

Koor Industries Limited

Financial Statements as at December 31, 2006

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Report of Independent Registered Public Accounting Firm to the Shareholders of Koor Industries Ltd.

We have audited the accompanying balance sheets of Koor Industries Ltd. (hereinafter – “the Company”) as at December 31, 2006 and 2005 and the consolidated balance sheets of the Company and its subsidiaries (hereinafter – “the consolidated”) as at December 31, 2006 and 2005, and the related statements of operations, changes in shareholders’ equity and cash flows, for each of the years in the three-year period ended December 31, 2006. These 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 financial statements based on our audits.

We did not audit the financial statements of certain subsidiaries, including those consolidated by the proportionate consolidation method. The financial statements of these subsidiaries reflect total assets constituting 9% and 13% of the total consolidated assets as at December 31, 2006 and 2005, respectively, and total revenues and earnings constituting 45%, 13% and 10% of the total continuing consolidated revenues and earnings and 40% and 34% of the total discontinuing consolidated revenues and earnings for the years ended December 31, 2005 and 2004, respectively. Furthermore, we did not audit the financial statements of certain affiliates, whose company's investments constitute NIS 134,593 thousand and NIS 66,107 thousand, as at December 31, 2006 and 2005, respectively, and its equity in earnings (losses) constitute NIS 9,315 thousand, NIS (5,469) thousand and NIS 7,336 thousand for the years ended December 31, 2006, 2005 and 2004, respectively. The financial statements of those subsidiaries and affiliates were audited by other auditors whose reports thereon were furnished to us, and our opinion, insofar as it relates to amounts included for such subsidiaries and affiliates, is based solely on the reports of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards, including standards prescribed by the Auditors Regulations (Manner of Auditor's 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 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 Board of Directors and Management, as well as evaluating the overall financial statement presentation. We believe that our audits, and reports of the other auditors, provide a reasonable basis for our opinion.

In our opinion, based on our audits and on the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the Company and the consolidated financial position of the Company and its subsidiaries as at December 31, 2006 and 2005 and their results of operations, changes in shareholders’ equity and cash flows - Company and consolidated - for each of the years in the three-year period ended December 31, 2006, in conformity with accounting principles generally accepted in Israel. Furthermore, in our opinion, these statements are prepared in accordance with the Securities Regulations (Preparation of Annual Financial Statements), 1993.

As explained in Note 2(B) to the financial statements, these financial statements are stated in reported amounts, in accordance with the accounting standards of the Israel Accounting Standards Board.

Somekh Chaikin
Certified Public Accountants (Isr.)
Member Firm of KPMG International

March 14, 2007

Tel Aviv, Israel

Consolidated Balance Sheets as at December 31

		2 0 0 6	2 0 0 5	Convenience translation (Note 1B) 2 0 0 6
	Note	N I S t h o u s a n d s		US \$ thousands
Assets				
Current assets				
Cash and cash equivalents		277,197	309,666	65,609
Short-term deposits and investments	4	695,931	530,829 **	164,717
Trade receivables	5	82,041	78,557	19,418
Other receivables	6	82,456	79,467	19,516
Inventories	7	65,728	90,909	15,557
		<u>1,203,353</u>	<u>1,089,428</u>	<u>284,817</u>
Investments and long-term receivables				
Investments in affiliates	8	3,324,220	2,664,020 *	786,798
Other investments and receivables	9	202,672	556,127 **	47,970
		<u>3,526,892</u>	<u>3,220,147</u>	<u>834,768</u>
Fixed assets, net	10	<u>755,478</u>	<u>725,050</u>	<u>178,811</u>
Intangible assets, deferred expenses and deferred tax assets	11	<u>18,108</u>	<u>15,816</u>	<u>4,286</u>
Assets relating to discontinued operations	24	<u>-</u>	<u>237,822</u>	<u>-</u>
		<u><u>5,503,831</u></u>	<u><u>5,288,263</u></u>	<u><u>1,302,682</u></u>

* Restated – See Note 2R(4).

** Reclassified

	Note	2 0 0 6	2 0 0 5	Convenience translation (Note 1B) 2 0 0 6
		N I S t h o u s a n d s		US \$ thousands
Liabilities and Shareholders' Equity				
Current liabilities				
Credit from banks and others	12	53,967	272,127	12,773
Trade payables	13	67,845	71,090	16,058
Other payables	14	191,135	197,988	45,239
Customer advances		5,042	5,565	1,193
		<u>317,989</u>	<u>546,770</u>	<u>75,263</u>
Long-term liabilities				
Long-term bank loans	15	1,868,932	1,555,149	442,351
Other long-term loans	15	47,467	54,147	11,235
Debentures	15B	988,482	390,854	233,960
Deferred taxes	16G	11,011	78	2,606
Liability for employee severance benefits, net	17	6,239	3,634	1,477
		<u>2,922,131</u>	<u>2,003,862</u>	<u>691,629</u>
Liabilities relating to discontinued operations	24	<u>-</u>	<u>201,290</u>	<u>-</u>
Contingent liabilities and commitments	18			
Minority interest		<u>74,523</u>	<u>57,907</u>	<u>17,639</u>
Shareholders' equity	20	<u>2,189,188</u>	<u>2,478,434 *</u>	<u>518,151</u>
		<u>5,503,831</u>	<u>5,288,263</u>	<u>1,302,682</u>

Jonathan Kolber
Chairman of the Board of
Directors

Raanan Cohen
Chief Executive Officer

Michal Yageel
Corporate Controller

March 14, 2007

* Restated – See Note 2R(4).

