenses required for the construction of the project within 8 months of the signing of the concession agreement.

The general planning of the desalination plant has reached 90% of completion and the detailed planning reached approximately 30%. The weighted average of progress in the planning stood at approximately 55% as of the date of the financial statements.

Via Maris submitted all the applications for licensing to the relevant authorities (the Shorkut Local Committee, the Central District Committee and the Committee for the Coastal Waters). In addition, the approvals in principle were received from the planning division and the National Parks Authority for the route of the land and sea lines. Notwithstanding this, the licensing procedures have not yet been completed mainly due to the continuing sanctions by the civil servants. In addition, since the date of signing the concession agreement, there were significant changes in the financial markets, as a result of which the economic feasibility of the project deteriorated. For example, there was a significant devaluation in the rate of exchange of the shekel - euro and an increase in the rate of the interest margin that the banks demand.

As a result, Via Maris requested that the State make certain adjustments to the concession agreement, including: extending the period of linkage of the fixed component of the price of water to the basket of currencies until such time as the plant becomes operable, delaying the date for updating the fixed component of the price of water in accordance with changes in the rates of interest as of the date when the plant becomes operable, compensation to Via Maris in the event of a delay supplying natural gas or in the event that its price will higher than expected, delaying the timetables of the project by 8-12 months and changing the nature of the engagement with a certain supplier to the project.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 28 Collateral, commitments and contingent liabilities (contd.)

C. The subsidiaries have commitments and liabilities on the balance sheet date as follows: (contd.)

2. Commitments for investments: (contd.)

From the State's responses to Via Maris' request, it appears that the requests were only partially accepted. The State agreed, in principle, to extend the period of linkage of the fixed component of the price of water to the basket of currencies, subject to receiving a certain discount in the price of water, but did not respond to Via Maris' request regarding the natural gas. Regarding the timetables, the State demanded that Via Maris fulfill the obligations undertaken in the agreement by the date stipulated (as defined in the concession agreement), such as signing the financing agreement by April 1, 2004, but did not approve the concurrent deferral of the duration of the concession agreement.

Following the receipt of the State's response to Via Maris' requests, Via Maris prepared an updated version of the project's economic model, a copy of which it submitted to a bank which expressed interest in financing the project. The bank has not yet completed examining the updated economic model, but has clarified that it will require Via Maris' shareholders to guarantee the risk inherent in a delay in the supply of natural gas to the desalination plant.

Via Maris is engaging its full resources in order to meet the required timetables. At this stage, Via Maris cannot determine whether it will meet the project's updated timetables, also due to factors beyond its control. A delay in meeting the timetables may be considered to be a violation of the terms of the concession agreement and to enable the State, under certain circumstances, to exercise the performance guarantee. Nevertheless, in the opinion of Via Maris' management, inasmuch as most of the delays result from unforeseen factors, not under Via Maris' control, the likelihood that the State will not approve an additional deferral in the timetables is small.

Construction of the project will be carried out by a partnership which will comprise of Via Maris' shareholders (subject to a subsidiary replacing the Company) (hereinafter: the construction partnership). The construction partnership will enter into a Turn-Key agreement with Via Maris which will ensure the construction of the desalination plant at a price and timetable to be determined in advance. The partners in the construction partnership will be jointly and severally responsible for meeting its obligations. Furthermore, the obligations of the construction partnership will be secured by a bank guarantee in an amount to be agreed upon between the parties.

Operation and maintenance work on the project will be carried out by a partnership to be comprised of Via Maris shareholders (subject to the subsidiary replacing the Company) or by a private company which will be owned by the same parties. According to the agreement between the partners in Via Maris, the subsidiary has a first right of refusal regarding operating the desalination plant during the full term of the agreement.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 28 Collateral, commitments and contingent liabilities (contd.)

C. The subsidiaries have commitments and liabilities on the balance sheet date as follows: (contd.)

2. Commitments for investments: (contd.)

Via Maris intends to supply the energy required to operate the desalination plant, both through a private power station, powered by natural gas, which will be constructed on the plant's grounds and through purchases from the Israel Electric Corporation.

The timetable for operating the facility is not contingent on the completion of the power station, and its initial operation is planned on the basis of electricity to be supplied by a high tension line which will pass close to the plant.

The total costs related to constructing the desalination plant are estimated at approximately 80-85 million dollars (including the power station).

(2) In accordance with an agreement signed between the Company and a subsidiary, the subsidiary will serve as the operative wing of the Company regarding the water treatment and the construction of desalination plants. Subject to the approval of the Tenders Committee and provided that the State will give its approval in the future, Via Maris shares held by the Company, will be transferred to a subsidiary at an adjusted cost as reflected in the Company's books. It was agreed between the companies that the aforesaid does not derogate from the Company's legal and financial responsibility in all matters relating to its being awarded the tender and the construction of the project. In addition the subsidiary has undertaken to assume by itself and on its own account, all the expenses and investments, of any type, that were paid or will be paid by the Company in connection with submitting the tender offer or for being awarded it within the framework of Via Maris and in every matter concerning or resulting from the tender or the project. Accordingly, the costs of the investments will be included in the books of the subsidiary. The Company intends to assign the guarantees that it provided Via Maris to the subsidiary, subject to receiving the required approvals.

(3) As of the date of the financial statements the subsidiary's share in Via Maris shareholders' loans is NIS 3,541 thousand. The loans are linked to the consumer price index.

As of the balance sheet date, an investment in the amount of NIS 4,132 thousand, including shareholders' loans and the capitalization of various expenses, was recorded in the subsidiary's books.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 28 Collateral, commitments and contingent liabilities (contd.)**C. The subsidiaries have commitments and liabilities on the balance sheet date as follows: (contd.)****2. Commitments for investments: (contd.)**

- f. In October 2002 a partnership agreement was signed in equal shares between a subsidiary and Hefer Ecologies Aguda Shitufit Agricultural Cooperative Ltd. (hereinafter: Hefer). According to the agreement, the partnership will engage in the construction of a plant for the treatment of agricultural residues (hereinafter: Residues Plant) and its operation in the Emek Hefer area.
- In November 2003 the partnership agreement was amended to include the following provisions:
- Hefer will pledge all the Residues Plant's equipment to the bank that will provide construction financing to the partnership for the plant and equipment. The partnership will be granted the right of use of the Residues Plant's facilities for a period of 20 years commencing from the time of collection of customer receivables from the Residues Plant's customers. Under certain conditions, the period can be extended to 24 years.
- All the income earned by the Residues Plant will belong to the partnership.
- Each of the parties will provide shareholders' loans to the partnership in the amount of NIS 2.5 million. The partnership will receive financing from the bank in the amount of NIS 7.5 million and will provide Hefer with a long-term loan to finance the construction of the Residues Plant in the amount of NIS 12.5 million.
- As of the balance sheet date the shareholders' loan from Hefer had not yet been received. Hefer announced that its application for a grant from the State to construct the Residues Plant for 50% of the actual costs up to an amount of NIS 10 million was approved by the Investments Administration of the Ministry of Agriculture. Should the amount of the grant received be less than stated above, Hefer will be responsible for the balance.
- If the total estimated cost of the Residues Plant exceeds NIS 22.5 million the partnership will raise the balance of the investment required from a banking source with guarantees by the two partners in equal shares.
- As of the date of the financial statements the construction of the Residues Plant has not yet been completed.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 28 Collateral, commitments and contingent liabilities (contd.)**D. Subsidiaries have contingent liabilities on the balance sheet date as follows:**

	NIS thousands
1. Acquisition of equipment – open letter of credit	584
2. Bank guarantees for customers and investee companies	65,340
3. Performance guarantees to customers and others	23,742
4. Guarantees to the authorities	655
5.	474

Bank guarantees for credit and other liabilities of affiliated companies

6.	Other guarantees*	3,879
7.	A guarantee to a government agency on account of the liabilities of a subsidiary regarding its share in an oil and gas exploration drilling agreement	Unlimited amount
8.	A guarantee given on account of the liabilities of a subsidiary regarding participation in a tender	Unlimited amount
9.	A guarantee to the State of Israel for grants that an affiliated company received from the Government of Israel in accordance with Law for the Encouragement of Capital Investments 1959	Unlimited amount

* On April 1, 2004 a guarantee, which on the balance sheet date stood at NIS 5 million will increase to NIS 13.2 million. The guarantee was given in favor of the State of Israel regarding compliance with the provisions of Section 3a of the edict-Supervision of Goods and Services Prices (Prices at Filling Stations) 2002.

E. Credit risks

- The maximum credit risk that the Company faces regarding its financial assets does not exceed the amount of their book value less existing collateral.
- The concentration of credit risks results from a subsidiary having a number of customers and long-term receivables (long-term loans granted), which are of a similar nature (independent fuel agents). The highest balance is that of an agent whose current debt (included in trade receivables) and long-term debt (included in long-term loans granted) amounts to approximately NIS 25.3 million. A portion of amounts due from customers is collateralized as is customary in the industry. In addition, the subsidiary has long-term service agreements which give it the right to offset amounts against the receivable payments. The statements include a specific provision for debts whose collection in management's opinion is in doubt.

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Granite Hacarmel Investments Limited and its Subsidiaries**Notes to the Financial Statements as at December 31, 2003****Note 28 Collateral, commitments and contingent liabilities (contd.)****F. Forward currency transactions**

	Currency receivable	Currency payable	Date of maturity / redemption / realization	Amounts receivable	Amounts payable	Fair value
NIS thousands						
	US dollars	NIS	(1)	2,199	2,204	(5)
	Euro	NIS	(1)	2,765	2,674	91
Total				4,964	4,878	86

(1) January 2004

G. Fair value of financial instruments

The book amount of cash and cash equivalents, short-term investments, trade receivables, other receivables, credit from banks and others, liabilities for trade payables and other payables are equal or close to their fair value.

Fair value as at December 31, 2003 of long-term loans given, is higher by NIS 1.5 million than their book value.

Note 29 Events relating to the fuel sector

According to the Law for Arrangements in the State of Economy 2001 and its regulations, changes have been enacted regarding the holding of Emergency inventories of fuel products. According to the new regulations the Security inventories are to be held in separate tanks at specified locations and earmarked for use in times of emergency. In view of this, these inventories are presented as Non-current inventories. The State will continue to finance the holding of the inventories and guarantee the value of the fuel defined as Security inventories. A regulation regarding holding of Civilian inventories, stipulated in the same law, was cancelled in 2002.

Sonol is exposed to changes in the value of its operating inventories used to meet its current needs, as a result of fluctuations in fuel market prices. Fluctuations in the fuel prices could significantly affect Sonol's periodic business results. Sonol is exploring ways to minimize such effects. It is not possible to estimate the effects of these changes on Sonol's business results.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 30 Transactions and balances with interested and related parties

a. Income and expenses from interested and related parties

1. Consist of:

For the year December 31,

	2003		2002		2001	
	Interested parties	Related parties	Interested parties	Related parties	Interested parties	Related parties
Financing income	-	338	-	925	-	846
Income from management services	-	1,529	-	796	-	457
Purchase of fuel products	195,359	-	341,143	-	400,992	-
Purchase of services	347	-	435	-	688	-

2. In purchases from an interested party the price of the transaction is determined by referring to the Oil Refineries Ltd. gate price at that time and to the prices which were offered by other competing suppliers. The price of the transaction at all times was lower than any other alternative that Sonol had at that time. The credit terms are not less than those which were given by the Oil Refineries Ltd. or by any other supplier.
3. Other transactions with interested and related parties are also conducted in the normal course of business and at regular credit terms and do not exceed 10% of the Company's transactions. The Company was granted an exemption pursuant to Section 64(3)d of the Securities Regulations [(Preparation of Annual Financial Statements (Amendment)) 1995 from the requirement to disclose transactions with interested parties and investee companies in the normal course of the Company's business.
4. Sonol purchases most of its fuel products from Oil Refineries Ltd. which is obligated to supply its products to the fuel companies at refinery gate prices which are controlled by the government.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 30 Transactions and balances with interested and related parties (contd.)

b. Benefits to interested parties

Group	For the year ended December 31,			
	Number of people	2003	2002	2001
		NIS thousands		
1. Interested party employed by the Corporation	1-2	5,637*	3,629	3,171
2. Directors fees	12	1,190	1,044	1,072
3. Management and consulting services**		2,518	2,092	-
4. Regarding indemnity and insurance of directors and officers	see Note 28(b)(1)			
5. According to the employment agreement signed with the Company's Chief Executive Officer(CEO), the period of his employment will be until June 2006 (which be extended automatically unless terminated by one of the parties). Should the Company terminate the agreement and/or should control in the Company be transferred within the meaning of the employment agreement, the CEO will be entitled to receive the balance of the salaries that he would have received up to June 2006, but not less than for a period of 12 months.				

* Including payments to a former interested party whose term ended during 2003.

** The Company has an agreement with an interested party to pay \$40,000 per month for management services for a period of 36 months beginning January 1, 2003. The expenses for the management services were approved at the General Meeting of the Company. In addition, the Company entered into an agreement with an interested party to pay \$7,000 per month for consulting services. Each of the parties may terminate the agreement with prior notice of two months to the other party.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 30 Transactions and balances with interested and related parties (contd.)

c. Balances with interested and related parties

December 31, 2003		December 31, 2002	
NIS thousands		NIS thousands	
Interested parties	Related parties	Interested parties	Related parties

Current assets				
Trade receivables	1,144	1,141	1,059	13,644
Other receivables	54	-	-	199
	<u>1,198</u>	<u>1,141</u>	<u>1,059</u>	<u>13,843</u>
Loans and capital notes to investee companies		<u>17,046</u>		<u>20,348</u>
Highest balance during the year with an interested party	<u>2,006</u>		<u>3,847</u>	
Current liabilities				
Trade liabilities		2,932	32,842	3,595
Other liabilities	-	259	-	5
	<u>-</u>	<u>3,191</u>	<u>32,842</u>	<u>3,600</u>
Highest balance during the year with interested party	<u>32,489</u>		<u>47,004</u>	
Commitment for the acquisition of fuel from interested party	<u>-</u>		<u>106,892</u>	

Note 31 Subsequent events

- In February 2004, Isramco Inc, the operator of the Med-Ashdod holding, announced that the supply of gas from the well Nir-1, in which the Company is a partner, holding 35% of its rights, is not economically feasible. The partners must inform the operator by not later than March 29, 2004 of their intentions. The balance of the Company's investment in the holding's concession rights is insignificant.
- In February 2004 the Company submitted a proposal to Nitzba Hitnahalut for the purchase of Nitzba Hitnahalut's shares. Concurrently, the Company announced negotiations taking place for the sale of its holdings.
- In February 2004, Tambour submitted a request to the Tel Aviv Jaffa District Court for the approval of a distribution pursuant to paragraph 303 of the Companies Law 1999 and for reduction in its capital deriving from the proposed distribution. Tambour's creditors may file an objection in court against the proposed distribution within 30 days of the date of its filing the request or within a later period as determined by the court. Tambour intends to pay a cash dividend to the Company of an amount not exceeding NIS 400,000 thousand, of which an amount not exceeding NIS 379,358 thousand is a distribution not out of its profits.

