

AFRICA ISRAEL PROPERTIES LTD.

Report of the Board of Directors for the Period January – December 2007

March 24, 2008

1. General

The net income of Africa Israel Properties Ltd. (hereinafter – “the Company” or “Africa Properties”) and its consolidated subsidiaries in 2007 amounted to about NIS 359.9 million compared with about NIS 74.4 million in 2006 – an increase of 383.7%.

The Company’s consolidated net income in the fourth quarter of 2007 totaled about NIS 132.5 million, versus about NIS 13.2 million in the corresponding quarter of the prior year – an increase of 904%.

Set forth below is selected data from the financial statements (in millions of NIS):

	For the Year Ended December 31		
	2007	2006	2005
Earnings from rental and operation of properties	353.3	269.0	234.2
Earnings from construction and real estate transactions, net	11.7	–	–
Operating income	321.1	188.2	155.1
Financing expenses, net	174.8	46.6	58.1
Other income	15.3	49.3	22.9
Gain from revaluation of properties (net of minority interest and taxes)	299.5	–	–
Net income	<u>359.9</u>	<u>74.4</u>	<u>53.3</u>

2. Significant Data and Description of the Company’s Business Activities

The Company has been engaged in the rental real estate sector since 1971 and has buildings serving as industrial, commercial and office space, both in and outside of Israel. In addition, the Company has properties under construction, land and unused building rights. In 2006, the Company commenced operating in the area of residential real estate in Europe.

2.1 Office Space in Israel

The main office buildings held by the Group companies in Israel are: the Africa Israel Tower in Tel-Aviv; Hakiryia complex in Tel-Aviv; an office building situated above the Ramat Aviv Shopping Mall; the Concord Towers in B’nei B’rak; and office space located above the Savyonim Shopping Mall in Yehud.

2.2 Science and Industrial Parks in Israel

The Group companies have science and industrial parks, including: Kiryat Weizman Science Park in Nes Ziona; The Science Park in Migdal HaEmek; the Global Park in Lod; and Park Rehovot.

2.3 Commercial Space in Israel

The Group companies have shopping malls and additional commercial space in Israel, the main ones being: the Ramat Aviv Shopping Mall in Tel-Aviv; and the Savyonim Shopping Mall in Yehud.

2.4 Office, Commercial and Logistical Space Overseas

The Group companies have rights in a number of real estate properties overseas, the main ones being in the Flora Palace Shopping Mall located in Prague in the Czech Republic along with a number of properties in Germany.

In addition, the Company is in various stages of construction of office-building, commercial and logistics projects in the Czech Republic, Rumania, Serbia, Bulgaria and the Philippines.

2.5 Residential Units Overseas

The Company is engaged in the residential area in Europe. The Company is in various stages of construction of residential projects in the Czech Republic, Rumania, Bulgaria, Latvia and Poland.

2.6 Others

The Group constructed student dormitories on Mt. Zofim in Jerusalem via the "B.O.T." method and now operates them.

3. Financial Position

Significant balance sheet data is presented below (in NIS millions):

	<u>December 31</u> <u>2007</u>	<u>December 31</u> <u>2006</u>
Total assets	9,744	2,965
Shareholders' equity and minority interest	3,042	1,285
Long-term liabilities (including capital note)	3,853	1,230
Short-term credit from banks and others	734	279
Other current liabilities	2,115	172
Real estate for investment	5,437	*1,850
Fixed assets	255	*68
Real estate for investment under construction	1,381	*344
Investments in investee companies	309	68
Long-term loans and receivables	11	45
Real estate	1,244	115
Cash and cash equivalents	230	79
Other current assets	780	361

* Restated.

The total assets of the Company and its subsidiaries as presented in the consolidated balance sheet as at December 31, 2007, amounted to about NIS 9,744 million, compared with about NIS 2,965 million as at December 31, 2006.

Commencing from January 1, 2007, the Company applies Accounting Standard No. 16 regarding "Real Estate for Investment". Pursuant to the Standard, the Company presents the real estate for investment based on fair value in accordance with valuations performed by outside appraisers. Accordingly, the fair value of the Company's real estate for investment as at January 1, 2007 was set at about NIS 3.5 billion. The net increase from the revaluation net of taxes and the minority interest, in the amount of about NIS 942 million, was recorded directly in the shareholders' equity section.

Regarding additional revaluation during the period – see Section 4 below.

4. Results of Business Operations

4.1 Significant data from the statements of operations is presented below (in NIS millions):

	For the Year Ended December 31		
	2007	2006	2005
<u>Revenues:</u>			
Income from rental and operation of properties	353.3	269.0	234.2
Income from construction and real estate transactions	122.6	–	–
Increase in fair value of real estate for investment	522.6	–	–
<u>Costs and Expenses:</u>			
Expenses of operating and maintaining properties	(42.3)	(38.2)	(36.8)
Expenses of construction and real estate transactions	(110.9)	–	–
Depreciation and amortization	<u>(1.7)</u>	<u>(42.6)</u>	<u>(42.3)</u>
Operating income	843.6	188.2	155.1
Administrative and general expenses	<u>(66.6)</u>	<u>(23.1)</u>	<u>(15.5)</u>
Income before financing	777.0	165.1	139.6
Financing expenses, net	(174.8)	(46.6)	(58.1)
Other income, net	<u>15.3</u>	<u>49.3</u>	<u>22.9</u>
Income before taxes on income	617.5	167.8	104.4
Taxes on income	<u>(127.6)</u>	<u>(56.6)</u>	<u>(19.3)</u>
Income before taxes on income	489.9	111.2	85.1
Share of Company in income (losses) of affiliated companies, net	8.9	(3.8)	(14.2)
Share of minority in income of subsidiaries, net	(138.9)	(33.0)	(16.3)
Cumulative effect of change in accounting method	–	–	<u>(1.3)</u>
Net income for the period	<u>359.9</u>	<u>74.4</u>	<u>53.3</u>

– **Income from rental and operation of properties**

The Company's revenues from rental and operation of properties amounted to about NIS 353.3 million in 2007, compared with about NIS 269 million in 2006 – an increase of 31.3%.

In the second quarter of the year the Company commenced recording income in respect of its properties in Germany and in the third quarter in respect of its properties in Warna. The total income recorded from these properties in 2007 amounted to about NIS 34 million.