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

Company Balance Sheets as at December 31

		<u>2 0 0 6</u>	<u>2 0 0 5</u>	<u>Convenience translation (Note 1B) 2 0 0 6</u>
	<u>Note</u>	<u>N I S t h o u s a n d s</u>		<u>US \$ thousands</u>
Assets				
Current assets				
Cash and cash equivalents		238,207	266,962	56,380
Short-term deposits and investments	4	657,285	485,143 **	155,570
Short-term loans and current maturities of loans to investee companies		39,308	37,212	9,304
Receivables:				
Investee companies		1,114	2,606	264
Others	6	2,510	16,095	594
		<u>938,424</u>	<u>808,018</u>	<u>222,112</u>
Investments and long-term receivables				
Investments in investees	8	2,579,219	2,962,192 *	610,466
Other investments and receivables	9	62,799	366,994 **	14,864
		<u>2,642,018</u>	<u>3,329,186</u>	<u>625,330</u>
Fixed assets, net	10	<u>60,143</u>	<u>62,367</u>	<u>14,235</u>
		<u><u>3,640,585</u></u>	<u><u>4,199,571</u></u>	<u><u>861,677</u></u>

* Restated – See Note 2R(4).

** Reclassified.

		<u>2 0 0 6</u>	<u>2 0 0 5</u>	<u>Convenience translation (Note 1B) 2 0 0 6</u>
	<u>Note</u>	<u>N I S t h o u s a n d s</u>		<u>US \$ thousands</u>
Liabilities and Shareholders' Equity				
Current liabilities				
Credit from banks and others	12	-	204,715	-
Trade payables	13	1,346	1,223	319
Others	14	95,888	48,007 **	22,695
		<u>97,234</u>	<u>253,945</u>	<u>23,014</u>
Long-term liabilities				
Loans from banks and others	15	306,961	1,028,758	72,654
Debentures	15B	988,482	390,854	233,960
Liability for employee severance benefits, net	17	2,137	-	506
Excess of accumulated losses over investments in subsidiaries		56,583	47,580 **	13,392
		<u>1,354,163</u>	<u>1,467,192</u>	<u>320,512</u>
Contingent liabilities and commitments	18			
Shareholders' equity	20	<u>2,189,188</u>	<u>2,478,434 *</u>	<u>518,151</u>
		<u>3,640,585</u>	<u>4,199,571</u>	<u>861,677</u>

* Restated – See Note 2R(4).

** Reclassified.

Jonathan Kolber
Chairman of the Board of
Directors

Raanan Cohen
Chief Executive Officer

Michal Yageel
Corporate Controller

March 14, 2007

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

Consolidated Statements of Operations for the Year Ended December 31

	Note	2 0 0 6	2 0 0 5	2 0 0 4 ⁽¹⁾	Convenience translation (Note 1B) 2 0 0 6
		N I S t h o u s a n d s			US \$ thousands
Revenues and earnings					
Revenue from sales and services	23A	583,253	733,631	7,815,782	138,048
Group's equity in the operating results of investee companies, net	23G	(36,549)	359,362 (*)	(35,060)	(8,650)
Other income, net	23F	104,206	223,622	-	24,664
		<u>650,910</u>	<u>1,316,615 (*)</u>	<u>7,780,722</u>	<u>154,062</u>
Costs and losses					
Cost of sales and services	23B	437,719	582,158	5,111,356	103,602
Selling and marketing expenses	23C	63,546	84,150	1,062,367	15,041
General and administrative expenses	23D	134,601	140,640 (*)	438,823	31,858
Other expenses, net	23F	-	-	72,392	-
Financing expenses, net	23E	113,935	182,021	271,955	26,967
		<u>749,801</u>	<u>988,969 (*)</u>	<u>6,956,893</u>	<u>177,468</u>
Earnings (losses) before income tax		<u>(98,891)</u>	<u>327,646 (*)</u>	<u>823,829</u>	<u>(23,406)</u>
Income tax	16H	(9,369)	(79,979)	(272,280)	(2,218)
		<u>(108,260)</u>	<u>247,667 (*)</u>	<u>551,549</u>	<u>(25,624)</u>
Minority interest in consolidated companies' results, net		<u>(5,414)</u>	<u>10,175</u>	<u>(430,860)</u>	<u>(1,281)</u>
Net earnings (losses) from continuing operations		<u>(113,674)</u>	<u>257,842 (*)</u>	<u>120,689</u>	<u>(26,905)</u>
Net earnings from discontinued operations	24	10,474	52,809	24,301	2,479
Cumulative effect as of the beginning of the year of change in accounting method (see Note 2E(9))		<u>62,552</u>	<u>(3,054)</u>	<u>-</u>	<u>14,805</u>
Net earnings (losses) for the year		<u>(40,648)</u>	<u>307,597 (*)</u>	<u>144,990</u>	<u>(9,621)</u>
		<u>N I S</u>	<u>N I S (*) (**)</u>	<u>N I S (**)</u>	<u>U S \$</u>
Basic earnings (loss) per ordinary share:					
	27				
From continuing operations		(6.413)	16.286	7.436	(1.518)
From discontinued operations		0.639	3.294	1.538	0.151
From cumulative effect of change in accounting method		<u>3.815</u>	<u>(0.191)</u>	<u>-</u>	<u>0.903</u>
Net earnings (loss) for the year		<u>(1.959)</u>	<u>19.389</u>	<u>8.974</u>	<u>(0.464)</u>
Diluted earnings (loss) per ordinary share:					
	27				
From continuing operations		(6.951)	13.647	5.090	(1.645)
From discontinued operations		0.639	3.192	1.493	0.151
From cumulative effect of change in accounting method		<u>3.815</u>	<u>(0.185)</u>	<u>-</u>	<u>0.903</u>
Net earnings (loss) for the year		<u>(2.497)</u>	<u>16.654</u>	<u>6.583</u>	<u>(0.591)</u>