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Granite Hacarmel Investments Limited and its Subsidiaries**Notes to the Financial Statements as at December 31, 2003****Note 31 Subsequent events (contd.)**

- Following a claim filed by the fuel companies Paz, Delek and Sonol and Dor Energy against the Oil Refineries Ltd., Oil Infrastructures and Energy Ltd. and the State of Israel in November 2002 totaling approximately NIS 25 million (Sonol's share amounts to approximately NIS 4.6 million) on account of damages incurred as a result of negligent maintenance of inventories of crude oil, the State of Israel in March 2004 submitted a claim against Sonol, Paz, Delek and Dor Energy and against the Oil Refineries and the Oil Infrastructures and Energy Ltd., contending that over the years they collected storage fees and insurance for the Emergency fuel inventories of the State of Israel. According to the State it became clear retroactively that a considerable part of the inventories was not usable, having turned into sludge, due to the negligence of the Refineries, the Oil Infrastructure and Energy Ltd. and the other fuel companies noted above. Sonol's

share is approximately NIS 21 million. The fuel companies reject the States contentions outright.

- e. In March 2004 a financial claim was filed against Supergas by a supplier, in the amount of NIS 5 million. The supplier contends that it carried out various projects for Supergas in the field of computerization, consulting and information systems, but Supergas did not pay all the amounts due for these projects. Supergas' management rejects the contentions in the claim outright.

NOTE 32 Financial statements translated into U.S. dollars

The financial records of the Company and its consolidated companies are maintained on a current basis in historical nominal New Israel Shekels and U.S. dollars.

The translated consolidated financial statements, stated in U.S. dollars, have been prepared in accordance with generally accepted accounting principles for use in connection with the preparation of the financial statements of a U.S. shareholder.

The functional currency of the Company is the U.S. dollar. The consolidated financial statements in U.S. dollars are prepared in accordance with translation principles identical to those prescribed by Statement of Financial Accounting Standards No. 52 (F.A.S.B. 52), based on the historical nominal amounts.

The financial statements of subsidiaries, whose functional currency is NIS., were translated into U.S. dollars according to the exchange rate in effect on the balance sheet date. Differences arising from the Company's investment in its subsidiaries based on the U.S. dollars, and the Company's share in the equity of these subsidiaries, translated to U.S. dollars at the current exchange rate, are included in Accumulated foreign currency translation adjustments in shareholders' equity. Exchange rate differences arising from loans taken in NIS. for the financing of investments in subsidiaries, have also been included in that component of shareholders' equity.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

NOTE 32 Financial statements translated into U.S. dollars

**CONSOLIDATED BALANCE SHEETS
(In thousands)**

	Translated to U.S. Dollars	
	December 31,	
	2003	2002
Current assets		
Cash and cash equivalents	1,707	7,153*
Marketable securities	669	3,716
Trade receivables	220,511	217,771*
Other receivables	16,489	28,817*
Receivables for work in progress	3,298	3,672
Inventories	44,559	46,055
Affiliated company designated for sale	1,817	-
	289,050	307,184
Non-current inventories	25,344	25,344

Investments, long-term loans and receivables		
Affiliated companies and other investments	25,531	32,286*
Long-term loans	29,647	27,988*
Deferred taxes, net	12,041	3,627
	<u>67,219</u>	<u>63,901</u>
Fixed assets, net	<u>251,001</u>	<u>246,240</u>
Other assets	<u>36,992</u>	<u>30,513*</u>
	<u>669,606</u>	<u>673,182</u>

*Reclassified

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

NOTE 32 Financial statements translated into U.S. dollars (continued)

CONSOLIDATED BALANCE SHEETS
(In thousands)

	Translated to U.S. Dollars	
	December 31,	
	2003	2002
Current liabilities		
Credit from banks and others	301,990	242,237
Trade payables	43,134	39,875*
Other payables	44,656	38,464
	<u>389,780</u>	<u>320,576</u>
Long-term liabilities		
Long-term loans	164,436	198,807*
Customers deposits	13,267	13,136
Liabilities for severance pay, net	5,214	6,210
Deferred taxes	16,154	14,614
	<u>199,071</u>	<u>232,767</u>

	_____	_____
Minority interest	1,888	1,740
	_____	_____

Shareholders equity

Ordinary shares, NIS 1 par value		
Authorized 225,000,000 shares		
Issued and outstanding 139,336,000 shares as of December 31, 2003 and 2002	59,696	59,696
Capital reserves	65,042	65,042
Company's shares held by a consolidated Company	(2,106)	(2,106)
Retained earnings	(41,890)	(3,189)
Accumulated other comprehensive income	(766)	(1,109)
Cumulative foreign currency translation Adjustment	(1,109)	(235)
	_____	_____
Total shareholders equity	78,867	118,099
	_____	_____
	669,606	673,182
	_____	_____

*Reclassified

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

NOTE 32 Financial statements translated into U.S. dollars (continued)

CONSOLIDATED STATEMENT OF INCOME
(In thousands except per share data)

	Translated to U.S. Dollars		
	Year ended December 31,		
	2003	2002	2001
	_____	_____	_____
Sales	934,795	902,737	906,300
Less: Government imposts	302,170	291,354	301,286
	_____	_____	_____
Net sales	632,625	611,383	605,014
Cost of sales	464,649	450,659	461,856
	_____	_____	_____
Gross profit	167,976	160,724	143,158
	_____	_____	_____

Selling, general and administrative expenses	122,648	105,883*	88,816*
Depreciation and amortization	20,829	20,432	18,653
	<u>143,477</u>	<u>126,315</u>	<u>107,469</u>
Income from operations	24,499	34,409	35,689
Financing expenses, net	(35,570)	(19,892)	(9,074)
Other (expenses) income, net	(10,077)	(9,844)	2,011
	<u>(45,647)</u>	<u>(29,736)</u>	<u>(7,063)</u>
(Loss) income before taxes on income	(21,148)	4,673	28,626
Taxes on income	3,239	(4,292)*	(6506)*
(Loss) income after taxes on income	(17,909)	381	22,120
Company's share in results of affiliated companies, net	(3,896)	(995)	2,687
Minority interest in the results of Subsidiaries	(274)	(545)	(476)
Net (loss) income for the year	<u>(22,079)</u>	<u>(1,159)</u>	<u>24,331</u>
Net (loss) earnings per ordinary share (in U.S. dollars):			
Primary and diluted (loss) income	<u>(0.16)</u>	<u>(0.01)</u>	<u>0.18</u>

*Reclassified

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

NOTE 32 Financial statements translated into U.S. dollars (continued)

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(In thousands)

Translated to U.S. Dollars

	Common Stock	Capital reserves	Company's Shares held by a consolidated company	Retained earnings	Accumulated other comprehensive income *	Cumulative foreign currency translation adjustment	Total
Balance as at January 1, 2001	59,696	65,042	(810)	1,573	865	-	126,366
Changes in 2001:							
Net income for the year	-	-	-	24,331	-	-	24,331
Dividend paid	-	-	-	(27,934)	-	-	(27,934)
Acquisition of the Company's shares by a subsidiary	-	-	(62)	-	-	-	(62)
Reclassification adjustment for gains included in net income	-	-	-	-	(353)	-	(353)
Balance as at December 31, 2001	59,696	65,042	(872)	(2,030)	512	-	122,348
Changes in 2002:							
Net loss for the year	-	-	-	(1,159)	-	-	(1,159)
Acquisition of the Company's shares by a subsidiary	-	-	(1,234)	-	-	-	(1,234)
Unrealized losses on securities	-	-	-	-	(1,198)	-	(1,198)
Foreign currency translation adjustment	-	-	-	-	-	(235)	(235)
Reclassification adjustment for gains included in net income	-	-	-	-	(423)	-	(423)
Balance as December 31, 2002	59,696	65,042	(2,106)	(3,189)	(1,109)	(235)	118,099
Changes in 2002:							
Net loss for the year	-	-	-	(22,079)	-	-	(22,079)
Dividend paid	-	-	-	(16,622)	-	-	(16,622)
Unrealized losses on securities	-	-	-	-	263	-	263
Foreign currency translation adjustment	-	-	-	-	-	(874)	(874)
Reclassification adjustment for gains included in net income	-	-	-	-	80	-	80
Balance as December 31, 2003	59,696	65,042	(2,106)	(41,890)	(766)	(1,109)	78,867

* Deriving from unrealized gains (losses) on marketable securities, net of tax effect.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

Note 32 Financial statements translated into U.S. dollars (continued)

The material differences between Israeli GAAP and U.S. GAAP as applicable to the financial statements are:

- a) **Deferred taxes in respect of differences in measuring non-monetary items:**
Deferred taxes in respect of differences in the measuring of non-monetary items (mainly fixed assets and inventories) for accounting purposes (U.S. dollar) and for tax purposes (Adjusted NIS).

In accordance with Israeli GAAP:

Companies record deferred taxes in respect of all such differences.

In accordance with U.S. GAAP:

According to paragraph 9(f) of FAS No. 109, deferred taxes should not be provided in respect of such differences.

b) **Marketable securities**

In accordance with Israeli GAAP:

Israeli GAAP divides marketable securities into two categories:

Marketable securities that constitute a current investment are stated at market value.

Marketable securities, that constitute a permanent investment are stated at cost (and in respect to debentures include accumulated interest), except where their market value is lower, and the decline in value is not considered to be temporary. Changes in value are charged to the statement of income. See also note 2F above.

In accordance with U.S. GAAP:

FAS No. 115 divides marketable securities into three categories:

- (1) Marketable securities that are acquired and held principally for the purpose of selling them in the near future, are classified as trading securities and are reported at their fair value. Unrealized gains and losses are included in the statement of income.
- (2) Debt securities that the company intends hold to maturity are classified as held-to-maturity securities are reported at their amortized cost.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

NOTE 32 Financial statements translated into U.S. dollars (continued)

- (3) Marketable securities, not classified as either held-to-maturity securities or trading securities, are classified as available-for-sale securities and are reported at their fair value. Unrealized gains and losses are included in a separate item within the shareholders equity, and reported as other comprehensive income.

c) **Amortization of goodwill**

In accordance with Israeli GAAP:

Under Israeli GAAP goodwill is amortized over the estimated benefit period, but usually no longer than 10 years.

In accordance with U.S. GAAP:

Under US GAAP, commencing January 1, 2002, goodwill is no longer amortized but is reviewed annually (or more frequently if impairment indicators arise) for impairment.

Goodwill represents the excess of costs over fair value of assets of businesses acquired. The Company adopted the provisions of SFAS No. 142, Goodwill and Other Intangible Assets, as of January 1, 2002. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets.

In connection with SFAS No. 142's transitional goodwill impairment evaluation, the Statement required the Company to perform an assessment of whether there was an indication that goodwill is impaired as of the date of adoption. The implied fair value of this reporting unit exceeded its carrying amount and the Company was not required to recognize an impairment loss.

Prior to the adoption of SFAS No. 142, goodwill was amortized on a straight-line basis over the expected periods to be benefited, generally 10 years, and assessed for recoverability by determining whether the amortization of the goodwill balance over its remaining life could be recovered through undiscounted future operating cash flows of the acquired operation.

d) **Impairment of Assets**

In accordance with Israeli GAAP:

The Company applied Standard No. 15 under which the Company needs to test the recoverable amount of the assets, which is the higher of the net sales price and usage value. A loss from impairment will be reversed only if changes have occurred in the estimates used in determining the recoverable value of the asset, from the date of which the last impairment was recognized.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

NOTE 32 Financial statements translated Into U.S. dollars (continued)

In accordance with US GAAP:

The Company applied FAS 144 with respect to long-lived assets and APB 18 with respect to equity method investees.

Under FAS 144 an impairment of long-lived asset is recorded only if the undiscounted cash flows of the related asset does not cover its book value.

Under APB 18 a loss is recorded only when the impairment investees is other than temporary.

Both under FAS 144 and under APB 18 reversals of impairments are not allowed, unless the assets are held for sales.

e) **Other disclosures**

Government imposts consist of excise taxes imposed on fuel products mainly gasoline and gasoil.