In addition, starting from the third quarter, due to acquisition of the share of a third party in the Hakiryra project in Tel-Aviv and the student dormitories in Jerusalem, the Company included the full amount of the income received from these projects.

Further, during the year there was an increase in the occupancy rates of the Company's properties.

– **Expenses of operation and maintenance of properties**

The expenses of operating and maintaining properties amounted to about NIS 42.3 million in 2007, compared with about NIS 38.2 million in 2006.

– **Income from real estate transactions**

In the second quarter of the year, the Company commenced recording for the first time income from projects in the residential sector. In 2007, the total income in this area of activities less the cost of the units sold came to about NIS 11.7 million.

– **Increase in the fair value of real estate for investment**

Commencing from January 1, 2007, the Company applies Accounting Standard No. 16 regarding "Real Estate for Investment". As a result, the Company revalued its investment real estate properties and recorded them at their fair values as at January 1, 2007. In addition, as part of its policy, during the year the Company revalued properties whose construction was completed or that were acquired during the period or whose fair value, in Management's estimation, changed significantly during the year. As at the date of the report, the Company revalued its investment real estate properties and set them at their fair values on December 31, 2007. As a result of that stated above, in 2007 the Company recognized income of about NIS 522.6 million (before tax and minority interest) from revaluation of properties. The net revaluation less taxes and minority interest amounted to about NIS 299 million.

– **Depreciation and amortization**

In 2007, no depreciation expenses were recorded on the real estate for investment due to the initial application of Standard 16.

– **Administrative and general expenses**

The administrative and general expenses in 2007 amounted to about NIS 66.6 million, compared with about NIS 23.1 million in 2006.

Most of the increase stems from expansion of the Company's activities in Europe and from its entry into activities in new countries, as well as from an increase in the management fees paid to Africa Israel Investments Ltd. (the parent company) and due to an increase in the Company's income.

– **Financing expenses**

The financing expenses in 2007 amounted to about NIS 174.8 million, compared with about NIS 46.6 million in 2006. The increase in the financing expenses in 2007 stems from, among other things, an increase in the credit taken out by the Company for expansion of its activities and from linkage differences on the Company's CPI-linked debentures deriving from an increase in the index in 2007.

– **Taxes on income**

In 2007, the tax expenses amounted to about NIS 127.6 million, compared with about NIS 56.6 million in 2006.

With respect to the differences between the effective tax rate and the theoretical rate applicable to the Company – see Note 11 to the Company's financial statements as at December 31, 2007 attached hereto.

4.2 Presented below is the Company's Statement of Operations for 2007 broken down by quarter in reported amounts (in NIS thousands):

	<u>1-3/2007</u> <u>(Unaudited)</u>	<u>4-6/2007</u> <u>(Unaudited)</u>	<u>7-9/2007</u> <u>(Unaudited)</u>	<u>10-12/2007</u> <u>(Unaudited)</u>	<u>1-12/2007</u> <u>(Audited)</u>
Revenues					
Rental and operation of properties	72,119	80,143	94,295	106,761	353,318
Construction and real estate transactions	–	48,830	43,104	30,676	122,610
Increase in fair value of real estate for investment	<u>–</u>	<u>–</u>	<u>338,932</u>	<u>183,652</u>	<u>522,584</u>
	<u>72,119</u>	<u>128,973</u>	<u>476,331</u>	<u>321,089</u>	<u>998,512</u>
Expenses					
Operation and maintenance of properties	6,774	6,958	14,163	16,085	43,980
Construction and real estate transactions	–	43,820	41,649	25,393	110,862
Administrative and general	8,603	10,660	23,206	24,171	66,640
Financing, net	<u>12,301</u>	<u>24,683</u>	<u>92,257</u>	<u>45,516</u>	<u>174,757</u>
	<u>27,678</u>	<u>86,121</u>	<u>171,275</u>	<u>111,165</u>	<u>396,239</u>
Operating income	44,441	42,852	305,056	209,924	602,273
Other income (expenses), net	<u>3,929</u>	<u>3,048</u>	<u>(632)</u>	<u>8,916</u>	<u>15,261</u>
Income before taxes on income	48,370	45,900	304,424	218,840	617,534
Taxes on income	<u>15,755</u>	<u>9,470</u>	<u>29,981</u>	<u>72,371</u>	<u>127,577</u>
Income after taxes on income	32,615	36,430	274,443	146,469	489,957
Company' share in income (losses) of affiliated companies, net	651	1,109	(3,413)	10,545	8,892
Minority interest in income of subsidiaries, net	<u>(4,435)</u>	<u>(6,471)</u>	<u>(103,518)</u>	<u>(24,478)</u>	<u>(138,902)</u>
Net income for the period	<u>28,831</u>	<u>31,068</u>	<u>167,512</u>	<u>132,536</u>	<u>359,947</u>

4.3 Events Occurring during the Period of the Report

4.3.1 Regarding transactions executed by the Company and its subsidiaries during the period of the report – see Note 6 to the financial statements as at December 31, 2007 attached hereto.

4.3.2 In May 2007, the Company completed issue of a series of debentures (Series C), in the total amount of NIS 500 million, and another series of debentures (Series D), in the total amount of NIS 100 million.

Maalot, The Israeli Securities Rating Company Ltd. (hereinafter – “Maalot”) notified the Company of the granting of a rating of “AA/Stable” to the private issuance of the two series of debentures issued.

The debentures (Series C) bear annual interest at the rate of 4.4% and are repayable in 6 equal annual payments in each of the years 2010 up to and including 2015. The interest is payable semi-annually. The debentures (Series C) are linked (principal and interest) to the Consumer Price Index.

The debentures (Series D) bear annual interest at the rate of 5.9% and are repayable in 4 equal annual payments in each of the years 2010 up to and including 2013. The interest is payable annually. The debentures (Series D) are not linked (principal and/or interest).

Pursuant to the terms of the debentures (Series C) and the debentures (Series D), if during the period of the debentures (Series C) and the debentures (Series D) the Company publishes (based on its sole discretion) a prospectus offering its securities on the Tel-Aviv Stock Exchange Ltd. (hereinafter – “the Stock Exchange”) and/or a registration prospectus for listing its securities on the Stock Exchange, the Company will be required to register the debentures (Series C) and the debentures (Series D) for trading on the Stock Exchange.

Pursuant to the terms of the debentures, if the debentures (Series C) and the debentures (Series D) are registered for trading on the Stock Exchange, the annual interest rates to be borne by the debentures (Series C) and the debentures (Series D) in respect of the period commencing from their registration date, will be the rates determined as stated above, less 0.25%.