(1) See Note 3B(2) relating to discontinuance of consolidation of M-A Industries and Note 3C(1) relating to discontinuance of proportionate consolidation of Telrad Networks.

(*) Restated – See Note 2R(4).

(**) Restated – See Note 2W.

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

Company Statements of Operations for the Year Ended December 31

		<u>2 0 0 6</u>	<u>2 0 0 5</u>	<u>2 0 0 4</u>	<u>Convenience translation (Note 1B) 2 0 0 6</u>
	<u>Note</u>	<u>N I S</u>	<u>t h o u s a n d s</u>		<u>US \$ thousands</u>
Revenues and earnings					
Management services from subsidiaries		7,499	20,024	22,334	1,775
Koor's equity in the operating results of investee companies, net	23G	7,094	130,443 *	26,200	1,679
Other income, net	23F	61,914	438,133	234,959	14,654
		<u>76,507</u>	<u>588,600 *</u>	<u>283,493</u>	<u>18,108</u>
Costs and losses					
General and administrative expenses	23D	65,773	58,684 *	46,648	15,568
Financing expenses, net	23E	51,382	144,836	110,806	12,161
		<u>117,155</u>	<u>203,520 *</u>	<u>157,454</u>	<u>27,729</u>
Earnings (loss) before income tax		(40,648)	385,080 *	126,039	(9,621)
Income tax		-	(77,483)	18,951	-
Net earnings (losses) for the year		<u>(40,648)</u>	<u>307,597 *</u>	<u>144,990</u>	<u>(9,621)</u>

* Restated – See Note 2R(4).

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

Consolidated Statement of Changes in Shareholders' Equity

	Number of ordinary shares (1)	Share capital	Capital reserves	Amounts received in respect of stock options	Company shares held by the Company and subsidiaries	Cumulative foreign currency translation adjustments	Accumulated losses	Total
	N I S t h o u s a n d s							
Balance at December 31, 2003	15,741,160	564,515	2,564,099	-	(80,321)	(196,758)	(1,111,142)	1,740,393
Changes during 2004:								
Net earnings for the year	-	-	-	-	-	-	144,990	144,990
Exercise of stock options granted to employees	83,025	-	-	-	-	-	-	-
Cumulative foreign currency translation adjustments, net	-	-	-	-	-	(8,916)	-	(8,916)
Balance as December 31, 2004	15,824,185	564,515	2,564,099	-	(80,321)	(205,674)	(966,152)	1,876,467
Changes during 2005:								
Net earnings for the year	-	-	-	-	-	-	307,597 *	307,597 *
Stock-based compensation expense	-	-	1,389 *	-	-	-	-	1,389 *
Issuance of treasury stock (Note 20B)	193,229	-	-	-	74,250	-	(24,641)	49,609
Issuance of stock options (Note 20D)	-	-	-	21,715	-	-	-	21,715
Exercise of stock options granted to employees	129,254	-	-	-	-	-	-	-
Cumulative foreign currency translation adjustments, net	-	-	-	-	-	221,657	-	221,657
Balance as December 31, 2005	16,146,668	564,515	2,565,488*	21,715	(6,071)	15,983	(683,196) *	2,478,434 *
Changes during 2006:								
Net loss for the year	-	-	-	-	-	-	(40,648)	(40,648)
Stock-based compensation expense	-	-	1,236	-	-	-	-	1,236
Exercise of stock options granted to employees	420,402	-	-	-	-	-	-	-
Cumulative foreign currency translation adjustments, net	-	-	-	-	-	(249,834)	-	(249,834)
Balance as December 31, 2006	16,567,070	564,515	2,566,724	21,715	(6,071)	(233,851)	(723,844)	2,189,188

(1) Net of the Company holdings and its subsidiaries' holdings.

* Restated – See Note 2R(4).