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

LIST OF MAIN INVESTEE COMPANIES

List of the main subsidiaries and affiliates	Holdings and Control as of December 31,2003
	%
<u>Consolidated Subsidiaries:</u>	
Sonol Israel Ltd.	100
Sprint Motors Ltd.	100
Milchen Sonol Agency Ltd.	66.67
Sonol J-M Ltd.	70

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Sonol Dan (1992) Ltd.	100
Sonol Darom Ltd.	100
Sonol Cnaan Ltd	51
Sonol Shani Agencies Ltd.	51
Sprint Motors Transport (1999) Ltd.	100
Kleesson Holdings (1999) Ltd.	100
Sonor Ltd.	100
After Holdings Ltd.	100
Granita Holdings Ltd.	75
Granite-Sonol Oil and Gas Drilling-Limited Partnership	100
Tambour Ltd.	100
Tambour Ecology Ltd.	100
Tambourechev Paints1997 Ltd.	100
Safety Kleen (Israel) Ltd.	100
Tzach Serafon Ltd.	100
Serafon Trading 1997 Ltd.	100
Tambour Distribution Ltd.	100
Texma Chemicals Ltd.	100
Supergas Israel Gas Distribution Company Ltd.	100
Supergas Hanegev Ltd.	65
Supergas Rehovot (1989) Ltd.	100
M. Solomon & Co. Gas Agencies Ashkelon Ltd.	51
Supergas Hagalil Ltd.	100
Rav Gas Ltd.	55
Allied Oils and Chemicals Ltd.	100
Sonefco Bank Street Corporation	100
Granite Hacarmel Holdings (1993) Ltd.	100
Granite Hacarmel Properties (1993) Ltd.	100
Granite Hacarmel Holdings and Development Ltd	100
Granite Hacarmel Industries Ltd.	100
Granite Hacarmel Y.A. Holdings Ltd.	100
Granite Hacarmel NZV Holdings Ltd.	100
Granite Hacarmel Energy (1997) Ltd.	100
Granite Hacarmel Tourism Ltd.	100
Otzem Promotion and Investments (1991) Ltd.	100

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Granite Hacarmel Investments Limited and its Subsidiaries

Notes to the Financial Statements as at December 31, 2003

List of the main subsidiaries and affiliates (cont.)	Holdings and Control as of December 31, 2003
---	---

%

Affiliated Companies

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Aero Echo Ltd.	33.33
International Ilios	43
Via Maris Joint Venture	24
Via Maris Desalinization Ltd.	26.5
Tambour Hefer Ecology Partnership	50
Yarok Az Ltd.	22.9
Nitzba Holdings 1995 Ltd.	9.82
Orpak Industries (1983)Ltd.	10.1
Park Mini Israel Limited Partnership	35
L.D.I.-Leasing Dynamics International Ltd.	25.1
Green Anchors Ltd.	50

The above list does not include inactive and/or immaterial affiliated companies and others

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OPHIR HOLDINGS LTD.

(An Israeli Corporation)

2005 ANNUAL REPORT

OPHIR HOLDINGS LTD.

2005 ANNUAL REPORT

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REPORT OF INDEPENDENT AUDITORS

To the shareholders of

OPHIR HOLDINGS LTD.

We have audited the consolidated financial statements of Ophir Holdings Ltd. and its subsidiaries (the Company): balance sheets as of December 31, 2005 and 2004 and the related statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Boards (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2005 and 2004 and the consolidated results of operations and cash flows of the Company for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

As explained in note 1b, the financial statements, as of dates and for reporting periods subsequent to December 31, 2003, are presented in New Israeli Shekels, in conformity with accounting standards issued by the Israel Accounting Standards Board. The financial statements as of dates and for reporting periods ended prior to, or on the above date, are presented in values that have been adjusted for the changes in the general purchasing power of the Israeli currency, through that date, in accordance with pronouncements of the Institute of Certified Public Accountants in Israel.

Accounting principles generally accepted in Israel vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in note 14 to the consolidated financial statements.

Tel-Aviv, Israel
March 27, 2006

Kesselman & Kesselman
Certified Public Accountants (Isr.)

OPHIR HOLDINGS LTD.

CONSOLIDATED BALANCE SHEETS

	Note	December 31	
		2005	2004
		NIS in thousands (see note 1b)	
A s s e t s			
CURRENT ASSETS :	12		
Cash and cash equivalents	1k	2,396	2,894
Short term investments	4a	25,018	86,935
Accounts receivable:	13a		
Related parties		54,952	151
Other		11,062	4,853
T o t a l c u r r e n t a s s e t s		93,428	94,833
LAND - BUSINESS INVENTORY	1e;8(2)	13,048	13,048
INVESTMENTS:			
Associated companies	3	157,248	187,275
Other companies	4;8	1,387	72,854
Loan to related party	11b	8,306	8,114
		166,941	268,243
FIXED ASSETS, net of accumulated depreciation	5		57,425
		273,417	433,549

(_____
DIRECTORS (**Avi Israel**
 (_____
 (_____
 (**Giora Bar-Nir**

Date of approval of the financial statements: March 27, 2006

	Note	December 31	
		2005	2004
Liabilities and shareholders equity			
CURRENT LIABILITIES:	12		
Bank credit and loans (mainly current maturities)	13b	3,834	8,383
Accounts payable and accruals	13c	4,245	4,121
T o t a l current liabilities		8,079	12,504
LONG-TERM LIABILITIES:	12		
Bank loans (net of current maturities)	6	22,552	58,675
Capital notes to an associated company	7	151,601	151,601
Capital note to related party	7	1,069	1,069
Payables in respect of acquisition of land - business inventory	8(2)	11,894	11,843
Deferred income taxes	10b		2,550
T o t a l long-term liabilities		187,116	225,738
T o t a l liabilities		195,195	238,242
COMMITMENTS	8		
MINORITY INTEREST		25	25
SHAREHOLDERS EQUITY	9	78,197	195,282
		273,417	433,549

The accompanying notes are an integral part of the consolidated financial statements.

OPHIR HOLDINGS LTD.

CONSOLIDATED STATEMENTS OF INCOME (LOSS)

	Note	2005	2004	2003
NIS in thousands (see note 1b)				
REVENUES AND GAINS:				
From lease of buildings		3,649	6,737	10,278
Share in profits (losses) of associated companies - net	3	651	(1,150)	(2,071)
Gain from sale and increase in value of marketable securities- net		1,815	2,183	164
Dividend received from other companies		79	11,623	7,896
Management fees from associated company and others	11a		433	438
Others		240	2,141	120
		<u>6,434</u>	<u>21,967</u>	<u>16,825</u>
EXPENSES AND LOSSES:				
Operating cost of leased buildings (including depreciation)		1,909	2,703	3,613
Impairment of investments in associated companies and other companies	3;4	4,571	950	
General and administrative expenses - net	11a	2,314	1,480	4,623
Loss from sale of investments in associated companies		1,618		
Loss (gain) from sale of real estate		7,519	(535)	30
Financial expenses (income) - net	11a;13f	(183)	700	1,532
Others		106		
		<u>17,854</u>	<u>5,298</u>	<u>9,798</u>
INCOME (LOSS) BEFORE TAXES ON INCOME		(11,420)	16,669	7,027
TAXES ON INCOME (TAX SAVING)	10c	(5,255)	2,374	4,731
INCOME (LOSS) AFTER TAXES ON INCOME (TAX SAVING)		(6,165)	14,295	2,296
MINORITY INTEREST SHARE IN LOSSES OF A SUBSIDIARY			1	15
NET INCOME (LOSS) FOR THE YEAR		<u>(6,165)</u>	<u>14,296</u>	<u>2,311</u>

The accompanying notes are an integral part of the consolidated financial statements.

OPHIR HOLDINGS LTD.

STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

	Share capital	Capital surplus	Dividend Declared Subsequent to balance sheet Date	Retained earnings	Total
NIS in thousands (see note 1b)					
BALANCE AT JANUARY 1, 2003	2,832	80,488		139,375	222,695
CHANGES DURING 2003:					
Net income				2,311	2,311
Dividend paid				(14,000)	(14,000)
Erosion of capital note		(20)			(20)
BALANCE AT DECEMBER 31, 2003	2,832	80,468		127,686	210,986
CHANGES DURING 2004:					
Net income				14,296	14,296
Dividend paid				(30,000)	(30,000)
Appropriation for distribution of dividend subsequent to balance sheet date			90,830	(90,830)	
BALANCE AT DECEMBER 31, 2004	2,832	80,468	90,830	21,152	195,282
CHANGES DURING 2005:					
Net loss				(6,165)	(6,165)
Dividend paid (In kind and in cash)		(5,103)	(90,830)	(14,987)	(110,920)
Appropriation for distribution of dividend subsequent to balance sheet date		(55,000)	55,000		
BALANCE AT DECEMBER 31, 2005	2,832	20,365	55,000	-,	78,197

The accompanying notes are an integral part of the consolidated financial statements.

OPHIR HOLDINGS LTD.**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	2005	2004	2003
	NIS in thousands (see note 1b)		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss) for the year	(6,165)	14,296	2,311
Adjustments to reconcile net income (loss) to net cash flows provided by operating activities*	8,820	(3,032)	3,703
Net cash provided by operating activities	<u>2,655</u>	<u>11,264</u>	<u>6,014</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from sale of investments in other companies and trading securities	74,923	21,242	
Proceed from sale of Associated Company	32,564		
Proceed from sale of leased buildings, net	42,397	7,847	30,190
Investment in associated companies (including capital notes and loans - net)	(746)	(499)	(424)
Investments in other companies	(496)	(549)	(301)
Purchase of short term investments, net	(24,707)	(196)	
Other		1,935	(72)
Net cash provided by investing activities	<u>123,935</u>	<u>29,780</u>	<u>29,393</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Repayment of long-term bank loans- net	(42,172)	(8,382)	(8,307)
Related parties	(55,000)		
Dividend paid	(29,990)	(32,953)	(11,047)
Short-term bank credit and loans - net	74	(30)	(13,254)
Net cash used in financing activities	<u>(127,088)</u>	<u>(41,365)</u>	<u>(32,608)</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(498)	(321)	2,799
BALANCE OF CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>2,894</u>	<u>3,215</u>	<u>416</u>
BALANCE OF CASH AND CASH EQUIVALENTS AT END OF YEAR	<u><u>2,396</u></u>	<u><u>2,894</u></u>	<u><u>3,215</u></u>

OPHIR HOLDINGS LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	2005	2004	2003
NIS in thousands (see note 1b)			
* Adjustments to reconcile net income (loss) to net cash flows provided by operating activities:			
Income and expenses not involving cash flows:			
Share in losses (profits) of associated companies - net	(651)	1,150	2,071
Depreciation	729	1,459	1,953
Deferred income taxes - net	(2,550)	(126)	2,971
Minority interest in losses of a subsidiary		(1)	15
Loss (gain) from sale of fixed assets - net	7,519	(535)	(90)
Gain from sale and increase in value of marketable securities - net	(1,815)	(2,183)	(164)
Loss from sale of associated companies	1,618		
Gain from sale of investment in other company		(305)	
Impairment (reversal of impairment) of investment in associated companies and others - net	4,571	(873)	
Linkage differences (erosion) on long-term bank loans- net	1,426	676	(67)
Linkage differences and interest on loans to associated companies and others	(1,770)	(1,604)	(1,497)
	<u>9,077</u>	<u>(2,342)</u>	<u>5,192</u>
Changes in operating asset and liability items:			
Decrease (increase) in accounts receivable	1,370	(369)	1,677
Decrease in accounts payable and accruals	(1,627)	(321)	(3,166)
	<u>(257)</u>	<u>(690)</u>	<u>(1,489)</u>
	<u>8,820</u>	<u>(3,032)</u>	<u>3,703</u>

Supplementary information on investing and financing activities not involving cash flows:

- a. As resolved by the board of directors on February 9, 2005, the Company distributed the remaining shares in Industrial Buildings to its shareholders, as a quasi-dividend in the amount of NIS 80,930 thousands.
- b. The balance of receivables includes an amount of NIS 6,780 thousands, which is deposited in a trust account, in respect of the sale of a building. This balance was not reflected within the framework of investing activities in the statement of cash flows.
- c. The balance of receivables includes an amount of NIS 3,500 thousands, in respect of the sale of buildings for rent, which were sold during 2003. This balance was not reflected in the statements of cash flows in 2003, and will be included at the time of its settlement.

The accompanying notes are an integral part of the consolidated financial statements.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies, applied on a consistent basis, are as follows:

a. General:

- 1) Ophir Holdings Ltd. (the Company) is a holding and investment company.

The subsidiary Merkazim Investments Ltd. is engaged in the renting of commercial buildings. In 2003, this company sold all its holdings in the commercial buildings that were designated for rent.

The subsidiary, New Horizons (1993) Ltd., holds a number of real estates (designated for sale), which were purchased from a related party, see also note 8(2).

As to the activities of the associated companies, see note 3c.

- 2) Definitions:

Subsidiary - a company controlled or owned to the extent of over 50%, the financial statements of which have been consolidated with the financial statements of the Company.

Associated company - a company controlled to the extent of 20% or over (which is not a subsidiary), or a company less than 20% controlled which complies with the condition relating to significant influence , as prescribed by Opinion 68 of the Institute of Certified Public Accountants in Israel (the Israeli Institute), the investment in which is presented by the equity method.

Other company - a company to which the conditions specified in the preceding paragraphs do not apply.

The Group - the Company, its subsidiaries and its associated companies.

Related parties - as defined in Opinion 29 of the Israeli Institute.

- 3) Principles of accounting

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Israel (Israeli GAAP). Israeli GAAP vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in note 14.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (continued):

b. Financial statements presentation basis:

The Company draws up and presents its financial statements in Israeli currency (shekels or NIS).

1) Transition to nominal financial reporting in 2004

With effect from January 1, 2004, the Company has adopted the provisions of Israel Accounting Standard No. 12 - Discontinuance of Adjusting Financial Statements for Inflation - of the Israel Accounting Standards Board (the IASB) and, pursuant thereto, the Company has discontinued, from the aforesaid date, the adjustment of its financial statements for the effects of inflation in Israel.

The amounts adjusted for the effects of inflation in Israel (see 2 below), presented in the financial statements as of December 31, 2003 (the transition date), were used as the opening balances for the nominal financial reporting in the following periods. Additions made after the transition date have been included in the financial statements at their nominal values.

Accordingly, the amounts reported in 2005 and 2004 are composed as follows: amounts originating from the period that preceded the transition date are composed of their adjusted to December 2003 shekel amount, with the addition of amounts in nominal values that were added after the transition date, and net of amounts that were deducted after the transition date (the retirement of such sums is effected at their adjusted values as of transition date, their nominal values, or a combination of the two, according to the circumstances). All the amounts originating from the period after the transition date are included in the financial statements at their nominal values.

2) Comparative figures - amounts adjusted to end of 2004 shekels

Through December 31, 2003, the Company prepared its financial statements on the basis of historical cost adjusted for the changes in the general purchasing power of Israeli currency (NIS), based upon changes in the consumer price index (the CPI), in accordance with pronouncements of the Israeli Institute. The comparative figures included in these financial statements are based on the amounts included for the prior reporting periods, as adjusted for the changes in the general purchasing power of the Israeli currency, based on the CPI for December 2003 (the CPI in effect at the transition date).