It is hereby clarified that the Company has not undertaken to register the debentures (Series C) and/or the debentures (Series D) for trading on the Stock Exchange, except as stated above.

4.3.3 In 2007, NIS 2,509,310 par value debentures (Series B) were converted into 18,722 ordinary shares of NIS 1 of the Company.

4.3.4 In 2007, 987,945 options (Series 1) were exercised for 987,945 ordinary shares of NIS 1 of the Company. The balance of the options (Series 1) (614 options) expired on December 31, 2007.

- 4.3.5 AFI Europe is continuing its preparations for making an offering of its shares to the public and/or to institutional investors and for listing the shares for trading on the stock exchange in London. The issuance date will be determined based on the market conditions as well as on additional factors, including completion of the readiness of the Company to execute such an offering.

The above information includes estimates and forecasts that are within the ambit of “forward looking information” within the definition thereof in the Securities Law, 1968. Since a complex transaction is involved that is spread over a period of time that is not short, and that is subject to the influence of factors not under the control of the Company or of AFI Europe, such as the situation in the international capital market, the situation in the European real estate market and the economic situation in Europe, there is no certainty that the transaction described above will be completed on the conditions and dates set forth above, if at all.

As part of the preparations for the issuance, as stated, all the share holdings in the companies in Eastern Europe were transferred to AFI Europe in exchange for an issuance of shares. For this purpose, the Company has received an advance ruling from the Tax Authorities covering the above-mentioned transaction and the related tax aspects.

4.4 Events Occurring Subsequent to the Balance Sheet Date

- 4.4.1 Regarding transactions executed by the Company and its subsidiaries subsequent to the balance sheet date – see Note 38 to the financial statements as at December 31, 2007 attached hereto.
- 4.4.2 Subsequent to the balance sheet date and up to March 17, 2008, NIS 1,742.39 debentures (Series B) were exercised for 13 ordinary shares of NIS 1 of the Company.

5. Sources of Financing and Liquidity

During the year of account, the Company's sources of financing were mainly from current operating activities, floating of debentures, credit from banks and credit from related companies:

5.1 The Company's total assets were financed as follows:

	<u>%</u>	<u>NIS millions</u>
Shareholders' equity and minority interest	31	3,042
Long-term liabilities (including capital note)	40	3,853
Current liabilities (including short-term bank credit)	29	2,849
	<u>100</u>	<u>9,744</u>

Approximately 43% of the Company's assets were financed by shareholders' equity and minority interest.

The working capital ratio at December 31, 2007 reached 0.35 (compared with 1.0 as at December 31, 2006).

5.2 Set forth below is a condensed statement of cash flows for the year ended December 31, 2007:

	<u>NIS millions</u>	<u>NIS millions</u>
Sources		
Net earnings	359.9	
Adjustments to earnings	189.5	
Net cash from operating activities		549.4
Proceeds from sale of real estate for investment and real estate for investment under construction		20.2
Receipt of short-term credit from banks, net		1,315.0
Receipt of long-term loans from banks, net		1,005.8
Related companies		215.5
Issuance of shares		124.5
Issuance of debentures		599.4
Collection of loans from long-term debtors		1.5
Receipt of long-term loans from others, net		40.1
Total sources		<u>3,871.4</u>
Uses		
Investment in fixed assets, real estate for investment and real estate for investment under construction		1,700.1
Investment in subsidiaries and investee companies		982.5
Dividend paid to the minority interest		66.5
Investment in other assets		15.5
Investment in long-term loans and receivables, net		1.3
Redemption of debentures		34.9
Increase in real estate		829.4
Investment in deposits		92.6
Increase in cash balances		148.6
Total uses		<u>3,871.4</u>

6. Qualitative Report on Exposure to Market Risks and Risk Management

6.1 General

“Market Risk” – the risk to the business results, shareholders’ equity, cash flows or Company value, deriving from changes in the interest rates, currency exchange rates, inflation, raw material prices, other prices, prices of securities in Israeli and overseas, and economic indices having a material impact on the assets and the liabilities, including the Company’s liabilities to suppliers, customer debts to the Company and other assets and loans.

6.2 Description of the Market Risks to which the Company is Exposed and the Risk Management Policy

In the course of its activities, the Company is exposed to market risks, the main ones of which are as follows:

Currency Risk

The Company has credit in foreign currency, as well as lease agreements denominated in foreign currency.

Revaluation of the loans taken out by the Company to finance its activities overseas, as well as the proceeds from lease agreements denominated in foreign currency are impacted by fluctuations in the foreign currency exchange rates.

The Company has accounting exposure to changes in the foreign currency exchange rates in autonomous companies operating overseas. This exposure is in respect of the difference between the balance of the loans to the aforementioned companies and their assets.

The Company has excess liabilities linked to the euro deriving from financing of its activities overseas (mainly in the Czech Republic) and an excess of liabilities linked to the Czech koruna and the Polish zloty. Fluctuations in the foreign currency exchange rates impact the revaluation of these liabilities.

Interest Rate Risks

The Company makes use of short-term shekel credit, short-term dollar-linked credit, long-term CPI-linked credit from banks and long-term CPI-linked credit from the debenture holders. In addition, for purposes of financing its activities overseas, the Company takes out credit in the operating currency from foreign banks.

From time to time, the Company examines the linkage of the loans in accordance with its assessments regarding the developments of the interest rate and the rate of inflation.

A decline in the “prime” interest rate in the economy could have a positive impact on the Company’s earnings.

Index Risks

The Company has excess CPI-linked liabilities. In October 2001, the Israeli Accounting Standards Board published Accounting Standard No. 12 regarding “Discontinuance of the Adjustment of Financial Statements”. In the beginning of 2004, upon entry of the Standard into effect, an accounting exposure was created with respect to the Company.

In the Company's estimation, the exposure does not constitute an economic threat since, in its assessment, over time the value of the real estate properties exceeds at least the increase in the index.

6.3 Market Risk Management Policy

The Company's policy is to take out loans or to invest in deposits in accordance with the functional currency of the relevant operations.

Decisions regarding investments or taking out credit in foreign currency are made by the Board of Directors of the Company or of the Parent Company.

Company Management examines the scope of the exposure on a current basis and consults with local and international parties in order to reduce the said exposure.