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

Consolidated Statement of Changes in Shareholders' Equity**Convenience translation into \$ (Note 1B)**

	Share capital	Capital reserves	Amounts received in respect of stock options	Company shares held by the Company and subsidiaries	Cumulative foreign currency translation adjustments	Accumulated losses	Total
			U S \$	t h o u s	a n d s		
Balance at December 31, 2005	133,613	607,216 *	5,140	(1,437)	3,783	(161,703) *	586,612 *
Changes during 2006							
Net loss for the year	-	-	-	-	-	(9,621)	(9,621)
Stock-based compensation expense	-	293	-	-	-	-	293
Cumulative foreign currency translation adjustments, net	-	-	-	-	(59,133)	-	(59,133)
Balance as December 31, 2006	133,613	607,509	5,140	(1,437)	(55,350)	(171,324)	518,151

* Restated – See Note 2R(4).

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

Consolidated Statement of Cash Flows for the Year Ended December 31

	2 0 0 6	2 0 0 5	2 0 0 4 ⁽¹⁾	Convenience translation (Note 1B) 2 0 0 6
	N I S	t h o u s a n d s		US \$ thousands
Cash flows generated by operating activities				
Net earnings (loss) for the year	(40,648)	307,597 *	144,990	(9,621)
Adjustments to reconcile net earnings (loss) to net cash flows generated by operating activities (A)	24,031	(314,733) *	703,293	5,688
Net cash inflow (outflow) generated by continuing operating activities	(16,617)	(7,136)	848,283	(3,933)
Net cash inflow (outflow) generated by discontinued operating activities	23,798	(167,915)	46,123	5,633
Net cash flows from operating activities	7,181	(175,051)	894,406	1,700
Cash flows generated by investing activities:				
Purchase of fixed assets	(29,776)	(23,233)	(211,306)	(7,048)
Investment grants in respect of fixed assets	-	2,226	6,908	-
Amounts charged to intangible assets and deferred expenses	-	(1,351)	(153,206)	-
Acquisition of subsidiaries (B)	-	-	(293,781)	-
Investments in affiliates	(924,501)	-	(646,672)	(218,817)
Loans to affiliates	-	-	(1,680)	-
Repayment of loans from affiliates	7,042	-	-	1,668
Proceeds from realization of investments in formerly consolidated subsidiaries, net of cash in those subsidiaries at the time they ceased being consolidated (C)	-	199,953	-	-
Acquisition of control in proportionately consolidated subsidiary (F)	(45,019)	-	-	(10,656)
Repayment of liability in respect of purchase of subsidiary in prior years	-	-	(28,309)	-
Proceeds from realization of investment in proportionately consolidated subsidiary at the time it ceased being proportionately consolidated (E)	-	(14,122)	-	-
Acquisition of minority in subsidiaries	-	-	(4,762)	-
Proceeds from disposal of investments in investee companies and others	182,161	644,850	636,286	43,116
Receipts on account of sale of subsidiary	26,321	-	-	6,230
Proceeds from sale of fixed assets and intangible assets	936	1,272	7,195	222
Investment in venture capital companies	(7,417)	(15,426)	(34,928)	(1,756)
Decrease (increase) in other investments, net	1,649	(351,901)	(5,195)	390
Decrease (increase) in short-term deposits and investments, net	1,708	(167,297)	16,910	404
Proceeds from realization of subsidiary's shares that became proportionately consolidated (D)	-	-	38,239	-
Net cash inflow (outflow) generated by continuing investing activities	(786,896)	274,971	(674,301)	(186,247)
Net cash inflow (outflow) generated by discontinued investing activities	(14,945)	143,959	(48,538)	(3,538)
Net cash flows from investing activities	(801,841)	418,930	(722,839)	(189,785)

(1) See Note 3B(2) relating to discontinuance of consolidation of M-A Industries and Note 3C(1) relating to discontinuance of proportionate consolidation of Telrad Networks.

* Restated – See Note 2R(4).

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

Consolidated Statements of Cash Flows for the Year Ended December 31 (cont'd)

	2 0 0 6	2 0 0 5	2 0 0 4 ⁽¹⁾	Convenience translation (Note 1B) 2 0 0 6
	N I S	t h o u s a n d s		US \$ thousands
Cash flows generated by financing activities				
Proceeds from issuance of debentures, net	593,988	375,535	-	140,589
Proceeds from issuance of stock options	-	21,715	-	-
Proceeds from issuance of treasury stock	-	49,609	-	-
Issuance of shares to minority interest in subsidiaries	17,133	7,938	14,466	4,055
Acquisition of stock options by subsidiary	(1,138)	-	-	(269)
Dividend paid to minority interest in subsidiaries	-	-	(107,006)	-
Issuance of convertible debentures in subsidiary	-	-	665,982	-
Receipt of long-term loans and other long-term liabilities	198,988	1,337,485	971,671	47,098
Repayment of long-term loans, debentures and other long-term liabilities	(66,597)	(1,885,820)	(1,781,048)	(15,763)
Increase (decrease) in credit from banks and others, net	(13,367)	(475,089)	14,701	(3,164)
Net cash inflow (outflow) generated by continuing financing activities	729,007	(568,627)	(221,234)	172,546
Net cash inflow (outflow) generated by discontinued financing activities	(2,067)	15,638	93,165	(489)
Net cash flows from financing activities	726,940	(552,989)	(128,069)	172,057
Translation differences in respect of cash balances of autonomous foreign investee companies in continuing operations	(657)	3,672	(8,654)	(156)
Translation differences in respect of cash balances of autonomous foreign investee companies in discontinued operations	74	18,881	(7,205)	18
Decrease in cash and cash equivalents	(68,303)	(286,557)	27,639	(16,166)
Increase (decrease) in cash and cash equivalents from discontinued operations	35,834*	309,512 *	(83,545)	8,481*
Increase (decrease) in cash and cash equivalents from continuing operations	(32,469)	22,955	(55,906)	(7,685)
Balance of cash and cash equivalents at beginning of year	309,666	286,711	342,617	73,294
Balance of cash and cash equivalents at end of year	277,197	309,666	286,711	65,609