The components of the income statements were, for the most part, adjusted as follows: the components relating to transactions carried out during the reported period - revenues, expenses, etc. - were adjusted on the basis of the index for the month in which the transaction was carried out, while those relating to non-monetary balance sheet items (mainly - depreciation) were adjusted on the same basis as the related balance sheet item. The financing component represents financial income and expenses in real terms and the erosion of balances of monetary items during the year.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 1 **SIGNIFICANT ACCOUNTING POLICIES** (continued):

- 3) The amounts of non-monetary assets do not necessarily represent realization value or current economic value, but only the reported amounts of such assets, as described in (1) above. In these financial statements, the term cost signifies cost in reported amounts.

c. Principles of consolidation:

- 1) The consolidated financial statements include the accounts of the Company and its subsidiaries. The companies included in consolidation are listed in note 2.
- 2) Intercompany balances and transactions have been eliminated.

d. Short term investments - marketable securities

These securities (except for investment in shares constituting permanent investment, see f(2) below), are stated at market value.

The changes in value of the above securities are carried to income.

e. Land - business inventory

The land is presented at cost, which - in managements estimation - is lower than market value.

According to the agreements for the purchase of land, the Company might pay additional costs of up to 90% of the net sale proceeds, see also note 8(2).

f. Investments:

- 1) Associated companies:
 - (a) The investments in these companies are accounted for by the equity method. The company reviews at each balance sheet date - whether any events have occurred or changes in circumstances have taken place, which might indicate that there has been an impairment of its investment in associated companies. The balance of the investment as of December 31, 2005 is presented net of a provision for the impairment in value of an associated company, see j. below and note 3.
 - (b) The excess of cost of the investment in associated companies over the Company's share in their equity in net assets at date of acquisition (excess of cost of investment) represents the amount attributed to land and buildings. The amount attributed to buildings is amortized in equal annual installments of 4% per year.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 1 **SIGNIFICANT ACCOUNTING POLICIES** (continued):

- 2) Other companies

The investments in the shares of these companies, including investments in quoted shares, which the Company intends to hold for a long period (permanent investment), are stated at cost, net of impairment for decrease in value, which is not of a temporary nature.

g. Fixed assets:

- 1) These assets are stated at cost.

- 3) Cost of fixed assets includes the Company's share in a joint venture engaged solely in construction of a building and rental thereof.

During the reported year the Company realized the building for rent - see also note 5.

- 3) Financial expenses in respect of loans and credit applied to finance the construction or acquisition of buildings - incurred until construction was completed - were charged to cost of the buildings.

- 4) The assets are depreciated by the straight-line method, on basis of their estimated useful life. Annual rates of depreciation are 2% or 4%.

h. Deferred income taxes:

- 1) Deferred taxes are computed in respect of differences between the amounts presented in these statements and those taken into account for tax purposes. As to the factors in respect of which deferred taxes have been included - see note 10b.

Deferred tax balances are computed at the tax rate expected to be in effect at time of release to income from the deferred tax accounts. The amount of deferred taxes presented in the income statement reflects changes in the above balances during the year.

- 2) Taxes which would apply in the event of disposal of investments in subsidiaries and associated companies have not been taken into account in computing the deferred taxes, since as of the date of approval of these financial statements it is the Company's policy to hold these investments, not to realize them.

i. Revenue recognition

Income from leasing of buildings is recognized on the accrual basis, in accordance with the terms of the agreements with tenants.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (continued):

j. Impairment of assets:

The company reviews - at each balance sheet date - whether any events have occurred or changes in circumstances have taken place, which might indicate that there has been an impairment of fixed assets and identifiable intangibles, including goodwill. When such indicators of impairment are present, the company evaluates whether the carrying value of the asset in the company's accounts can be recovered from the cash flows anticipated from that asset, and, if necessary, records an impairment provision up to the amount needed to adjust the carrying amount to the recoverable amount.

The recoverable value of an asset is determined according to the higher of the net selling price of the asset or its value in use to the company. The value in use is determined according to the present value of anticipated cash flows from the continued use of the asset, including those expected at the time of its future retirement and disposal.

During 2005 the Company recorded an impairment charge on its investment in other company of NIS 4,571 thousand see also note 4b

In 2004 the Company recorded an impairment charge on its investment in Lysh of NIS 950 thousand see also note 3c(3).

The impairment loss is carried directly to income. Where indicators are present that beneficial events have occurred or beneficial changes in circumstances have taken place, the impairment provision in respect of the asset (other than goodwill) may be cancelled or reduced in the future, so long as the recoverable value of the asset has increased, as a result of changes in the estimates previously employed in determining such value.

k. Cash equivalents

The Group considers all highly liquid investments, which include short-term bank deposits (up to three months from date of deposit) that are not restricted as to withdrawal or use, to be cash equivalents.

l. Loss per NIS 1 of par value of shares

The financial statements do not include data regarding loss per NIS 1 of par value of shares, since the data would not provide significant additional information to that otherwise provided by the financial statements.

m. Format of income statements

In view of the nature of the Company's activities - holding of companies which operate in different fields - the Company is of the opinion that concentrated presentation of all revenue and gain items as a group, and of all expense and loss items in a separate group is more suitable to reflect its activities.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (continued):

n. Linkage basis

Balances the linkage arrangements in respect of which stipulate linkage to the last index published prior to date of payment are stated on the basis of the last index published prior to the latest balance sheet date (the index for November).

o. Use of estimates in the preparation of 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 disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting years. Actual results could differ from those estimates.

p. Dividend declared subsequent to balance sheet date

Liabilities relating to dividends declared subsequent to balance sheet date are included in the accounts for the period in which the declaration was made. The amount declared is appropriated, however, from retained earnings, and reported as a separate item in the shareholders' equity - Dividend declared subsequent to balance sheet date .

q. Recently issued accounting pronouncements in Israel:

1. In August 2005, the Israel Accounting Standards Board issued Israel Accounting Standard No. 22 - Financial Instruments: Disclosure and Presentation , which is based on International Accounting Standard No. 32. This standard prescribes the rules for the presentation of financial instruments and the proper disclosure required therefore. The standard sets forth the rules for classifying financial instruments, the rules for splitting and classifying compound financial instruments and the rules for offsetting financial assets and financial liabilities. The standard also prescribes the rules for classifying interest, dividends, losses and gains relating to financial instruments.

This accounting standard applies to financial statements for periods commencing on or after January 1, 2006. The standard is to be applied prospectively and, accordingly, comparative data that are presented in the financial statements for periods commencing from the effective date of the standard will not be re-presented. Financial instruments issued before the standard's effective date are to be classified and presented in conformity with the provisions of the standard from its effective date. Compound financial instruments (that include both an equity component and a liability component), which were issued in periods prior to the standard's effective date, and which had not yet been converted or redeemed at that date, are to be classified according to their component parts and are to be presented in conformity with the provisions of the standard, commencing from the effective date of the standard.

When the standard becomes effective, Opinion 48 - Accounting Treatment of Option Warrants , and Opinion 53 - Accounting Treatment of Convertible Liabilities will be revoked.

In the Company's opinion, implementation of this standard is not expected to have a material effect on its financial statements in future periods.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (continued):

2. In February 2006, the IASB issued Israel Accounting Standard No. 25 - Revenue , which is based on International Accounting Standard No. 18. This standard prescribes recognition, measurement, presentation and disclosure criteria for revenues originating from the sale of goods purchased or manufactured by the company, the provision of services, as well as revenues deriving from the use of the company's assets by others (interest income, royalties or dividends).

The principal issue in accounting for revenue is determining the timing of revenue recognition. Revenue from the sale of goods shall be recognized when all the following conditions have been satisfied: (a) the significant risks and rewards of ownership of the goods have been transferred to the buyer; (b) the company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold; (c) the amount of revenue can be measured reliably; (d) it is probable that the economic benefits associated with the transaction will flow to the company; and (e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Revenue from the provision of services shall be recognized by reference to the stage of completion of the transaction at the balance sheet date, subject to the satisfaction of conditions (c) through (e) above, and only when the stage of completion of the transaction at the balance sheet date can be measured reliably.

A clarification of said standard was issued by the IASB in February 2006: Clarification No. 8 - Reporting of Revenue on a Gross or Net Basis . According to the clarification, a company acting as an agent or an intermediary without bearing the risks and rewards resulting from the transaction, will present its revenue on a net basis (as profit or commission). However, a company that acts as a principal supplier and bears the risks and rewards resulting from the transaction will present its revenue on a gross basis, distinguishing the turnover from the related expenses.

Standard 25 shall be applicable to financial statements for periods commencing on or after January 1, 2006. The standard is to be applied prospectively; nevertheless, in accordance with the transitional provisions of the standard, the classification and presentation of revenue on a gross or net basis, as above, shall be applied with retroactive effect, including the restatement of revenues and expenses appearing in the comparative figures in the financial statements for periods commencing on the effective date of the standard.

Until the publication of said standard and the related clarification, there were no accounting pronouncements in Israel concerning revenue, and the accounting treatment of this issue was mostly based on generally accepted accounting practices and foreign accounting pronouncements; nevertheless, as the principles applied by the company do not differ materially from the directives of the standard, its implementation is not expected to have a material effect on the financial statements of the company in future periods.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 2 INVESTMENTS IN SUBSIDIARIES

Following is a list of the subsidiaries consolidated in Ophir's financial statements:

Wholly-owned:

Ophir Financing Ltd. - inactive;

Maoz Financial Investments Ltd. (Maoz) - inactive;

Merkazim Investments Ltd. (Merkazim) a wholly-owned subsidiary of Maoz. During 2005 Merkazim ceased its activity.

80%-owned - New Horizons (1993) Ltd. (New Horizons).

NOTE 3 INVESTMENTS IN ASSOCIATED COMPANIES:

a. The investments are composed as follows:

	consolidated	
	December 31	
	2005	2004
	NIS in thousands	
Equity in net assets:		
Cost of shares	7,252	14,449
Share in accumulated undistributed profit (1)	81,825	83,984
Share in capital surplus derived by Mivnat Holdings Ltd. from sale of its investment in Industrial Buildings Ltd. to its Shareholders (see c(1) below and 4(a)) (1)	66,065	66,065
	155,142	164,498
Long-term loans (2)	3,056	28,731
Less - provision for impairment of investment, see c(2), (3) below	(950)	(5,954)
	157,248	187,275

(1) Including accumulated erosion of capital notes and gains on dilution of holding in associated companies resulting from issuance of shares to a third party.

(2) As of December 2005 the loans are linked to the Israeli CPI, bear interest at annual rates of 1% and have no fixed maturity date.

b. The changes in the investments in 2005 are as follows:

	NIS in thousands
Balance at beginning of year	187,275
Changes during the year:	
Share in profits of associated companies - net	651

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Loans to an associated company	746
Accrued linkage differentials and interest in respect of long-term loans	1,007
Sale of investment	(32,431)
	<hr/>
Balance at end of year	157,248
	<hr/>

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 3 INVESTMENTS IN ASSOCIATED COMPANIES (continued):

c. Following are details relating to the associated companies:

1) Mivnat Holdings Ltd. (Mivnat)

Mivnat was established in March 1993 by the Company, the subsidiary Merkazim and others, some of whom were interested parties, in order to acquire the Israeli Government's shares in Industrial Buildings Ltd. (Industrial Buildings). During March 1993, Mivnat acquired these shares in consideration of NIS 1,053 million. Ophir holds 18.75% interest in Mivnat directly, and 25% interest jointly with Merkazim.

On December 31, 1998, Mivnat sold its holdings in Industrial Buildings to its shareholders (including the Company). Upon the consummation of the transaction, Mivnat ceased to have any rights in the shares of Industrial Buildings.

During 2004, the Company realized all of its shares in Industrial Buildings see note 4a.

2) Shmey-Bar Real Estate 1993 Ltd., Shmey-Bar (T.H.) 1993 Ltd. and Shmey-Bar (I.A.) 1993 Ltd. (Shmey-Bar companies).

The Company, along with a group of companies, established the Shmey-Bar companies in 1993. These companies were established for the purpose of dealing in development of fruit-bearing properties. They purchased rights to real estate and options to purchase real estate in Tel-Aviv, Haifa, Beer-Sheva, Kiryat Shemona, Eilat, Jerusalem, Holon, Tel-Hanan and Ramla, all from Hamashbir Hamerkazi Israel Cooperative Wholesale Society Ltd. The Company's holdings in Shmey-Bar companies total 22.2%.

On December 31, 2002, the Company wrote down its investment in the Shmey-Bar companies by NIS 5,004 thousands.

On September 20, 2005 the Company and Durban Investments Ltd. signed an agreement for the sale of all its shares and rights (including indemnification of the Company in connection with shareholders loan) in Smei Bar companies, the consideration for the sale amounted to NIS 32.6 million; as a result of the sale of the holdings as above, the Company recorded a loss in the amount of NIS 1,618 thousands, which includes expenses of NIS 1.8 million attributed to the sale.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 3 INVESTMENTS IN ASSOCIATED COMPANIES (continued):

3) Lysh The Coastal High-way Ltd. (L1)

In June 1999, the Company entered into an investment agreement with Lysh Commercial and Road Services Ltd. (L2), a company controlled by Polar Investments Ltd. - an interested party in the Company, and with L1, a wholly-owned subsidiary of L2.

L1 has a 50% holding in Beit Herut-Lysh Development Company Ltd. (BHL), which has invested in a project for the leasing of commercial premises near Moshav Beit Herut (the project).

BHL developed 16,850 square meters of land owned by the Israel Lands Administration (the Administration), in accordance with resolution 717 of the Administration. A commercial project occupying approximately 10,000 square meters was constructed on that land initially, and there is an option to construct an additional 4,000 square meters at a later stage. The Company's share in L1 is approximately 25% (its share in the project being approximately 12.5%). The project commenced in March 2000. As of December 31, 2005 and 2004, the Company invested in L1 approximately NIS 5.5 million.

The Company has also undertaken to provide guarantees in an amount equivalent to 25% of the construction costs. As of December 31, 2005, the Company's share in the loans made to BHL amounts to approximately NIS 16.5 million.