6.4 Authority in connection with Exposure to Market Risks and Means of Supervision

The risks detailed above are managed at the level of the Company's current on-going management and the party responsible for the management thereof is Mr. Avi Barzilay – the Company CEO.

Supervision of the market risk management policy – the Company's Board of Directors receives a current report from Company management at its periodic meetings regarding the market risks and the management policy with respect to such risks.

No quantitative frameworks have been determined regarding exposure to market risks.

6.5 Company Positions in Financial Derivatives as at December 31, 2007

The Group companies have various open derivative financial instrument currency transactions. Set forth below is detail of the exposure to the market risks and the manner of their management as at December 31, 2007 (in thousands of NIS):

Euro / Rumanian Leu	Denominated Value		Fair Value	
	Long	Short	Asset	Liability
<u>Options</u>				
Euro purchase (1)		127,332	627	

(1) For hedging purposes – not recognized for accounting purposes. The options acquired are against a Rumanian Leu transaction wherein it committed to pay on a date fixed in advance.

6.6 Sensitivity Analysis

Set forth below is a table presenting the sensitivity of financial instruments as at December 31, 2007, based on the changes in the market factors:

Sensitivity to changes in the shekel-dollar exchange rate:

	10%	5%	3.846	-5%	-10%
	Shekel/dollar		Fair	Shekel/dollar	
	Gain (loss) from changes		value	Gain (loss) from changes	
	NIS thousands		NIS '000	NIS thousands	
<u>Other financial instruments</u>					
Cash	9	4	89	(4)	(9)
Deposits	2,489	1,244	24,889	(1,244)	(2,489)

Sensitivity to changes in the shekel–euro exchange rate:

	10%	5%	5.659	-5%	-10%
	Shekel/euro		Fair	Shekel/euro	
	Gain (loss) from changes		value	Gain (loss) from changes	
	NIS thousands		NIS '000	NIS thousands	
<u>Other financial instruments</u>					
Cash and cash equivalents	18,198	9,099	181,980	(9,099)	(18,198)
Deposits	936	468	9,364	(468)	(936)
Related companies	47	23	470	(23)	(47)
Other receivables and debits	4,640	2,320	46,400	(2,320)	(4,640)
Trade receivables	448	224	4,476	(224)	(448)
Investments in investees	1,131	566	11,313	(566)	(1,131)
Trade payables	(4,281)	(2,140)	(42,806)	2,140	4,281
Other payables and credits	(25,824)	(12,912)	(258,241)	12,912	25,824
Short-term credit	(35,324)	(17,662)	(353,237)	17,662	35,324
Loans from banks	(77,477)	(38,739)	(774,772)	38,739	77,477
Other long-term liabilities	(4,331)	(2,165)	(43,306)	2,165	4,331

Sensitivity to changes in the Czech koruna–shekel exchange rate:

	10%	5%	0.213	-5%	-10%
	Shekel/koruna		Fair	Shekel/koruna	
	Gain (loss) from changes		value	Gain (loss) from changes	
	NIS thousands		NIS '000	NIS thousands	
<u>Other financial instruments</u>					
Cash	1,694	847	16,938	(847)	(1,694)
Related companies	28	14	283	(14)	(28)
Other receivables and debits	8,300	4,150	83,003	(4,150)	(8,300)
Trade receivables	63	31	628	(31)	(63)
Other payables and credits	(6,952)	(3,476)	(69,523)	3,476	6,952
Trade payables	(4,163)	(2,081)	(41,629)	2,081	4,163
Loans from banks	(3,587)	(1,794)	(35,872)	1,794	3,587
Other long-term liabilities	(3,874)	(1,937)	(38,737)	1,937	3,874

Sensitivity to changes in the Hungarian forint–shekel exchange rate:

	10%	5%	0.022	-5%	-10%
	Shekel/forint		Fair	Shekel/forint	
	Gain (loss) from changes		value	Gain (loss) from changes	
	NIS thousands		NIS '000	NIS thousands	
<u>Other financial instruments</u>					
Other receivables and debits	216	108	2,156	(108)	(216)
Other payables and credits	(16)	(8)	(158)	8	16
Trade payables	(7)	(4)	(74)	4	7

Sensitivity to changes in the Polish zloty–shekel exchange rate:

	10%	5%	1.576	-5%	-10%
	Shekel/zloty		Fair	Shekel/zloty	
	Gain (loss) from changes		value	Gain (loss) from changes	
	NIS thousands		NIS '000	NIS thousands	
<u>Other financial instruments</u>					
Cash	477	238	4,765	(238)	(477)
Other receivables and debits	4,277	2,139	42,772	(2,139)	(4,277)
Trade receivables	28	14	283	(14)	(28)
Other payables and credits	(195)	(98)	(1,952)	98	195
Trade payables	(1,737)	(869)	(17,374)	869	1,737
Loans from banks	(2,514)	(1,257)	(25,137)	1,257	2,514
Short-term credit	(3,612)	(1,806)	(36,117)	1,806	3,612

Sensitivity to changes in the Latvian lat–shekel exchange rate:

	10%	5%	8.26	-5%	-10%
	Shekel/lat		Fair	Shekel/lat	
	Gain (loss) from changes		value	Gain (loss) from changes	
	NIS thousands		NIS '000	NIS thousands	
<u>Other financial instruments</u>					
Trade payables	(212)	(106)	(2,117)	106	212

Sensitivity to changes in the Serbian dinar–shekel exchange rate:

	10%	5%	0.071	-5%	-10%
	Shekel/dinar		Fair	Shekel/dinar	
	Gain (loss) from changes		value	Gain (loss) from changes	
	NIS thousands		NIS '000	NIS thousands	
<u>Other financial instruments</u>					
Cash	572	286	5,716	(286)	(572)

Sensitivity to changes in the Rumanian lei–shekel exchange rate:

	10%	5%	1.578	-5%	-10%
	Shekel/lei		Fair	Shekel/lei	
	Gain (loss) from changes		value	Gain (loss) from changes	
	NIS thousands		NIS '000	NIS thousands	
<u>Other financial instruments</u>					
Cash	227	113	2,269	(113)	(227)
Other receivables and debits	548	274	5,484	(274)	(548)
Trade payables	(443)	(221)	(4,425)	221	443
Other payables and credits	(121)	(60)	(1,205)	60	121
Other long-term liabilities	(620)	(310)	(6,202)	310	620