* Including proceeds received from realization of subsidiaries classified as discontinued operations in the amount of NIS 42,694 thousand (2005 – NIS 320,074 thousand).

(1) See Note 3B(2) relating to discontinuance of consolidation of M-A Industries and Note 3C(1) relating to discontinuance of proportionate consolidation of Telrad Networks.

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

Consolidated Statements of Cash Flows for the Year Ended December 31 (cont'd)

				Convenience translation (Note 1B)
	2 0 0 6	2 0 0 5	2 0 0 4 ⁽¹⁾	2 0 0 6
	N I S	t h o u s a n d s		US \$ thousands
A. Adjustments to reconcile net earnings to net cash flows generated by operating activities:				
Income and expenses not involving cash flows:				
Earnings from discontinued operations	(10,474)	(52,809)	(24,301)	(2,479)
Minority interest in earnings (losses) of subsidiaries, net	5,414	(10,175)	430,860	1,281
Group's equity in operating results of affiliates, net	138,444	(268,209)	36,493	32,768
Depreciation and amortization	34,637	42,175	430,086	8,198
Deferred taxes, net	14,840	71,034	40,887	3,512
Increase in liabilities in respect of employee severance benefits, net	2,345	25,250	29,842	555
Net capital losses (gains) from realization of:				
Fixed assets and intangible assets	313	(254)	16,574	74
Investments in formerly consolidated subsidiaries	-	(204,619)	-	-
Investments in investee companies	(79,308)	(76,653)	(227,477)	(18,771)
Linkage of debentures and amortization of bond discount	3,640	15,318	-	862
Inflationary erosion (linkage) of principal of long-term loans and other liabilities	(25,545)	35,645	7,572	(6,046)
Inflationary erosion (linkage) of value of investments, deposits and loans receivable	(8,350)	(14,299)	16,534	(1,976)
Impairment (reserve) in value of assets and investments (primarily venture capital investments)	(1,504)	68,786	58,131	(356)
Amortization of stock based compensation	1,633	1,389	-	386
Cumulative effect as at the beginning of the year of change in accounting method	(62,552)	3,054	-	(14,805)
	<u>13,533</u>	<u>(364,367)</u>	<u>815,201</u>	<u>3,203</u>

(1) See Note 3B(2) relating to discontinuance of consolidation of M-A Industries and Note 3C(1) relating to discontinuance of proportionate consolidation of Telrad Networks.

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

Consolidated Statements of Cash Flows for the Year Ended December 31 (cont'd)

	<u>2 0 0 6</u>	<u>2 0 0 5</u>	<u>2 0 0 4 ⁽¹⁾</u>	<u>Convenience translation (Note 1B) 2 0 0 6</u>
	<u>N I S</u>	<u>t h o u s a n d s</u>		<u>US \$ thousands</u>
A. Adjustments to reconcile net earnings to net cash flows generated by operating activities (cont'd):				
Changes in operating asset and liability items:				
Decrease (increase) in trade receivables and other receivables (after taking into account non-current receivables)	30,960	(29,082)	(128,141)	7,328
Decrease (increase) in inventories (including long-term customer advances and deposits)	18,704	9,610	(291,989)	4,427
Increase (decrease) in trade payables and other payables	(39,166)	69,106	308,222	(9,270)
	<u>10,498</u>	<u>49,634</u>	<u>(111,908)</u>	<u>2,485</u>
	<u>24,031</u>	<u>(314,733)</u>	<u>703,293</u>	<u>5,688</u>
B. Acquisition of subsidiaries				
Assets and liabilities of the subsidiaries at date of acquisition:				
Working capital, excluding cash and cash equivalents	-	-	(38,239)	-
Issuance of shares by investee company	-	-	34,238	-
Fixed assets and investments, net	-	-	(286,907)	-
Long-term liabilities	-	-	187,019	-
Goodwill	-	-	(189,892)	-
	<u>-</u>	<u>-</u>	<u>(293,781)</u>	<u>-</u>

(1) See Note 3B(2) relating to discontinuance of consolidation of M-A Industries and Note 3C(1) relating to discontinuance of proportionate consolidation of Telrad Networks.