The auditors of L1, while not qualifying their opinion on L1's financial statements for 2005, drew attention to the financial position of BHL, whose financial statements presented a loss of approximately NIS 5.9 million (net of financial expenses in the amount of NIS 7.1 million) and negative working capital amounting to approximately NIS 3.8 million at December 31, 2005.

In 2005, BHL received shareholders' loans in the amount of approximately NIS 2 million from L1. In 2004, it was agreed that payments of principal of the loan for that year would be deferred. During the reported year, the Company and the bank agreed that the payments of principal of the loan for 2005 would be deferred and those payments would be made no later than March 31, 2006 and schedules the repayments of the balance of the loan over a period of 17 years.

BHL's management believes that the execution of the aforementioned arrangements will guarantee the continuance of BHL's regular operations.

In 2004, the Company wrote down its investment in BHL Company by NIS 950,000.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 4 INVESTMENTS IN OTHER COMPANIES:

	Consolidated	
	December 31	
	2005	2004
	NIS in thousands	
Industrial Buildings (a)		67,402
Memadim Investments Ltd. (Memadim) (b)		4,065
Mahalachim Investment in Technology Ltd. (Mahalachim) (c)	1,351	1,351
Others	36	36
	1,387	72,854

- a. Industrial Buildings is engaged in initiation and execution of construction projects - buildings for industry, designated for rental and sale - and in the management of land development and infrastructure preparation for residence and industry.

As of January 1, 2004, the Company held 36,281,616 ordinary shares of NIS 1 par value of Industrial Buildings that constitute 11.84% of the ordinary share capital of this company.

In 2004, the Company sold 4,400,036 shares of Industrial Buildings in consideration for approximately NIS 21.2 million, at a pre-tax gain of approximately NIS 0.3 million.

In 2004, the Company received a dividend in the amount of NIS 10.3 from Industrial Buildings.

In January 2005, 15 million shares were sold in an off-the-floor transaction for NIS 75 million, at a pre-tax gain of NIS 1.7 million. Consideration from sale of the said shares in the amount of NIS 68 million was utilized in 2005 for repayment of part of the balance of bank loan in the amount of NIS 38.4 million, in favor of which the shares were pledged. Part of the consideration from sale of the said shares in the amount of NIS 25 million is placed in a short-term deposit to secure the balance of the remaining loan (NIS 26.3 million) that was repaid in January and February 2006 (see note 6c). The short-term deposit, as stated above, is included under short-term investments at December 31, 2005.

On February 9, 2005, the Company's board of directors decided to distribute the remaining shares of Industrial Buildings, in the amount of NIS 80.9 million to shareholders, as a quasi-dividend. Additionally, the board decided to distribute the balance of cash, in the amount of NIS 9.9 million, to shareholders.

- b. Memadim was established in 1995 by the Company, along with a group of companies, one of which is Industrial Buildings, for the purpose of real estate development. The Company directly holds 10% of the ownership and control of Memadim. see also note 8(1).

The Company currently negotiates the sale of its holdings in Meimadim; therefore, in 2005 the Company recorded in its accounts a provision of NIS 4,571 thousands for impairment of its investment in this Company.

- c. Mahalachim is a venture capital fund; the Company holds approximately 3.5% of shares therein. In 2004, the Company received a dividend in the amount of NIS 3,255,000 from Mahalachim. The share of the dividend that was carried to income amounted to NIS 1,320,000. The balance of the amount was used to reduce the amount of the investment.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 FIXED ASSETS - BULDINGS FOR RENT:

Composition of assets (buildings for rent - including land) as of December 31, 2004 are as follows

Cost	Accumulated depreciation	Depreciated balance
N I S i n t h o u s a n d s		
66,247	8,822	57,425

The Company had rights in an industrial commercial building on leased land for a period of 44 years, which will expire on October 31, 2037, jointly with other companies. The building is leased as part of a joint venture, the Copany share in which is 70%.

On July 11, 2005, the Company sold its share in the rights in a commercial-industrial building in consideration for NIS 51 million. The Company recorded a loss of NIS 7.5 million in respect of this transaction.

NOTE 6 LONG-TERM BANK LOANS:

- a. The loans are linked to the Israeli CPI and bear interest at the annual rate of 4%.
- b. An early repayment of NIS 38.4 million was made in 2005. The balance of the loan is to be repaid in accordance with an updated clearing schedule received from the bank.
- c. The original clearing schedule of the loans for the years subsequent to balance sheet date is as follows:

	December 31	
	2005	2004
	N I S i n t h o u s a n d s	
First year - current maturities	3,759	8,382
Second year	3,759	8,382
Third year	3,759	8,382
Fourth year	3,759	8,382
Fifth year	3,759	8,382
Sixth year and thereafter (through 2012)	7,516	25,147
	22,552	58,675
	26,311	67,057

- d. An early repayment of 26.3 million (the balance of the said loans) was made in January and February 2006.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 7 CAPITAL NOTES:

- a. On December 31, 1998, the Company and a subsidiary, Merkazim, issued capital notes to Mivnat with a par value of NIS 113,770,000 and NIS 37,831,000, respectively. The capital notes are unlinked and interest-free.

Capital notes with an aggregate par value of NIS 151,351,000 are repayable at par, upon demand of Mivnat, on January 1, 2005 and only on that date. After balance sheet date, the shareholders of Mivnat decided to extend the repayment date until January 1, 2007. The balance of the capital notes, NIS 250,000 par value, is repayable annually under the terms stipulated in the agreement.

- b. On December 31, 1998 and on June 30, 2004, the Company issued capital notes to its subsidiary with a par value of NIS 37,769,000 and NIS 25,409,000, respectively. The capital notes are unlinked and interest-free, and are repayable at par, upon demand, on January 1, 2005 and only on that date. After balance sheet date, the shareholders of Merkazim decided to extend the repayment date until January 1, 2007.
- c. In 2002, the subsidiary New Horizons issued capital notes with a par value of NIS 119,000 and NIS 1,069,000 to the Company and the minority shareholder in the subsidiary, respectively. the Company and the minority shareholder in the subsidiary are entitled to receive from New Horizons the principal of the note, without interest or linkage, this after a period of not less than one year.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 8 COMMITMENTS, PLEDGES AND LIMITATIONS IN RESPECT OF LIABILITIES:

1) The Company has undertaken to invest in Memadim (see note 4b) approximately 10% of the cost of land and construction of a rental project which is constructed by Memadim on the Carmel shore. The investment was made partly through investment in Memadim (mainly shareholders' loans), and partly by way of a guarantee provided. The Company's share in future construction costs is estimated at approximately U.S.\$ 17 million. As of December 31, 2005, the balance of the loans to Memadim from banks amounts to approximately NIS 89 million, and the balance of the loans to Memadim from interested parties as of December 31, 2005 amounts to approximately NIS 45 million see note 4b.

2) In December 1996, the subsidiary New Horizons acquired real estate (designated for sale) from a then interested party, which holds 20% of New Horizons' shares. The selling company will be entitled to 90% of the profits from the subsequent sale of the real estate, with the balance accruing to New Horizons. The registration of the real estate in New Horizons' name in the Land Registry has not yet been completed.

On December 4, 2005, the subsidiary was granted an irrevocable option to sell all the rights in the real estate inventory that it owns for a consideration of 17,330 thousands dollar.

The option period is limited to June 15, 2006. As of the date of approval of these financial statements, the subsidiary had not exercised the option granted to it.

3) As to the Company's commitment to grant guarantees to BHL, see note 3c(3).

4) The Company and a subsidiary receive various services from the shareholders in Ophir, including management services, head office services, bookkeeping and legal services. As to the expenses recorded in respect of such services, see note 11.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 9 SHARE CAPITAL:

- a. Composed at December 31, 2005 and 2004 as follows:

	Number of shares		Amount in NIS	
	Authorized	Issued and paid	Authorized	Issued and paid
Ordinary shares of NIS 0.001 par value	160,000	100,000	162	101
Deferred shares of NIS 0.0001 par value*	3	3	0.0003	0.0003

- * The deferred shares confer upon their holders the right to receive their par value upon liquidation of the Company.

- b. In February 2005 the Company's board of directors resolved to distribute its shareholders the balance of the shares of Industrial Buildings (amounting to NIS 80,930 thousands) as a dividend in kind. Also, the Company distributed its shareholders a cash dividend of NIS 9,990 thousands.

Also, on October 16, 2005, the Company's board of directors resolved to distribute the shareholders a dividend in the total amount of NIS 82 million. For the purpose of distributing this dividend, the Company requested the Court to approve a deduction of capital for the Company in an amount of up to NIS 64 million. On November 29, 2005, the Court approved the said request.

At a later date, in order to clarify the board of directors' resolution dated October 16, 2005 and the Company's shareholders' resolution dated November 6, 2005 to approve a certain amount out of which the Company would distribute its shareholders a dividend in the total amount of up to NIS 82 million for the years 2005 and 2006 and in light of the Tel-Aviv District Court's resolution to approve a distribution of dividend that does not meet the criteria of the profit test as required under Section 303 of the Companies Law, 1999 and also since in December 2005 the owners of the Company resolved that the declaration and distribution of the dividend will take place in 2005 and 2006, the board approved in February 2006 the declaration and distribution of dividend to the shareholders, as follows: a total of NIS 20 million paid in cash on December 28, 2005 and a total of NIS 55 million on January 8, 2006.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 10 TAXES ON INCOME:

- a. **Measurement of results for tax purposes under the Income Tax (Inflationary Adjustments) Law, 1985** (hereafter - the inflationary adjustments law)

Under the inflationary adjustments law, results for tax purposes are measured in real terms, having regard to the changes in the Israeli CPI. The Company and its Israeli subsidiaries are taxed under the inflationary adjustments law.

- b. **Deferred income taxes:**

The composition of the deferred taxes, and the changes therein during the reported years, are as follows:

	Depreciable fixed assets
	NIS in thousands
Balance at January 1, 2004	(2,676)
Changes in 2004- amounts carried to income	(126)
Balance at December 31, 2004	(2,550)
Changes in 2005- amounts carried to income	2,550
Balance at December 31, 2005	-,-

Deferred taxes are presented in the balance sheets as long-term liabilities.

- c. **Taxes on income included in the income statements:**

- 1) As follows:

	2005	2004	2003
	NIS in thousands		
For the reported year:			
Current			1,760
Deferred, see also b. above	(2,550)	(126)	2,971
	(2,550)	(126)	4,731
For previous years- current	(2,705)	2,500	

<u>(5,255)</u>	<u>2,374</u>	<u>4,731</u>
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Current taxes are computed at the tax rate of 34%. For tax rates amendment see (e) below.

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OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 10 TAXES ON INCOME (continued):

- 2) Following is a reconciliation of the theoretical tax expense, assuming all income is taxed at the regular tax rates applicable to companies in Israel (see (1) above), and the actual tax expense:

	2005	2004	2003
	NIS in thousands		
Income (loss) before taxes on income as reported in the income statements	(11,420)	16,669	7,027
Add (less) - share in profits of associated companies - net	651	1,150	2,071
B a l a n c e - income (loss)	(12,071)	17,819	9,098
Theoretical tax expense (tax saving)	(4,104)	6,237	3,275
Increase (decrease) in taxes resulting from permanent differences - the tax effect:			
Disallowable deductions (exempt income)	(626)	337	(156)
Differences for which deferred taxes were not created, net	2,224	(870)	4,101
Taxes on income subject to different rates - dividends received from other companies		(4,418)	(2,843)
Taxes in respect of previous years	(2,705)	2,500	
Difference between the basis of measurement of income reported for tax purposes and the basis of measurement of income for financial reporting purposes - net	(309)		
Sundry net	265	(1,412)	354
Taxes on income for the reported year	(5,255)	2,374	4,731

d. Tax assessments

The Company has received final assessments through tax year 2001.

Subsidiaries:

Merkazim - final assessments has been received through tax year 2004.

New Horizons - assessments that are considered as final through tax year 2001.

Ophir Financing Ltd. - assessments that are considered as final through tax year 2001.

e. Tax rates

The Company's income in Israel is subject to the regular corporate tax rate; until December 31, 2003, a corporate tax rate of 36% was applied. In July 2004, an Amendment to the Income Tax Ordinance was published, which determined, inter alia, that the rate of corporate tax will be gradually reduced from 36% to 30%, in the following manner: the rate for 2004 will be 35%, in 2005 - 34%, in 2006 - 32%, and in 2007 and thereafter - 30%.

In August 2005, a further amendment (No. 147) was published, which makes a further revision to the corporate tax rates prescribed by Amendment No. 140. As a result of the aforementioned amendments, the corporate tax rates for 2004 and thereafter are as follows: 2004 - 35%, 2005 - 34%, 2006 - 31%, 2007 - 29%, 2008 - 27%, 2009 - 26% and for 2010 and thereafter - 25%.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 10 TAXES ON INCOME (continued):**f. Real losses on realization of marketable securities for tax purposes, carried forward to future years**

Carryforward real losses on realization of marketable securities at December 31, 2005 aggregate NIS 36 million; December 31, 2004 - NIS 11 million. The real losses are deductible from future real income from marketable securities, if any. No deferred tax assets have been included in respect of such losses, as it is not probable that they will be utilized in the foreseeable future.

NOTE 11 TRANSACTIONS AND BALANCES WITH RELATED PARTIES:**a. Transactions with related parties:**

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<u>NIS in thousands</u>		
Income (expenses):			
Linkage differences on short- term loans to related party company	194		165
Financial income on loan to shareholders and associated companies	1,607	1,371	637
Management fees from other company		433	438
Included in general and administrative expenses			(3,507)
Participation in expenses of shareholders and a corporate interested party			(250)
Management fees to shareholder	1,000		

As to other transactions with, and commitments to, interested parties, see note 8.

b. Balances with related parties:

1) Receivables:

	<u>December 31</u>	
	<u>2005</u>	<u>2004</u>
	<u>NIS in thousands</u>	
a) Loan to a corporate interested party (1)	8,306	8,114

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b) Long-term receivables - loans to associated companies (2)	3,056	28,731
c) A corporate related party current account		
d) Shareholders - current accounts	54,952	151

(1)The loan is linked to the Israeli CPI and bears no interest.