Sensitivity to changes in the Rumanian lei–euro exchange rate:

	10%	5%	0.278	-5%	-10%
	Euro/lei		Fair	Euro/lei	
	Gain (loss) from changes		value	Gain (loss) from changes	
	NIS thousands		NIS '000	NIS thousands	
<u>Other financial instruments</u>					
Receivables – put option euro / Rumanian lei	(6,045)	(4,629)	6,449	13,730	45,007

Sensitivity to changes in the Philippine peso–shekel exchange rate:

	<u>10%</u>	<u>5%</u>	<u>0.09</u>	<u>-5%</u>	<u>-10%</u>
	<u>Shekel/peso</u>		<u>Fair</u>	<u>Shekel/peso</u>	
	<u>Gain (loss) from changes</u>		<u>value</u>	<u>Gain (loss) from changes</u>	
	<u>NIS thousands</u>		<u>NIS '000</u>	<u>NIS thousands</u>	
<u>Other financial instruments</u>					
Cash	52	26	521	(26)	(52)
Related companies	24	12	243	(12)	(24)
Other receivables and debits	3	1	28	(1)	(3)
Other payables and credits	(59)	(29)	(589)	29	59
Short-term credit	(1,450)	(725)	(14,496)	725	1,450
Loans from banks	(3,449)	(1,725)	(34,492)	1,725	3,449

Sensitivity to changes in the shekel interest rate:

	<u>10%</u>	<u>5%</u>		<u>-5%</u>	<u>-10%</u>
	<u>Increase in interest</u>		<u>Fair</u>	<u>Decrease in interest</u>	
	<u>Gain (loss) from changes</u>		<u>value</u>	<u>Gain (loss) from changes</u>	
	<u>NIS thousands</u>		<u>NIS '000</u>	<u>NIS thousands</u>	
<u>Other financial instruments</u>					
Long-term loans and receivables	(35)	(18)	3,294	18	36
Short-term credit	3	1	(78,040)	(1)	(3)
Debentures	13,270	6,681	(752,871)	(6,774)	(13,642)
Convertible debentures	5	3	(949)	(3)	(5)
Loans from related companies	5,697	2,854	(1,419,073)	(2,866)	(5,743)
Loans from banks	3,195	1,608	(653,636)	(1,629)	(3,281)

Sensitivity to changes in the euro interest rate:

	<u>10%</u>	<u>5%</u>		<u>-5%</u>	<u>-10%</u>
	<u>Increase in interest</u>		<u>Fair</u>	<u>Decrease in interest</u>	
	<u>Gain (loss) from changes</u>		<u>value</u>	<u>Gain (loss) from changes</u>	
	<u>NIS thousands</u>		<u>NIS '000</u>	<u>NIS thousands</u>	
<u>Other financial instruments</u>					
Investments in investees	(55)	(28)	11,313	28	56
Short-term credit	10	5	(29,225)	(5)	(10)
Loans from banks	6,761	3,398	(742,480)	(3,433)	(6,903)
Other long-term loans	14,888	8,285	(91,742)	(10,426)	(23,585)

Sensitivity to changes in the Polish zloty interest rate:

	<u>10%</u>	<u>5%</u>		<u>-5%</u>	<u>-10%</u>
	<u>Increase in interest</u>		<u>Fair</u>	<u>Decrease in interest</u>	
	<u>Gain (loss) from changes</u>		<u>value</u>	<u>Gain (loss) from changes</u>	
	<u>NIS thousands</u>		<u>NIS '000</u>	<u>NIS thousands</u>	
<u>Other financial instruments</u>					
Loans from banks	56	28	(25,137)	(28)	(57)

Sensitivity to changes in the Czech koruna interest rate:

	<u>10%</u>	<u>5%</u>		<u>-5%</u>	<u>-10%</u>
	<u>Increase in interest</u>		<u>Fair</u>	<u>Decrease in interest</u>	
	<u>Gain (loss) from changes</u>		<u>value</u>	<u>Gain (loss) from changes</u>	
	<u>NIS thousands</u>		<u>NIS '000</u>	<u>NIS thousands</u>	
<u>Other financial instruments</u>					
Loans from banks	307	154	(35,872)	(155)	(311)

Sensitivity to changes in the Philippine peso interest rate:

	10%	5%	Fair value NIS '000	-5%	-10%
	Increase in interest			Decrease in interest	
	Gain (loss) from changes			Gain (loss) from changes	
	NIS thousands			NIS thousands	
<u>Other financial instruments</u>					
Short-term credit	60	30	(14,496)	(30)	(61)
Loans from banks	419	210	(34,492)	(213)	(428)

Sensitivity to changes in the Consumer Price Index:

	2%	1%	Fair value NIS '000	-1%	-2%
	Increase in the CPI			Decrease in the CPI	
	Gain (loss) from changes			Gain (loss) from changes	
	NIS thousands			NIS thousands	
<u>Other financial instruments</u>					
Cash	226	113	11,303	(113)	(226)
Other receivables and debits	675	337	33,735	(337)	(675)
Long-term loans and receivables	209	104	10,443	(104)	(209)
Investments in investees	1,278	639	63,885	(639)	(1,278)
Other payables and credits	(287)	(143)	(14,337)	143	287
Loans from banks	(11,841)	(5,920)	(592,048)	5,920	11,841
Loans from related companies	(426)	(213)	(21,300)	213	426
Short-term credit	(8,916)	(4,458)	(445,820)	4,458	8,916
Related companies	(28,176)	(14,088)	(1,408,797)	14,088	28,176
Debentures	(13,000)	(6,500)	(650,006)	6,500	13,000
Convertible debentures	(19)	(9)	(949)	9	19