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

Consolidated Statements of Cash Flows for the Year Ended December 31 (cont'd)

				Convenience translation (Note 1B)
	2 0 0 6	2 0 0 5	2 0 0 4 ⁽¹⁾	2 0 0 6
	N I S	t h o u s a n d s		U S \$ thousands
C. Proceeds from realization of investments in formerly consolidated subsidiaries, net of cash in those subsidiaries at the time they ceased being consolidated				
Assets and liabilities of the formerly consolidated subsidiaries at the time they ceased being consolidated:				
Working capital surplus (deficit), excluding cash and cash equivalents	-	1,031,023	-	-
Fixed assets and investments	-	1,971,804	-	-
Intangible assets	-	2,316,290	-	-
Long-term liabilities	-	(1,601,477)	-	-
Investments in affiliated companies, net	-	(1,315,995)	-	-
Realization of foreign currency translation adjustments of financial statements of autonomous investees	-	18,141	-	-
Capital gain (loss) on sale of investments in subsidiaries	-	200,987	-	-
Minority interest	-	(2,420,820)	-	-
	<u>-</u>	<u>199,953</u>	<u>-</u>	<u>-</u>
D. Proceeds from realization of subsidiary's shares that became proportionately consolidated				
Working capital surplus excluding cash and cash equivalents	-	-	23,057	-
Fixed assets, investments and intangible assets	-	-	40,851	-
Realization proceeds receivable	-	-	(25,544)	-
Capital loss	-	-	(125)	-
	<u>-</u>	<u>-</u>	<u>38,239</u>	<u>-</u>

(1) See Note 3B(2) relating to discontinuance of consolidation of M-A Industries and Note 3C(1) relating to discontinuance of proportionate consolidation of Telrad Networks.

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

Consolidated Statements of Cash Flows for the Year Ended December 31 (cont'd)

	2006	2005	2004 ⁽¹⁾	Convenience translation (Note 1B)
	N I S	t h o u s a n d s		2006 US \$ thousands
E. Proceeds from realization of investment in proportionately consolidated subsidiary at the time it ceased being proportionately consolidated				
Assets and liabilities of formerly proportionately consolidated subsidiary, at the time it ceased being proportionately consolidated:				
Working capital surplus, excluding cash and cash equivalents	-	36,900	-	-
Fixed assets and investments	-	129,917	-	-
Long-term liabilities	-	(62,023)	-	-
Investments in affiliated companies, net	-	(117,623)	-	-
Capital gain	-	3,632	-	-
Minority interest	-	(4,925)	-	-
	-	(14,122)	-	-
F. Acquisition of control in proportionately consolidated subsidiary				
Assets and liabilities of formerly proportionately consolidated subsidiary, at the date of acquisition:				
Working capital surplus, excluding cash and cash equivalents	3,801	-	-	900
Fixed assets, net	(42,118)	-	-	(9,969)
Goodwill	(17,215)	-	-	(4,075)
Long-term liabilities	10,513	-	-	2,488
	(45,019)	-	-	(10,656)
G. Non-cash transactions				
Purchase of fixed assets by credit	-	4,712	9,172	-
Purchase of other assets by credit	-	-	28,178	-
Sale of venture capital investments, net	56,159	-	-	13,292
Proposed dividend to minority shareholders by subsidiaries	-	-	29,614	-
Dividend in kind from affiliated company	10,470	-	33,363	-
Loans converted into shareholders' equity of subsidiary	-	13,419	14,042	-

(1) See Note 3B(2) relating to discontinuance of consolidation of M-A Industries and Note 3C(1) relating to discontinuance of proportionate consolidation of Telrad Networks.

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

Company Statements of Cash Flows for the Year Ended December 31

	2 0 0 6	2 0 0 5	2 0 0 4	Convenience translation (Note 1B) 2 0 0 6
	N I S	t h o u s a n d s		US \$ thousands
Cash flows generated by operating activities:				
Net earnings (loss) for the year	(40,648)	307,597 *	144,990	(9,621)
Adjustments to reconcile net earnings (loss) to net cash flows generated by operating activities (A)	(6,708)	(427,072) *	(136,907)	(1,588)
Net cash inflow (outflow) generated by operating activities	(47,356)	(119,475)	8,083	(11,209)
Cash flows generated by investing activities:				
Investee companies:				
Acquisition of shares	(938,545)	(23,442)	(667,779)	(222,141)
Loans granted, capital notes and non-current accounts	40,404	40,631	34,950	9,563
Purchase of fixed assets	(200)	(176)	(423)	(47)
Decrease (increase) in investments and other receivables, net	177,186	(351,631)	-	41,938
Proceeds from sale of fixed assets	66	8	-	16
Receipts on account of sale of subsidiary	26,321	-	-	6,230
Proceeds from realization of investments in investee companies	42,694	1,372,044	562,177	10,105
Investment in short-term deposits and investments, net	(9,826)	(143,307)	63,412	(2,326)
Net cash inflow (outflow) generated by investing activities	(661,900)	894,127	(7,663)	(156,662)
Cash flows generated by financing activities:				
Proceeds from issuance of debentures	593,988	375,535	-	140,589
Proceeds from issuance of stock options	-	21,715	-	-
Proceeds from issuance of treasury stock	-	49,609	-	-
Receipt of long-term loans and other long-term liabilities	142,897	1,007,119	637,000	33,821
Payments of long-term loans and other long-term liabilities	(49,094)	(1,812,366)	(628,703)	(11,620)
Credit from banks and others, net	(7,290)	(178,967)	11,743	(1,725)
Net cash inflow (outflow) generated by financing activities	680,501	(537,355)	20,040	161,065
Increase (decrease) in cash and cash equivalents	(28,755)	237,297	20,460	(6,806)
Balance of cash and cash equivalents at beginning of year	266,962	29,665	9,205	63,186
Balance of cash and cash equivalents at end of year	238,207	266,962	29,665	56,380

* Restated – See Note 2R(4).