The corporate related party is to repay this debt out of its future positive cash flow.

(2)The loans are linked to the Israeli CPI and bear annual interest at the rate of 1%.

As to current balances with associated and other companies, see note 13a.

- 2) Long-term liability in respect of acquisition of land - business inventory - is linked to the Israeli CPI and bears no interest.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 12 LINKAGE OF MONETARY BALANCES:

a. As follows:

	December 31, 2005		
	Linked to the Israeli CPI	Unlinked	Total
	NIS in thousands		
Assets:			
Current assets:			
Cash and cash equivalents		2,396	2,396
Short-term investments	24,549	469	25,018
Accounts receivable	55,419	10,595	66,014
Loan to a related party	8,306		8,306
Long-term loans to associated companies	3,056		3,056
	91,330	13,460	104,790
Liabilities:			
Current liabilities:			
Short-term credit from bank		75	75
Accounts payable and accruals		4,245	4,245
Long-term liabilities:			
Bank loans (including current maturities)	26,311		26,311
Capital notes to associated company		151,601	151,601
Capital note to an interested party		1,069	1,069
Acquisition of land - business inventory	11,894		11,894
	38,205	156,990	195,195

b. Data regarding the exchange rate and the Israeli CPI:

	Exchange rate of one dollar	Israeli CPI*
At end of year:		
2005	NIS 4.603	185.1 points
2004	NIS 4.308	180.7 points
2003	NIS 4.379	178.6 points
2002	NIS 4.737	182.0 points
Increase (decrease) during the year:		
2005	6.8%	2.4%
2004	(1.6) %	1.2%

2003	(7.5) %	(1.9) %
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* Based on the index for the month ending on each balance sheet date, on the basis of 1993 average = 100.

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OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 13 SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION:

Balance sheets:

	December 31	
	2005	2004
	NIS in thousands	
a. Accounts receivable - other:		
Deposits in respect of sale of fixed assets	10,280	3,500
Associated and others companies	467	626
Other	315	727
	<u>11,062</u>	<u>4,853</u>
b. Bank credit:		
Short-term credit and loans	75	1
Current maturities of long- term loans, see note 6	3,759	8,382
	<u>3,834</u>	<u>8,383</u>
c. Accounts payable and accruals:		
Trade	21	370
Institutions	2,516	2,545
Accrued expenses	404	202
Other	1,304	1,004
	<u>4,245</u>	<u>4,121</u>
d. Concentrations of credit risks		

The Group's cash and cash equivalents and short-term investments at December 31, 2005 and 2004 are deposited with Israeli banks. The Company is of the opinion that the credit risk in respect of these balances is remote.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 13 SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):

e. Fair value of financial instruments

The fair value of financial instruments included in the working capital of the Group is usually identical or close to their carrying value. The fair value of long-term loans to associated and other companies and long-term bank loans also approximates their carrying value, since they bear interest at rates close to prevailing market rates. The determination of the fair value of the capital notes to an associated company and a subsidiary and long-term liabilities in respect of acquisition of land - business inventory is not practical.

	2005	2004	2003
	NIS in thousands		
f. Financial expenses (income) - net:			
Financial expenses:			
In respect of long-term loans	3,593	3,692	3,324
In respect of short-term bank credit	11		232
Other	250	84	138
	<u>3,854</u>	<u>3,776</u>	<u>3,694</u>
Financial income:			
In respect of bank deposits	1,777	1,354	411
Financial income on loan to shareholders	600		
In respect of loans to a related party	194		
In respect of short-term loans to associated companies	1,007	1,371	637
Assigned interest and linkage differences and other	459	351	1,114
	<u>4,037</u>	<u>3,076</u>	<u>2,162</u>
	<u>(183)</u>	<u>700</u>	<u>1,532</u>

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 14 EFFECT OF MATERIAL DIFFERENCES BETWEEN GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN ISRAEL AND IN THE U.S.A.:

a. General:

1) The Company prepares its financial statements in accordance with Israeli GAAP. As applicable to these financial statements, Israeli GAAP and U.S. of America GAAP vary in certain significant respects, as described below:

2) Effect of inflation

In accordance with Israeli GAAP, through December 31, 2003, the Company comprehensively included the effect of the changes in the general purchasing power of Israeli currency in these financial statements, as described in note 1b. In view of the past inflation in Israel, this was considered a more meaningful presentation than financial reporting based on historical cost.

Under US GAAP Israel is not considered to be a highly inflationary country, thus the measurement currency should be in nominal NIS.

The adjustments to reflect the changes in the general purchasing power of Israeli currency have been reversed in the reconciliation of Israeli GAAP to U.S. GAAP.

3) Investment in marketable securities

In accordance with Israeli GAAP, since the Company's intent was to hold some of the investment as an investment for a long period, it was partly stated at cost, net of impairment for decrease in value, which was other than temporary decline in their value. During 2005 the company sold its investment (see also note 4).

Under U.S. GAAP, this investment was classified as an investment in available for sale and was reported at fair value with unrealized gains and losses, recorded as a separate component of other comprehensive income (loss) in shareholders' equity until realized in 2005.

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 14 EFFECT OF MATERIAL DIFFERENCES BETWEEN GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN ISRAEL AND IN THE U.S.A. (continued):

- b. The effect of the material GAAP differences, as described in a. above, on the consolidated financial statements is as follows:

- 1) Operating results:

	2005	2004	2003
	NIS in thousands		
Net income (losses) as reported in these financial statements according to Israeli GAAP	(6,165)	14,296	2,311
Effect of the treatment of the following items under U.S. GAAP:			
Reversal of the adjustment due to effect of inflation	76,050	7,631	39,051
Reversal of the adjustment due to Marketable securities- available for sale	1,985	(2,256)	
Other	478	107	(405)
Net income under U.S. GAAP	72,348	19,778	40,957

- 2) Shareholders equity:

	December 31,	
	2005	2004
	NIS in thousands	
Shareholders equity, as reported in these financial statements, according to Israeli GAAP	78,197	195,282
Effect of the treatment of the above differences under U.S. GAAP:		
Reversal of the adjustment due effect of inflation, net	(1,697)	(77,747)
Reversal of the adjustment due marketable securities-available for sale		(3,061)
Other comprehensive income-marketable securities		61,182
Other	218	(545)
Shareholders equity under U.S. GAAP	76,718	175,111

OPHIR HOLDINGS LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 14 EFFECT OF MATERIAL DIFFERENCES BETWEEN GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN ISRAEL AND IN THE U.S.A. (continued):

3) The effect of the foregoing GAAP difference on reporting comprehensive income, is as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<u>NIS in thousands</u>		
Net income as reconciled to U.S. GAAP, see above	72,348	19,778	40,957
Other comprehensive income - gains not reported (previously reported) in the income statements-			
Unrealized (realized) gains on marketable securities	<u>(61,182)</u>	<u>20,659</u>	<u>78,278</u>
Comprehensive income under U.S. GAAP	<u>11,166</u>	<u>40,437</u>	<u>119,235</u>

OPHIRTECH LTD.

(An Israeli Corporation)

2005 ANNUAL REPORT

OPHIRTECH LTD.

2005 ANNUAL REPORT

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REPORT OF INDEPENDENT AUDITORS

To the shareholders of

OPHIRTECH LTD.

We have audited the financial statements of Ophirtech Ltd. (hereafter - the Company): balance sheets as of December 31, 2005 and 2004 and the related statements of income, changes in shareholders' equity and cash flows for the three years ended December 31, 2005. These financial statements are the responsibility of the Company's board of directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Boards (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2005 and 2004 and the results of operations and cash flows of the Company for the three years ended December 31, 2005, in conformity with accounting principles generally accepted in Israel.

As explained in note 1b, the financial statements, as of dates and for reporting periods subsequent to December 31, 2003, are presented in new Israeli shekels, in conformity with accounting standards issued by the Israel Accounting Standards Board. The financial statements as of dates and for reporting periods ended prior to, or on, the above date are presented in values that have been adjusted for the changes in the general purchasing power of the Israeli currency through that date, in accordance with pronouncements of the Institute of Certified Public Accountants in Israel.

Accounting principles generally accepted in Israel vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in note 7 to the financial statements.

Tel-Aviv, Israel
March 27, 2006

Kesselman & Kesselman
Certified Public Accountants (Isr.)

OPHIRTECH LTD.

BALANCE SHEETS

	Note	December 31	
		2005	2004
NIS in thousands (see note 1b)			
Assets			
CURRENT ASSETS:			
Cash		151	811
Government		28	49
Total current assets		179	860
INVESTMENTS IN COMPANIES	1c ; 2	32,809	36,063
		32,988	36,923
Liabilities and shareholders equity			
CURRENT LIABILITIES:			
Short-term credit:	6a(2)		
From bank credit	6a		966
From shareholders		4,125	4,267
Loan from a related party	6b	8,306	8,114
Accounts payable and accruals			23
Total current liabilities		12,431	13,370
SHAREHOLDERS EQUITY	3	20,557	23,553
		32,988	36,923

_____)
 Avi Israel)
) DIRECTORS
)
 _____)
 Shlomo Shalev)

Date of approval of the financial statements: March 27, 2006

The accompanying notes are an integral part of the financial statements.

OPHIRTECH LTD.

STATEMENTS OF OPERATIONS

	2005	2004	2003
	<u> </u>	<u> </u>	<u> </u>
	NIS in thousands (see note 1b)		
	<u> </u>	<u> </u>	<u> </u>
WRITE-DOWN OF INVESTMENTS IN COMPANIES, net	2,814		1,239
GENERAL AND ADMINISTRATIVE EXPENSES (note 6e)	34	3	251
FINANCIAL EXPENSES net	148	139	416
CAPITAL LOSS ON SALE OF FIXED ASSETS			2
	<u> </u>	<u> </u>	<u> </u>
LOSS FOR THE YEAR	2,996	142	1,908
	<u> </u>	<u> </u>	<u> </u>

The accompanying notes are an integral part of the financial statements.

OPHIRTECH LTD.

STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

	Share capital	Receipts on account of shares to be allotted	Accumulated deficit	Total
NIS in thousands (see note 1b)				
BALANCE AT JANUARY 1, 2003	1	137,622	(112,019)	25,603
CHANGES DURING 2003 - loss			(1,908)	(1,908)
BALANCE AT DECEMBER 31, 2003	1	137,622	(113,927)	23,695
CHANGES DURING 2004 - loss			(142)	(142)
BALANCE AT DECEMBER 31, 2004	1	137,622	(114,069)	23,553
CHANGES DURING 2005 - loss			(2,996)	(2,996)
BALANCE AT DECEMBER 31, 2005	1	137,622	(117,065)	20,557

The accompanying notes are an integral part of the financial statements.

OPHIRTECH LTD.

STATEMENTS OF CASH FLOWS

	2005	2004	2003
	NIS in thousands (see note 1b)		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Loss for the year	(2,996)	(142)	(1,908)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities*	3,004		714
Net cash provided by (used in) operating activities	8	(142)	(1,194)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from disposal of investments	1,746	1,699	
Investment in companies	(1,306)		(3,089)
Proceeds from sale of fixed assets			70
Net cash provided by (used in) investing activities	440	1,699	(3,019)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Short-term credit loans from shareholders - net	(142)	101	4,166
Increase in short term loan from a related party			191
Short-term bank credit	(966)	(873)	(124)
Net cash provided by (used in) financing activities	(1,108)	(772)	4,233
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(660)	785	20
BALANCE OF CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	811	26	6
BALANCE OF CASH AND CASH EQUIVALENTS AT END OF YEAR	151	811	26
* Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Expenses not involving cash flows:			
Depreciation			7
Write-down of investments in companies, net	2,814		1,239
Capital loss on sale of fixed assets			2
Linkage differences of a loan from a related party	192		165
	3,006		1,413
Changes in operating asset and liability items:			
Decrease (increase) in accounts receivables	21		(33)
Decrease in accounts payable and accruals	(23)		(666)
	(2)		(699)
	3,004		714

The accompanying notes are an integral part of the financial statements.

OPHIRTECH LTD.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies, applied on a consistent basis, are as follows:

a. General:

- 1) Ophirtech Ltd. (the Company), invests in start-up companies in various stages of development, from newly established enterprises to companies that have reached advanced development stage.

On March 30, 2000, the Company purchased investments in high-tech companies engaged in various fields of activity (communications, software, security, etc.) from Ophir Holdings Ltd. (Ophir Holdings), which at that time was a company under common control, for approximately adjusted NIS 76 million. The difference between the proceeds and the carrying value of those investments on the books of Ophir Holdings was carried to the Company's accumulated deficit, in accordance with the Israeli Securities (Presentation in Financial Reports of Acts between Body Corporate and its Controlling Member) Regulations, 1996.

- 2) Related parties - as defined in Opinion 29 of the Israeli Institute.

- 3) Principles of accounting

The financial statements have been prepared in accordance with accounting principles generally accepted in Israel (Israeli GAAP). Israeli GAAP vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in note 7.

b. Financial statements presentation basis:

The company draws up and presents its financial statements in Israeli currency (hereafter - shekels or NIS).

- 1) Transition to nominal financial reporting in 2004

With effect from January 1, 2004, the company has adopted the provisions of Israel Accounting Standard No. 12 Discontinuance of Adjusting Financial Statements for Inflation of the Israel Accounting Standards Board (hereafter the IASB) and, pursuant thereto, the company has discontinued, from the aforesaid date, the adjustment of its financial statements for the effects of inflation in Israel.

The amounts adjusted for the effects of inflation in Israel, presented in the financial statements as of December 31, 2003 (hereafter the transition date), were used as the opening balances for the nominal financial reporting in the following periods. Additions made after the transition date have been included in the financial statements at their nominal values.

Accordingly, the amounts reported for 2003, as well as reported amounts for subsequent

OPHIRTECH LTD.

NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (continued):

b. Financial statements presentation basis (continued):

periods, that relate to non-monetary assets including permanent investment and equity items, which originate from the period that preceded the transition date, are based on the adjusted-for-inflation data (based on the CPI for December 2003), as previously reported. All the amounts originating from the period after the transition date are included in the financial statements at their nominal values.