6.7 Balance Sheet at December 31, 2007 based on Linkage Bases (in Millions of NIS)

	<u>Not linked</u>	<u>Linked to index</u>	<u>Linked to euro</u>	<u>Linked to Czech koruna</u>	<u>Linked to PLN</u>	<u>Other</u>	<u>Non- monetary items</u>	<u>Total</u>
<u>Assets</u>								
Real estate for investment							5,437	5,437
Real estate for investment under construction							1,381	1,381
Fixed assets							255	255
Investments in investee companies		64	11				234	309
Long-term loans and receivables		11						11
Other assets and deferred expenses							26	26
Deferred taxes							72	72
Real estate							1,244	1,244
Inventory of buildings for sale							446	466
Trade receivables	10		4	1				15
Other receivables and debits	50	34	46	83	43	7		263
Related companies						1		1
Deposits			9			25		34
Cash and cash equivalents	<u>6</u>	<u>11</u>	<u>182</u>	<u>17</u>	<u>5</u>	<u>9</u>		<u>230</u>
	<u>66</u>	<u>120</u>	<u>252</u>	<u>101</u>	<u>48</u>	<u>42</u>	<u>9,115</u>	<u>9,744</u>
<u>Liabilities</u>								
Shareholders' equity							2,708	2,708
Minority interest in subsidiaries							334	334
Capital note	40							40
Loans from banks	228	484	1,307	38	20	36		2,113
Loans from related companies	86	21						107
Debentures	100	687						787
Convertible debentures		1						1
Other long-term liabilities	26		46	38		6		116
Reserve for deferred taxes							689	689
Short-term liabilities	9	446	227		36	16		734
Related companies		1,409						1,409
Other payables and credits	121	14	384	70	2	2		593
Trade payables	<u>4</u>		<u>43</u>	<u>42</u>	<u>17</u>	<u>7</u>		<u>113</u>
	<u>614</u>	<u>3,062</u>	<u>2,007</u>	<u>188</u>	<u>75</u>	<u>67</u>	<u>3,731</u>	<u>9,744</u>
Net balance sheet balance	<u>(548)</u>	<u>(2,942)</u>	<u>(1,755)</u>	<u>(87)</u>	<u>(27)</u>	<u>(25)</u>	<u>5,384</u>	<u>-</u>

6.8 Balance Sheet at December 31, 2006 based on Linkage Bases (in Millions of NIS)

	Not linked	Linked to index	Linked to euro	Linked to U.S.\$	Linked to Can\$	Other	Non- monetary items	Total
<u>Assets</u>								
Fixed assets							2,262	2,262
Investments in investee companies		59					9	68
Long-term loans and receivables	7	6		32				45
Other assets and deferred expenses							19	19
Real estate							116	116
Inventory of buildings for sale							34	34
Deferred taxes receivable							19	19
Trade receivables	8		2					10
Other receivables and debits	18		23		9	12		62
Related companies		211	5					216
Deposits				26	9			35
Cash and cash equivalents	<u>10</u>	<u>---</u>	<u>68</u>	<u>1</u>	<u>---</u>	<u>---</u>	<u>---</u>	<u>79</u>
	<u>43</u>	<u>276</u>	<u>98</u>	<u>59</u>	<u>18</u>	<u>12</u>	<u>2,459</u>	<u>2,965</u>
<u>Liabilities</u>								
Shareholders' equity							1,255	1,255
Minority interest in subsidiaries							30	30
Capital note	40							40
Loans from banks	121	239	394					754
Loans from related companies	103							103
Debentures		200						200
Convertible debentures		4						4
Other long-term liabilities	26		43					69
Liabilities for severance pay								
Reserve for deferred taxes							59	59
Short-term liabilities	193	36	13			37		279
Related companies		39	3		2			44
Other payables and credits	60	13	46		8	1		128
Trade payables								
	<u>543</u>	<u>531</u>	<u>499</u>	<u>---</u>	<u>10</u>	<u>38</u>	<u>1,344</u>	<u>2,965</u>
Net balance sheet balance	<u>(500)</u>	<u>(255)</u>	<u>(401)</u>	<u>59</u>	<u>8</u>	<u>(26)</u>	<u>1,115</u>	<u>---</u>

7. The Board of Directors and Management of the Company

During the current period, the Board of Directors and its committees held 9 meetings and 9 written decisions were made.

On January 28, 2007, Mr. Avi Nota completed his service as a Company director.

On January 28, 2007, Mr. Uriel Ezran completed his service as a Company director.

On May 24, 2007, Mr. Mordechai Labovitch completed his service as a Company director.

On July 31, 2007, Mr. Shaul Glicksburg completed his position as a Company director.

On August 1, 2007, Mr. Ron Finaro was appointed as an additional director of the Company.

On December 19, 2007, Mr. Zvi Stauber completed his service as an outside director of the Company.

On December 19, 2007, Ms. Nina Admoni completed her service as an outside director of the Company.

On December 26, 2007, Mr. Avinadav Grinshpon was appointed as an additional director of the Company.

On December 31, 2007, Mr. Erez Meltzer completed his position as the Company's CEO and as a Company director.

On January 1, 2008, Mr. Avinadav Grinshpon was appointed as the Company's Acting CEO.

On February 19, 2008, Mr. Avraham Meron was appointed as an outside director of the Company.

On February 19, 2008, Attorney Michael Aviram was appointed as an outside director of the Company.

8. Internal Audit

A. Details with respect to the Internal Auditor – commencing from August 2006 Mr. Yaron Herrari (CPA) serves as the Company's internal auditor. The Internal Auditor is a Certified Public Accountant, graduate of the University of Bar-Ilan in Economics and Accounting and is a member of the Institute of Certified Public Accountants in Israel.

The Internal Auditor meets the conditions provided in Section 146(B) of the Companies Law and the conditions of Section 8 of the Internal Audit Law.

The Internal Auditor is an employee of the parent company who provides audit services to the Company as "an outside service provider", as part of the management services provided by the parent company.

B. Manner of Appointment – appointment of the Internal Auditor was approved by the Company's Board of Directors and the Audit Committee on August 22, 2006. His education, qualifications, familiarity with the Company and experience are part of the Board of Directors' reasons for approving the appointment.

C. Party Responsible for the Internal Auditor – the party responsible for the Internal Auditor is the Chairman of the Board of Directors.

8. Disclosure Regarding the Internal Auditor (Cont.)

- D. **Work Plan** – a multi-year work plan was prepared for the Company, extending over a period of 4 years. The plan is based on a systematic mapping of the different business units comprising the Company and the activities to which they are assigned.

The annual work plan, which constitutes the detailed formal framework for the audit work, was derived from the multi-year work plan.

Determination of the annual audit topics was made, among other things, after taking the following factors into consideration:

- The exposure to risk of the matters and activities.
- Existence of relevant controls for the said matter and the information available regarding the effectiveness and weaknesses of such controls.
- The probability of the existence of operating, management and administrative deficiencies.
- Findings of prior audits and the period of time that has passed since the last audit of such matter or other relevant matter.
- The administrative, operational or economic significance of the matter from an internal audit standpoint.