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

Company Statements of Cash Flows for the Year Ended December 31 (cont'd)

	<u>2 0 0 6</u>	<u>2 0 0 5</u>	<u>2 0 0 4</u>	Convenience translation (Note 1B) 2 0 0 6
	<u>N I S</u>	<u>t h o u s a n d s</u>		<u>US \$ thousands</u>
A. Adjustments to reconcile net earnings to cash flows generated by operating activities				
Income and expenses not involving cash flows:				
Equity in operating results of investee companies, net of dividend received therefrom	(2,785)	(109,173) *	47,879	(659)
Depreciation and amortization	1,905	2,043	2,022	451
Deferred taxes, net	-	77,483	(18,580)	-
Increase (decrease) in liability in respect of employee severance benefits, net	2,137	(1,917)	3,491	506
Net capital losses (gains) from realization of:				
Fixed assets	453	7	-	107
Investment in investee companies	(41,655)	(424,261)	(213,249)	(9,860)
Increase in value of deposits and other erosions, net	(8,084)	(13,611)	(6,623)	(1,913)
Exchange rate differences and erosion of long-term loans and other liabilities	5,116	49,006	6,077	1,210
Amortization of stock-based compensation	1,236	1,389 *	-	293
Changes in value of investments and assets	1,128	(377)	-	267
	<u>(40,549)</u>	<u>(419,411)</u>	<u>(178,983)</u>	<u>(9,598)</u>
Changes in operating assets and liability items:				
Decrease (increase) in current accounts of investee companies, net	(1,427)	2,103	36,543	(338)
Decrease (increase) in receivables	13,585	(9,535)	(213)	3,216
Increase (decrease) in trade payables and other payables	21,683	(229)	5,746	5,132
	<u>33,841</u>	<u>(7,661)</u>	<u>42,076</u>	<u>8,010</u>
	<u>(6,708)</u>	<u>(427,072)</u>	<u>(136,907)</u>	<u>(1,588)</u>
B. Significant non-cash transactions				
Dividend from subsidiary	<u>534,861</u>	<u>-</u>	<u>-</u>	<u>126,594</u>
Loans converted into shareholders' equity of subsidiary	<u>638,706</u>	<u>46,588</u>	<u>6,837</u>	<u>151,173</u>
Assignment of long-term liabilities	<u>1,014,170</u>	<u>-</u>	<u>-</u>	<u>240,040</u>

* Restated – See Note 2R(4).

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

Notes to the Financial Statements for the year ended December 31, 2006

Note 1 - General

- A.** Koor Industries Ltd. is a holding company, engaged mainly in the fields of agro-chemicals, telecommunications, tourism and venture capital investments, through its subsidiaries, proportionately consolidated companies and affiliates (the "Koor Group" or the "Group").
The Company's shares are traded both on the Tel Aviv Stock Exchange and on the New York Stock Exchange.
- B.** The financial statements in reported amounts as at December 31, 2006 and for the year ended have been translated into U.S. dollars using the representative exchange rate at that date (\$1 = NIS 4.225). The translation was made solely for the convenience of the reader.
The amounts presented in these financial statements should not be construed to represent amounts receivable or payable in dollars or convertible into dollars, unless otherwise indicated in these financial statements.

Note 2 - Significant Accounting Policies

The financial statements have been prepared in accordance with the Securities' Regulations (Presentation of Annual Financial Reports) – 1993 and in accordance with accounting principles generally accepted in Israel.

The significant accounting policies, which were applied on a consistent basis, are as follows:

A. Definitions

In these financial statements:

- | | | |
|---|---|---|
| 1. The Company | - | Koor Industries Ltd. ("Koor" or "the Company"). |
| 2. The Group | - | Koor Industries Ltd. and its investees |
| 3. Subsidiaries | - | companies, including partnerships, whose statements are fully consolidated, directly or indirectly, with those of the Company. |
| 4. Proportionately consolidated Companies | - | jointly controlled companies, which are proportionately consolidated, directly or indirectly, in Koor's consolidated financial statements. |
| 5. Affiliates | - | companies in which voting rights grant the Company significant influence over the operating and financial policies of these companies, and which are not subsidiaries or proportionately consolidated companies. Such companies are included on the equity basis. |