Through December 31, 2003, the company prepared its financial statements on the basis of historical cost adjusted for the changes in the general purchasing power of Israeli currency (NIS), based upon changes in the consumer price index (hereafter the CPI), in accordance with pronouncements of the Institute of Certified Public Accountants in Israel (hereafter the Israeli Institute).

In 2003, the components of the income statements were, for the most part, adjusted as follows: the components relating to transactions carried out during the reported period were adjusted on the basis of the index for the month in which the transaction was carried out, while those relating to non-monetary balance sheet items were adjusted on the same basis as the related balance sheet item. The financing component represents financial income and expenses in real terms and the erosion of balances of monetary items during the year.

- 2) The amounts of non-monetary assets do not necessarily represent realization value or current economic value, but only the reported amounts of such assets, as described in (1) above. In these financial statements, the term cost signifies cost in reported amounts.

c. Investments in companies

The investments in the shares of these companies are presented at cost net of write down for decrease in value, which is not of a temporary nature.

The Company performs from time to time fair value evaluations of its investments in start-up and development companies and includes, when necessary, a write-down for decrease in value which is not of a temporary nature, see also d. hereafter.

OPHIRTECH LTD.

NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 1 **SIGNIFICANT ACCOUNTING POLICIES** (continued):

d. Impairment of assets:

- 1) The company reviews - at each balance sheet date - whether any events have occurred or changes in circumstances have taken place, which might indicate that there has been an impairment of fixed assets and identifiable intangibles. When such indicators of impairment are present, the company evaluates whether the carrying value of the asset in the company's accounts can be recovered from the cash flows anticipated from that asset, and, if necessary, records an impairment provision up to the amount needed to adjust the carrying amount to the recoverable amount.

The recoverable value of an asset is determined according to the higher of the net selling price of the asset or its value in use to the company. The value in use is determined according to the present value of anticipated cash flows from the continued use of the asset, including those expected at the time of its future retirement and disposal.

- 2) During 2005, the company has written-down its investments in companies in the total amount of 2,814 thousands NIS (2004- NIS 0; 2003- NIS 1,239 in thousand).

e. Loss per NIS 1 of par value of shares

The financial statements do not include data regarding loss per NIS 1 of par value of shares, since the data would not provide significant additional information to that otherwise provided by the financial statements.

f. Linkage basis

Balances the linkage arrangements in respect of which stipulate linkage to the last index published prior to date of payment are stated on basis of the last index published prior to balance sheet date (the index for November).

g. Use of estimates in the preparation of 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 disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

OPHIRTECH LTD.

NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 1 **SIGNIFICANT ACCOUNTING POLICIES** (continued):**h.** **Data regarding the exchange rate and the Israeli CPI:**

	Exchange rate of one U.S. dollar	Israeli CPI*
At end of year:		
2005	NIS 4.603	185.05 points
2004	NIS 4.308	180.74 points
2003	NIS 4.379	178.58 points
Increase (decrease) during:		
2005	6.8%	2.4%
2004	(1.6%)	1.2%
2003	(7.6%)	(1.9%)

* Based on the index for the month ending on each balance sheet date, on the basis of 1993 average = 100.

i. **Recently issued accounting pronouncements in Israel:**

- 1) In August 2005, the Israel Accounting Standards Board issued Israel Accounting Standard No. 22 – Financial Instruments: Disclosure and Presentation, which is based on International Accounting Standard No. 32. This standard prescribes the rules for the presentation of financial instruments and the proper disclosure required therefor. The standard sets forth the rules for classifying financial instruments, the rules for splitting and classifying compound financial instruments and the rules for offsetting financial assets and financial liabilities. The standard also prescribes the rules for classifying interest, dividends, losses and gains relating to financial instruments. This accounting standard applies to financial statements for periods commencing on or after January 1, 2006. The standard is to be applied prospectively and, accordingly, comparative data that are presented in the financial statements for periods commencing from the effective date of the standard will not be re-presented. Financial instruments issued before the standard's effective date are to be classified and presented in conformity with the provisions of the standard from its effective date. Compound financial instruments (that include both an equity component and a liability component), which were issued in periods prior to the standard's effective date, and which had not yet been converted or redeemed at that date, are to be classified according to their component parts and are to be presented in conformity with the provisions of the standard, commencing from the effective date of the standard.

When the standard becomes effective, the Israeli institute's Opinion 48 – Accounting Treatment of Option Warrants, and Opinion 53 – Accounting Treatment of Convertible Liabilities will be revoked.

OPHIRTECH LTD.

NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (continued):

i. Recently issued accounting pronouncements in Israel (continued):

In the Company's opinion, implementation of this standard is not expected to have a material effect on its financial statements in future periods.

- 2) In February 2006, the IASB issued Israel Accounting Standard No. 25 - Revenue, which is based on International Accounting Standard No. 18. This standard prescribes recognition, measurement, presentation and disclosure criteria for revenues originating from the sale of goods purchased or manufactured by the company, the provision of services, as well as revenues deriving from the use of the company's assets by others (interest income, royalties or dividends).

The principal issue in accounting for revenue is determining the timing of revenue recognition. Revenue from the sale of goods shall be recognized when all the following conditions have been satisfied: (a) the significant risks and rewards of ownership of the goods have been transferred to the buyer; (b) the company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold; (c) the amount of revenue can be measured reliably; (d) it is probable that the economic benefits associated with the transaction will flow to the company; and (e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

A clarification of said standard was issued by the IASB in February 2006: Clarification No. 8 - Reporting of Revenue on a Gross or Net Basis. According to the clarification, a company acting as an agent or an intermediary without bearing the risks and rewards resulting from the transaction, will present its revenue on a net basis (as profit or commission). However, a company that acts as a principal supplier and bears the risks and rewards resulting from the transaction will present its revenue on a gross basis, distinguishing the turnover from the related expenses.

Standard 25 shall be applicable to financial statements for periods commencing on or after January 1, 2006. The standard is to be applied prospectively; nevertheless, in accordance with the transitional provisions of the standard, the classification and presentation of revenue on a gross or net basis, as above, shall be applied with retroactive effect, including the restatement of revenues and expenses appearing in the comparative figures in the financial statements for periods commencing on the effective date of the standard.

Until the publication of said standard and the related clarification, there were no accounting pronouncements in Israel concerning revenue, and the accounting treatment of this issue was mostly based on generally accepted accounting practices and foreign accounting pronouncements; nevertheless, as the principles applied by the company do not differ materially from the directives of the standard, its implementation is not expected to have a material effect on the financial statements of the company in future periods.

OPHIRTECH LTD.

NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 2 INVESTMENTS IN COMPANIES:

The composition of the investments is as follows:

	December 31		
	2005	Percentage	2004
	Cost	of ownership/ Control*	Book value
	NIS in thousands	%	NIS in thousands
Pelican Security Ltd. - Pelican (a)	8,885	4	930
Expand Networks Ltd. - Expand (b)	10,033	10,033	9,378
Mainssoft Corporation - Mainssoft (c)	500	500	500
Netformx Ltd. - Netformx (d)	9,907	2,322	2,322
StoreAge Networking Technologies Ltd. - StoreAge (e)	13,946	13,946	13,292
Celvibe Ltd. - Celvibe (f)	12,278	-,-	163
Viola Networks Ltd. - Viola (g)	14,088	6,004	6,004
Cerel Ceramic Technologies Ltd. - Cerel (h)	4,451	-,-	3,474
Others (i)	57,708	-,-	-,-
T o t a l	131,796	32,809	36,063

* Ownership/ Control on a full and undiluted basis.

- (a) Pelican is engaged in the development of solutions to the problem of safeguarding information on the Internet against viruses and hackers.

In February 2003, Pelican sold the know-how that it had developed and owned.

Pelican was appointed an outside liquidator who, in 2005, had transferred to the company an aggregate of NIS 626,000 out of the liquidation monies.

- (b) Expand is engaged in the development of technology designed to accelerate communications over diverse network infrastructures (including E1, T1 and frame relay lines) and improve broadband efficiency.

In June 2003, as part of a Capital raise from existing shareholders in Expand, the Company invested an addition amount of \$ 250,000 (NIS 1,084,000) in Expand.

During April 2005, the Company gave a bridging loan to Expand in the amount of \$ 150,000 (NIS 653,000).

- (c) Mainssoft is engaged in the development of software and tools for software developers.

OPHIRTECH LTD.

NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 2 INVESTMENTS IN COMPANIES (continued):

- (d) Netformx is engaged in development, marketing and support of software designed for planning, operation and maintenance of computer networks.

The investment in Netformx as of December 31, 2005 is presented net of a provision of NIS 7.6 million for impairment of value.

Netformx is partly held by companies which are related parties.

- (e) StoreAge is engaged in the development and marketing of a software solution and innovative data storage solutions for communications networks (Storage Area Network).

During February 2005, the company gave a bridging loan to Storeage ,in the amount of \$ 150,000 (NIS 653,000).

StoreAge is partly held by a company which is related party.

- (f) Celvibe develops solutions for digital video transmission for Internet broadband networks and mobile phone communications.

In November 2002, Celvibe ceased its operations and entered a winding-up procedure.

On December 7, 2004, an amount of \$ 393,000 was received from Celvibe s liquidator, and On June 30, 2005, an amount of \$ 245,000 was received.

As of December 31, 2005, the balance of the investment is set at zero and the company is not expecting to receive an additional amounts from the liquidation of Celvibe.

- (g) Viola is engaged in the development of a software system to allow quick and uninterrupted identifications of problems and technical difficulties on various communications networks.

In October 2003, the Company invested \$ 150,000 (NIS 668,000) in Viola.

The investment in Viola as of December 31, 2005 is presented net of a provision of NIS 8 million for impairment of value.

- (h) Cerel develops ceramic layering technologies for the passive electronic components market.

In 2002, the company recorded an impairment provision of NIS 980,000 in respect of the investment. In 2005, due to adverse indicators, the company wrote off the balance of its investment in Cerel and recorded an impairment loss of NIS 3.3 million.

OPHIRTECH LTD.

NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 2 INVESTMENTS IN COMPANIES (continued):

- (i) Following is a list of the companies in which the Company has invested approximately NIS 58 million. An impairment provision has been made for the full amount invested:

Cipheractive Ltd;
Carmel Biosensors Ltd;
Elpas Electro-Optic Systems Ltd
Romidot Ltd;
RealM Technologies Ltd;
Camelot Information Technologies Ltd;
Interlink Computer Communications Ltd;
Techimage Ltd;
Indox online ltd.
Iradius.Com, Inc;
Trans4u Ltd;
Praxell Inc;
Electrochemical Light Switch Inc;

NOTE 3 SHAREHOLDERS EQUITY:

a. Share capital

The share capital as of December 31, 2005 and 2004 is composed of ordinary shares of NIS 1 par value, as follows: authorized - 10,000 shares; issued and paid - 1,000 shares.

b. Receipts on account of shares to be allotted

On November 1, 2000, the Company received a payment on account of shares in the amount of NIS 137,622,000 from its shareholders. The shares have not yet been allotted.

NOTE 4 TAXES ON INCOME:

- a.** Measurement of results for tax purposes under the Income Tax (Inflationary Adjustments) Law, 1985 (hereinafter - the Inflationary Adjustments Law)

Under the Inflationary Adjustments Law, results for tax purposes are measured in real terms, having regard to the changes in the Israeli CPI. The Company is taxed under this law.

b. Taxes rates

The income of the company is taxed at the regular rate. Through December 31, 2003, the corporate tax was 36%. In July 2004, Amendment No. 140 to the Income Tax Ordinance was enacted. One of the provisions of this amendment is that the corporate tax rate is to be gradually reduced from 36% to 30%. In August 2005, a further amendment (No. 147) was published, which makes a further revision to the corporate tax rates prescribed by Amendment No. 140. As a result of the aforementioned amendments, the corporate tax rates for 2004 and thereafter are as follows: 2004 35%, 2005 34%, 2006 31%, 2007 29%, 2008 27%, 2009 26% and for 2010 and thereafter 25%.

OPHIRTECH LTD.

NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 4 TAXES ON INCOME (continued):**c. Losses for tax purposes, carried forward to future years**

Carryforward losses aggregate approximately NIS 2 million at December 31, 2005. Under the Inflationary Adjustments Law such carryforward tax losses are linked to the Israeli CPI. No deferred tax asset has been included in respect of such losses. In addition, no deferred tax asset has been included in respect of the impairment provision created for the investments in companies.

d. Tax assessments

The company has received final tax assessments through tax year 2001.

NOTE 5 RELATED PARTIES - TRANSACTIONS AND BALANCES:**a. Transactions:**

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<u>NIS in thousands</u>		
Financial expenses in respect of short term loan from a company which is a related party	194		165

b. Balances:

	<u>December 31</u>	
	<u>2005</u>	<u>2004</u>
	<u>NIS in thousands</u>	
1) Short-term loan from a company which is a related party	(8,306)	(8,114)
2) Current liabilities - presented in the balance sheets as short-term credit from shareholders	(4,125)	(4,267)

NOTE 6 SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION:**Balance sheets:****a. Short-term bank credit:**

- Short-term bank credit was unlinked and beared annual interest rate of 5.46% in 2005 and 6.5% in 2004. During October 2005, the company had settled the bank credit in full.

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- 2) In February 2001, the Company and its shareholders gave a commitment to a certain bank that the Company would not make any repayments or settlements to its shareholders on account of shareholders' loans and/or sums received on account of shares up to an amount of approximately adjusted NIS 100 million.

b. Short-term loan from a related party

The loan is linked to the Israeli CPI and bears no interest.

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OPHIRTECH LTD.

NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 6 SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):**c. Concentrations of credit risks**

The Company's cash at December 31, 2005 and 2004 were deposited with Israeli banks. The Company is of the opinion that the credit risk in respect of these balances is remote.

d. Fair value of financial instruments

The fair value of the financial instruments included in working capital of the Company is usually identical or close to their carrying value.

Statements of operations -**e. General and administrative expenses:**

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<u>NIS in thousands</u>		
Professional fees	24		
Travel abroad	12		
Payroll and related expenses			187
Office rent and maintenance			22
Other	(2)	3	42
	<u>34</u>	<u>3</u>	<u>251</u>

OPHIRTECH LTD.

NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 7 EFFECT OF MATERIAL DIFFERENCES BETWEEN GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN ISRAEL AND IN THE U.S.A:

a. General:

- 1) The Company prepares its financial statements in accordance with Israeli GAAP. As applicable to these financial statements, Israeli GAAP and U.S. of America GAAP vary in certain significant respects, as described below:
- 2) Effect of inflation

In accordance with Israeli GAAP, through December 31, 2003, the Company comprehensively included the effect of the changes in the general purchasing power of Israeli currency in these financial statements, as described in note 1b. In view of the past inflation in Israel, this was considered a more meaningful presentation than financial reporting based on historical cost.

Under US GAAP Israel is not considered to be a highly inflationary country, thus the measurement currency should be in nominal NIS.

The adjustments to reflect the changes in the general purchasing power of Israeli currency have been reversed in the reconciliation of Israeli GAAP to U.S. GAAP.

OPHIRTECH LTD.

NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 8 EFFECT OF MATERIAL DIFFERENCES BETWEEN GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN ISRAEL AND IN THE U.S.A (continued):

- b. The effect of the material GAAP differences, as described in a. above, on the consolidated financial statements is as follows:

- 1) Operating results:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<u>NIS in thousands</u>		
Net losses as reported in these financial statements according to Israeli GAAP	2,996	142	1,908
Effect of the treatment of the following item under U.S. GAAP-			
Reversal of the adjustment due to effect of inflation	(50)	-,	(371)
Net losses under U.S. GAAP	<u>2,946</u>	<u>142</u>	<u>1,537</u>

- 2) Shareholders equity:

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
	<u>NIS in thousands</u>	
Shareholders equity, as reported in these financial statements, according to Israeli GAAP	20,557	23,553
Effect of the treatment of the above differences under U.S. GAAP:		
Reversal of the adjustment due To effect of inflation, net	(2,006)	(2,056)
Transaction with related party	800	800
Shareholders equity under U.S. GAAP	<u>19,351</u>	<u>22,297</u>

- 3) The company has no other comprehensive income (loss) components other than net loss for the reported periods.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
TO THE SHAREHOLDERS
OF AM-HAL LTD.**

We have audited the accompanying balance sheets of Am-Hal Ltd. (the Company) and the consolidated balance sheets of the Company and a consolidated partnership as of December 31, 2003 and 2002, and the related statements of operations, changes in shareholders' equity and cash flows of the Company and on a consolidated basis for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company and on a consolidated basis as of December 31, 2003 and 2002, and the results of operations, changes in shareholders' equity and cash flows of the Company and on a consolidated basis for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in Israel which, with respect to these financial statements, differ in certain respects from the accounting principles generally accepted in the United States of America. See Note 25 to the financial statements that describe the material differences.

As explained in Note 2B, these financial statements are presented in values adjusted for the changes in the general purchasing power of the Israeli currency, in accordance with pronouncements of the Institute of Certified Public Accountants in Israel.

Brightman Almagor & Co.
Certified Public Accountants
A member firm of Deloitte Touche Tohmatsu

Tel Aviv, February 15, 2004

INDEPENDENT AUDITORS SPECIAL REPORT

We have audited the balance sheets of Am-Hal Ltd. (the Company) and the consolidated balance sheets of the Company and a consolidated partnership as of December 31, 2003 and 2002, and the related statements of operations, changes in shareholders' equity and cash flows of the Company and on a consolidated basis for each of the three years in the period ended December 31, 2003, and have issued our unqualified report thereon dated February 15, 2004. The aforementioned financial statements (not presented separately herein) were prepared in new Israeli shekels (NIS) on the historical cost basis, adjusted for changes in the general purchasing power of the NIS in accordance with standards established by the Institute of Certified Public Accountants in Israel.

As described in Note 2B, the accompanying Company and consolidated financial data in U.S. dollars as of the abovementioned dates and for the abovementioned years then ended were prepared on the basis of financial data in nominal NIS (the basis on which the Company and consolidated adjusted NIS financial statements were also prepared), translated into US dollars in accordance with the principles described in Note 2B.

In our opinion, the accompanying financial data in US dollars was translated in accordance with the principles described in Note 2B.

This report is intended solely for the information and use of the Boards of Directors and management of the Company and Ampal-American Israel Corp., and should not be used for any other purpose.

Brightman Almagor & Co.
Certified Public Accountants
A member firm of Deloitte Touche Tohmatsu

Tel Aviv, February 15, 2004

INDEPENDENT AUDITORS' REPORT

TO THE SHAREHOLDERS OF

BAY HEART LTD. AND SUBSIDIARY

We have audited the accompanying balance sheets of Bay Heart Ltd. (the Company) as of December 31, 2005 and 2004, and the consolidated balance sheets as of those dates, and the related statements of operations, changes in shareholders' equity and cash flows of the Company and on a consolidated basis for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company and on a consolidated basis as of December 31, 2005 and 2004, and the results of operations, changes in shareholders' equity and cash flows of the Company and on a consolidated basis for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in Israel.

Accounting principles generally accepted in Israel differ in certain respects from accounting principles generally accepted in the United States. With respect to these financial statements, the difference in the application of the latter is described in Note 19.

As described in Note 2A, the financial statements are presented in reported amounts, in conformity with Accounting Standards of the Israel Accounting Standards Board.

The condensed consolidated financial information in U.S. dollars presented in Note 18 to the financial statements, prepared at the request of an investor, represents a translation of the Company's financial statements in nominal values, as stated in Note 18A. In our opinion, such translation into U.S. dollars was appropriately performed on the basis stated in Note 18A.

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As described in Note 1C to the financial statements regarding the Company's business condition, the Company has ongoing losses, a working-capital deficit, shareholders' deficiency and negative cash flows from operating activities. As stated in that note, the continuance of the Company's operations and its ability to satisfy its short-term liabilities is contingent upon the attainment of financing from the shareholders and/or bank financing arrangements. The Company's management is currently negotiating with a bank for rescheduling its short-term credit as a long-term loan.

Brightman Almagor & Co.
Certified Public Accountants
Member firm of Deloitte Touche Tohmatsu

Haifa, Israel, February 22, 2006.

REPORT OF INDEPENDENT PUBLIC ACCOUNTING FIRM

To the Shareholders of

CARMEL CONTAINER SYSTEMS LTD.

We have audited the accompanying balance sheets of Carmel Container Systems Ltd. (the Company) as of December 31, 2005 and 2004, and the consolidated balance sheets as of such dates and the related statements of operations, changes in shareholders' equity and cash flows Company and consolidated for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's board of directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of a certain subsidiary, whose assets constitute approximately 10% and 8% of total consolidated assets as of December 31, 2005 and 2004, respectively, and whose revenues included in consolidation constitute approximately 10%, 9% and 8% of total consolidated revenues for the years ended December 31, 2005, 2004 and 2003, 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 the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the company's internal control over financial reporting. Our audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2005 and 2004, and the consolidated results of their operations and cash flows for each of the three years in the period ended of December 31, 2005, in conformity with Israel generally accepted accounting principles, which differ in certain respects from those followed in the United States, as described in Note 22 to the consolidated financial statements.

Haifa, Israel,
March 6, 2006

KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

Report of Independent Registered Public Accounting Firm

To the shareholders of

C.D. PACKAGING SYSTEMS LTD.

We have audited the financial statements of C.D. Packaging Systems Ltd. (hereafter the Company) and the consolidated financial statements of the Company and its consolidated subsidiary: balance sheets as of December 31, 2005 and 2004 and statements of income (loss), changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's board of directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Israel and in the standards of the Public Company Accounting Oversight Board (United States), including those prescribed by the Israeli Auditors (Mode of Performance) Regulations, 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the company's Board of Directors and management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the aforementioned financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2005 and 2004 and the results of operations, changes in shareholders' equity and cash flows of the Company and consolidated for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted (GAAP) in Israel. Also, in our opinion, except for failure to meet the requirements of the Securities Regulations (Presentation of Transactions between a Corporation and its Controlling Shareholder in the Financial Statements), 1996, as explained in note 11, and except for the exclusion of certain specifications, as explained in that note, the abovementioned financial statements have been prepared in accordance with the Securities (Preparation of Annual Financial Statements) Regulations, 1993.

As explained in note 1b, the financial statements, as of dates and for reporting periods subsequent to December 31, 2003, are presented in new Israeli shekels, in conformity with accounting standards issued by the Israel Accounting Standards Board. The financial statements as of dates and for reporting periods ended prior to, or on, the above date are presented in values that have been adjusted for the changes in the general purchasing power of the Israeli currency through that date, in accordance with pronouncements of the Institute of Certified Public Accountants in Israel.

Haifa,
March 6, 2006

/s/ KESSELMAN & KESSELMAN CPAs (ISR) A member of pricewaterhouseCoopers International Limited

CORAL WORLD INTERNATIONAL LTD.

REPORT OF INDEPENDENT AUDITORS

TO THE SHAREHOLDERS

OF CORAL WORLD INTERNATIONAL LTD.

We have audited the accompanying consolidated balance sheets of **Coral World International Ltd.** (the Company) as of December 31, 2005 and 2004, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Board of Directors and management of the Company. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB) (United States). 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 Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by the Board of Directors and management of the Company, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Coral World International Ltd. as of December 31, 2005 and 2004, and the results of its operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

Fahn Kanne & Co.
Certified Public Accountants (Isr.)

Tel-Aviv, Israel, March 26, 2006

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the shareholders of

EPSILON INVESTMENT HOUSE LTD.

We have audited the balance sheets of Epsilon Investment House Ltd. (the Company) as of December 31, 2004 and 2003, and the consolidated balance sheets as of such date and the related statements of income, changes in shareholders' equity and cash flows of the Company and consolidated for the years then ended expressed in New Israeli Shekels (not presented herein). These financial statements are the responsibility of the Company's board of directors and management. Our responsibility is to express an opinion on these financial statements based on our audits. The financial statements of an investee company have been audited by other auditors whose report has been furnished to us; insofar as our opinion on the consolidated financial statements relates to the amounts included for the investee, it is based solely on their report. In the consolidated financial statements, the Company's investment in the investee is stated at NIS 331 thousand and NIS 26 thousand, respectively, at December 31, 2004 and 2003, and the Company's equity in the net income of the investee is stated at NIS 305 thousand and NIS 25 thousand for the years then ended.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted 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. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by the board of directors and management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the Company and consolidated as of December 31, 2004 and 2003, and the results of operations, changes in shareholders' equity and cash flows of the Company and consolidated for the years then ended, in conformity with generally accepted accounting principles in Israel, which differ in certain respects from those generally accepted in the United States (see Note 20 to the financial statements).

As described in Note 2a, the financial statements as of the dates and for the reported periods subsequent to December 31, 2003, are presented in reported amounts, in conformity with Accounting Standards of the Israeli Accounting Standards Board. The financial statements as of the dates and for the reported periods until the aforementioned date are presented in values that were adjusted until that date according to the changes in the general purchasing power of the Israeli currency, in accordance with pronouncements of the Institute of Certified Public Accountants in Israel.

Tel-Aviv, Israel
February 24, 2005

KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the shareholders of

Hod Hasharon Sport Center Limited

We have audited the consolidated balance sheets of Hod Hasharon Sport Center Limited and its subsidiaries as of December 31, 2005 and 2004 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States of America) and with auditing standards generally accepted in Israel, including those prescribed by the Israeli Auditors (Mode of Performance) Regulations, 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Company's Board of Directors and management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2005 and 2004 and the consolidated results of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

Somekh Chaikin
Certified Public Accountants (Isr)

February 28, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the shareholders of

Hod Hasharon Sport Center (1992) Limited Partnership

We have audited the consolidated balance sheets of Hod Hasharon Sport Center (1992) Limited Partnership and its subsidiaries as of December 31, 2005 and 2004 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States of America) and with auditing standards generally accepted in Israel, including those prescribed by the Israeli Auditors (Mode of Performance) Regulations, 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Company's Board of Directors and management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2005 and 2004 and the consolidated results of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

Somekh Chaikin
Certified Public Accountants (Isr)

February 28, 2006

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the shareholders of

RENAISSANCE INVESTMENT COMPANY LTD.

We have audited the balance sheets of Renaissance Investment Company Ltd. (the Company) as of December 31, 2004 and 2003, and the consolidated balance sheet as of December 31, 2004, and the related statements of income, changes in shareholders' equity and cash flows of the Company for the years ended December 31, 2004 and 2003 and the consolidated statements of income and cash flows for the year ended December 31, 2004, expressed in New Israeli Shekels (not presented herein). These financial statements are the responsibility of the Company's board of directors and management. Our responsibility is to express an opinion on these financial statements based on our audits. The financial statements of an investee company have been audited by other auditors whose report has been furnished to us; insofar as our opinion on the financial statements relates to the amounts included for the investee, it is based solely on their report. In the financial statements, the Company's investment in the investee is stated at NIS 3,571 thousand and NIS 1,070 thousand, respectively, at December 31, 2004 and 2003, and the Company's equity in the net income of the investee is stated at NIS 501 thousand and NIS 70 thousand for the years then ended.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in Israel, including those prescribed by the Auditors' Regulations (Auditors' 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. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by the board of directors and management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2004 and 2003, and the consolidated financial position as of December 31, 2004 and the results of operations, changes in shareholders' equity and cash flows of the Company for the years ended December 31, 2004 and 2003 and the consolidated results of operations and cash flows for the year ended December 31, 2004, in conformity with generally accepted accounting principles in Israel, which differ in certain respects from those generally accepted in the United States (see Note 15 to the financial statements).

As described in Note 2a, the financial statements as of the dates and for the reported periods subsequent to December 31, 2003, are presented in reported amounts, in conformity with Accounting Standards of the Israeli Accounting Standards Board. The financial statements as of the dates and for the reported periods until the aforementioned date are presented in values that were adjusted until that date according to the changes in the general purchasing power of the Israeli currency, in accordance with pronouncements of the Institute of Certified Public Accountants in Israel.

Tel-Aviv, Israel
February 24, 2005

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