The annual and multi-year work plans were prepared by the Internal Auditor in consultation with the Company's CEO and the Chairman of its Board of Directors, and was discussed and approved by the Audit Committee.

The work plan includes an ad hoc allocation of resources to the audit, in the framework of which the Internal Auditor is permitted, based on his discretion, to examine additional matters that are not included as part of the annual work plan.

- E. **Overseas Audit or of Investee Companies** – the work plan relates to the Company and its investee companies, as well as to the Company's activities outside of Israel.
- F. **Scope of the Employment** – the Internal Auditor provides audit services to the Company in the scope of half of a full-time position. During the period of the report, the Internal Auditor's services broke down as follows:

	The Company	Investee Companies
Israel	–	–
Outside of Israel	–	1/2 of a full-time position

- G. **Performance of the Audit** – the Internal Auditor performs his audit in accordance with the provisions of the Internal Audit Law and pursuant to the professional standards and directors published by the "Professional Council" of Institute of Internal Auditors in Israel.

In the opinion of the Board of Directors, the Internal Auditor meets the requirements provided in the professional standards, while taking his professionalism, qualifications, experience and familiarity with the Company and the manner in which he performs the audit and submits his audit findings.

- H. **Access to Information** – the Company's Internal Auditor is given free, continuous and direct access to all the information in the possession of the Company and the companies it controls in and outside of Israel, including financial details as stated in Section 9 of the Internal Audit Law.

8. Disclosure Regarding the Internal Auditor (Cont.)

- I. **The Auditor's Report** – the audit reports are submitted in writing to the Company's CEO and the Chairman of the Board of Directors, and they are discussed by the Audit Committee.

Set forth below is detail of the dates of submission of the audit findings and the dates of the discussions held by the Audit Committee during the period of the report:

	Submission Date	Discussion Date
Report A	5/07	6/07
Report B	8/07	8/07

- J. **Evaluation of the Board of Directors of the Activities of the Internal Auditor** – in the estimation of the Company's Audit Committee and Board of Directors, the scope, nature and continuity of activities of the Internal Auditor, as well as his work plan, are reasonable under the circumstances of the matter and they are sufficient to achieve the Company's internal audit goals.
- K. **Remuneration** – the Internal Auditor is an employee of the parent company and his remuneration is by means of a monthly salary. In the estimation of the Company's Board of Directors, the Internal Auditor's remuneration does not constitute a factor affecting his professional discretion with respect to performance of the audit.

9. Critical Accounting Estimates

When preparing the financial statements in accordance with the generally accepted accounting principles, Management is required to use estimates and assessments that affect the reported values of the assets, liabilities, contingent assets and contingent liabilities disclosed in the financial statements, as well as the income and expense data during the period of the report. When formulating the estimates, Company management must make assumptions regarding circumstances and events that involve a significant degree of uncertainty.

Revaluation of Real Estate for Investment

The Company determines the fair value of the real estate for investment based on the provisions of Accounting Standard No. 16 regarding "Real Estate for Investment". In determination of the fair value, the Company relied on valuations made by independent external appraisers. In determination of the fair value, account was taken of, among other things, the discount rates used to discount future cash flows, the length of the lease periods, the financial strength of the lessees, the scope of the vacant areas in the property, the term of the lease agreements and the amount of time necessary to lease out the buildings after they are vacated, the period and scope of vacancies in the properties, adjustment of the rents in properties wherein the level of the rental income is in an "over-rented" or "under-rented" situation, consequences deriving from investments required to develop and/or preserve the existing situation and deduction of operating expenses that are not covered in cases where the properties are managed by management companies having deficits.

9. Significant Accounting Estimates (Cont.)

Sale of Residential Units

Sale of residential units – the Company applies Accounting Standard No. 2 of the Israeli Accounting Standards Board – “Construction of Buildings for Sale”, and in accordance with this Standard, it recognizes in its results of operations income from the sale of residential units based on the percentage of completion method. Income recognition commences in the report period wherein the percentage of completion of the project at the end of the period of the report is 25% or more and the accumulated sales’ proceeds from the beginning of the project and up to the period of the report is 50% or more of the total revenues anticipated from the project. For purposes of calculating the revenues and costs from sale of the residential units, Company management uses estimates of the expected revenues and costs in respect of the project up to its completion.

Estimates of the expected revenues are based on price lists prepared by Company management on the basis of its forecast of the selling prices of the residential units, relying on past experience and the market condition.

Estimates of the anticipated costs are based on approved budgets prepared by Company management regarding the cost of each project. These estimates rely on, among other things, agreements signed with executing contractors and Company management’s past experience accumulated from the construction of similar projects.

Company management examines the estimates once a quarter, and in the case of an anticipated loss, such loss is recorded to the construction costs in the relevant period and is actually reported in the Company’s reports.

Deferred Taxes

The deferred taxes are calculated according to the tax rates anticipated to be in effect at the time of their realization. The tax benefit is included in the financial statements where according to the Company’s business plans realization of the tax benefit is anticipated. In the nature of things, the actual business results may be different than the business plans, which could ultimately affect the future realization of the tax benefits.

Contingent Liabilities

The Company has contingent liabilities in such amounts that the maximum possible exposure in respect thereof is material.

The Company makes a periodic assessment of potential liabilities in connection with each claim and demand. As a practical matter, it is very difficult to determine the outcome of the claims and the demands. The Company relies on its best judgment and on the opinion of its legal advisors in order to determine whether it is reasonable that the Company will bear costs connected with the settlement of the claims and demands, and whether such costs can be reasonably estimated.

Considering the inherent uncertainty in legal claims, it is possible that, ultimately, the Company will be charged for various amounts in respect of all or some of the claims.

Regarding details of the contingent liabilities – see Note 32 to the financial statements.

10. Approval Process of the Financial Statements

The Company’s Board of Directors is the body responsible for the overall control of the Company and for approval of its financial statements.

10. Approval Process of the Financial Statements (Cont.)

As part of the approval process of the Company's financial statements, work papers and/or drafts of the Company's financial statements are furnished, including the Report of the Board of Directors, for purposes of their review by the members of the Balance Sheet Committee and of the Board of Directors, as applicable, prior to the scheduled meeting for discussion of the financial statements.

During the meeting of the Board of Directors wherein the financial statements are discussed and approved, the Company's CFO, Mr. Avi Barzilay, presents a detailed review of the highlights of the financial statements as well as the significant issues impacting the financial report, including transactions that are not in the ordinary course of business, if any, the reasonableness of the data, the accounting policies applied along with any changes therein, and application of the proper disclosure principle in the financial statements and the accompanying data.

The managers of the Company's divisions review the current activities of the divisions along with the impact of these activities on their financial results and they bring significant issues to the attention of the Board of Directors.

Three of the six members of the Board of Directors have accounting and financial expertise, and their knowledge and experience regarding financial matters is a significant factor in the approval process of the Company's financial statements.

At the meeting of the Board of Directors at which the financial statements are discussed, representatives of the Company's outside auditors are invited and are present, and they are in the practice of adding their comments and remarks regarding the financial statements and are available to the members of the Board of Directors with respect to any question or clarification in connection with the financial statements prior to their approval.

The directors who were present at the meeting of the Board of Directors held on March 24, 2008, the purpose of which was approval of the financial statements as at December 31, 2007 were: Avinadav Grinshpon, Ron Finaro, Tvia Leviev-Alozorov, Avraham Meron – outside director, and Attorney Michael Aviram – outside director.

11. Fees of the Auditing CPAs

- A. The fee of the auditing CPAs, Somekh Chaikin and Zohar and Zohar & Co. (hereinafter – “the Auditors”) paid by the Company Group in Israel in respect of audit services, in respect of services relating to the audit and in respect of tax services in connection with 2007, amounted to NIS 998 thousand (2006 – NIS 1,050 thousand). The number of work hours invested by the Auditors of the Company in Israel in 2007 and 2006 amounted to 6,050 hours and 5,195 hours, respectively. The fee of the auditing CPA, (KPMG) auditing the companies overseas in respect of audit services, in respect of services relating to the audit and in respect of tax services in connection with 2007, amounted to NIS 4,858 thousand (2006 – NIS 1,059 thousand). The number of work hours invested by the auditing CPA, (KPMG) in respect of audit services, in respect of services relating to the audit and in respect of tax services in 2007 and 2006 amounted to 7,190 hours and 3,662 hours, respectively.
- B. The fee of the Auditor (KPMG) paid by the Group companies overseas in respect of consulting regarding various matters (mainly preparations for the issuance of AFI Europe) relating to 2007 amounted to NIS 162 thousand (2006 – NIS 2,750 thousand).

Report on Directors having Accounting and Financial Expertise

Pursuant to the provisions of the Companies Law, 1999, and the Regulations promulgated thereunder, the Company's Board of Directors determined that the minimum required number of directors having accounting and financial expertise is 2 directors. This determination was made after taking into consideration, among other things, the size of the Company, the nature of its activities, the number of members of its Board of Directors and its composition.

In the Company's estimation, taking into account all the relevant circumstances, as detailed below, the minimum number determined, as stated, will permit the Board of Directors to fulfill the obligations imposed on it in accordance with law and the Company's incorporation documents, and in particular with respect to its responsibility to examine the Company's financial position and to prepare the Company's financial statements, this also being in a case of absence or illness of one of the experts, as stated. In addition, the minimum number was determined after taking into account the close accounting-related accompaniment provided by the Company's auditors, including their participation in meetings of the Board of Directors at which accounting issues are deliberated and their availability to respond to questions raised by the Board of Directors.

Set forth below are the names of the directors having accounting and financial expertise along with a brief review of the facts in connection with each expert demonstrating that such person should be considered a director having accounting and financial expertise:

Mr. Avinadav Grinsphon, CPA, the Acting CEO of the Company and of Africa Israel Investments Ltd., serves as a member of the Boards of Directors of subsidiaries in the Africa Israel Group. Mr. Grinsphon holds a degree in accounting and business administration.

Mr. Ron Finaro, CPA, holds a degree in accounting. Mr. Finaro serves as the CFO of Africa Israel Investments Ltd. and as a member of the Boards of Directors of subsidiaries in the Africa Israel Group.

Mr. Avraham Meron, CPA, holds a degree in accounting and serves as an outside director of the Company. Up to 2005, Mr. Meron served as the senior CFO of Africa Israel Investments Ltd. and since then he serves as a consultant to and director of public and private companies in the economy.

All of the directors mentioned above have signed financial statements in the past and they are familiar with the functions of the auditing CPAs, with the process involved in the preparation of the financial statements and with the internal control systems of the companies.

12. Disclosure regarding Adoption of International Financial Reporting Standards (IFRS)

Pursuant to the provisions of Accounting Standard No. 29 – "Adoption of International Financial Reporting Standards (IFRS)" (hereinafter – "Standard 29"), commencing with the financial statements for the first quarter of 2008, the Company is required to prepare its financial statements in accordance with International Financial Reporting Standards (IFRS) (hereinafter – "the Mandatory Adoption Date").

Standard 29, provides that a company that prepares its financial statements for the first time in accordance with IFRS on the Mandatory Adoption Date is to include in the notes to the annual financial statements for they year ended December 31, 2007 the balance sheet date as at December 31, 2007 and the statement of income data for the year then ended, after they have been prepared in accordance with IFRS.

An explanation of the impacts of the transition from generally accepted accounting principles in Israel to IFRS on the Group's financial position, results of operations and cash flows is provided in Note 37 to the financial statements.

13. Peer Review

During July 2005, the Securities Authority published a Directive under Section 36A(B) of the Securities Law, 1968, relating to “disclosure with respect to consent to perform a peer review”, pursuant to which every reporting company is required to detail as part of the Board of Directors Report whether it provided its consent to transfer the required material for performance of the sample relating to a peer review. Further to that stated above, on March 23, 2006, the Company’s Board of Directors decided that the Company shall provide its consent to transfer the required material for performance of the sample relating to a peer review of the Institute for Peer Reviews to the Institute of Certified Public Accountants in Israel, in accordance with the conditions of the documents regarding this matter that were transferred for the Company’s perusal and the signing thereof by the Company’s auditing CPAs.

14. Contributions

As part of the assistance it provides to the community, the Company contributes to various causes. The amount contributed by the Company in the year of the report totaled NIS 540 thousand.

15. Company Personnel

The Board of Directors wishes to express its appreciation to the managements of the Company and its subsidiaries and to all the employees, for their dedicated work and contribution to the Company’s progress.

Lev Leviev
Chairman of the Board of Directors

Avinadav Grinshpon
Acting CEO