Note 2 - Significant Accounting Policies (cont'd)**A. Definitions (cont'd)**

- | | | | |
|-----|-----------------------------|---|---|
| 6. | Investees | - | subsidiaries, proportionately consolidated companies or affiliates. |
| 7. | Other companies | - | companies in which the investment does not confer significant influence, and are accounted for by the cost method. |
| 8. | Interested parties | - | as defined in Paragraph (1) of the definition of "interested parties" in Section 1 of the Israeli Securities Law - 1968. |
| 9. | Related parties | - | as defined in Opinion No. 29 of the Institute of Certified Public Accountants in Israel ("ICPAI"). |
| 10. | Controlling shareholders | - | as defined in the Israeli Securities Regulations (Financial Statement Presentation of Transactions between a Company and its Controlling Shareholder) - 1996. |
| 11. | Venture capital investments | - | an investment in a company that meets two conditions:
(a) The Company is engaged primarily in research, development or marketing of innovative and intellectual property intensive products or processes; and
(b) At least 90% of the company's financing stems from shareholder equity (including shareholder loans and shareholder guaranteed credit), support of State authorities or research grants. |
| 12. | Consumer Price Index | - | the Israeli Consumer Price Index (CPI) published by the Central Bureau of Statistics. |
| 13. | Dollar | - | U.S. dollar. |
| 14. | Adjusted amount | - | the historical nominal amount adjusted to the CPI for December 2003 in conformity with the provisions of Opinions 23 and 36 of the ICPAI. |
| 15. | Reported amount | - | the adjusted amount as at the transition date (December 31, 2003), with the addition of amounts in nominal values that were added after the transition date and less amounts eliminated after the transition date. |
| 16. | NIS | - | New Israeli Shekels |
| 17. | IASB | - | Israel Accounting Standards Board |

B. Financial statements in reported amounts

1. In October 2001, the Israel Accounting Standards Board published Accounting Standard No. 12 on "Discontinuation of Adjustment of Financial Statements". According to this standard, and in accordance with Accounting Standard No. 17 published in December 2002, the adjustment of financial statements for the effect of changes in the general purchasing power of the shekel was discontinued, commencing January 1, 2004. Until December 31, 2003, the Group continued to prepare financial statements adjusted for in accordance with Opinion No. 36 of the ICPAI. The Group has applied the provisions of the Standard and, accordingly, the adjustment was discontinued, commencing January 1, 2004.

Note 2 - Significant Accounting Policies (cont'd)**B. Financial statements in reported amounts (cont'd)**

2. In the past, the Company prepared its financial statements on the basis of historical cost, adjusted to the CPI. The adjusted amounts included in the financial statements as at December 31, 2003, served as the starting point for the nominal financial reporting as of January 1, 2004. Additions made during the period were included in nominal values.
3. The non-monetary asset amounts do not necessarily represent their realizable or current economic value, but only the reported amounts of such assets.
4. In the financial statements, the term "cost" means cost in reported amount.
5. The financial statements of certain companies classified as autonomous units are stated based on the changes in the exchange rates of their relevant functional currencies – see 2D below.

C. Reporting principles

1. Balance sheets:
 - a. The equity value of investments in investees was determined based on the reported or translated from foreign currency financial statements of these companies.
 - b. Non-monetary items (mainly – fixed assets, inventory, investments stated at cost and equity items) are stated in reported amounts.
 - c. Monetary items are stated in the balance sheet at historical nominal values as at the balance sheet date.
2. Statements of operations:
 - a. The equity in the results of operations of investees and the minority interest in the results of subsidiaries were determined based on the reported or translated from foreign currency financial statements of such companies.
 - b. Revenues and expenses deriving from non-monetary items (such as: depreciation and amortization, changes in inventory, prepaid expenses and income, etc.) or from provisions included in the balance sheet, are derived from the change between the reported amounts of the opening balance and the reported amount of the closing balance.
 - c. The remaining statement of operations items (such as: sales, purchases, current manufacturing costs, etc.) are stated at nominal values.
3. Statement of changes in shareholders' equity:

A dividend declared in the reporting period is stated in nominal values.

Note 2 - Significant Accounting Policies (cont'd)

D. Effects of the changes in foreign currency exchange rates

The Company has applied Accounting Standard No. 13 "Effect of Changes in Exchange Rates of Foreign Currency" since January 1, 2004. The Standard discusses the translation of foreign currency transactions and the translation of financial statements of foreign operations for their inclusion in the financial statements of the reporting entity. The Standard provides rules for classifying foreign operations as an autonomous foreign investee or as an integrated investee, based on indications described in the Standard and the use of judgment, as well as the method for translating the financial statements of autonomous foreign investees.

Foreign currency transactions

Transactions denominated in foreign currency are initially recorded at the exchange rate prevailing on the transaction date. Exchange rate differences arising upon the settlement of monetary items, or upon reporting of the Group's monetary items at exchange rates that are different than those used for initial recognition during the period, or from those reported in prior financial statements, are charged to the statement of operations.

Foreign operations classified as an autonomous investee

Certain investees domiciled in Israel earn revenues and purchase the raw materials and fixed assets primarily in dollars. The dollar is also the primary currency of the economic environment in which such investees operate. In accordance with the principles prescribed in Section 29(a) of Opinion No. 36 of the ICPAI the dollar constitutes the measurement and reporting currency in their financial statements.

The financial statements of investees operating in foreign countries as an "autonomous investee", and companies incorporated in Israel for which the measurement and reporting currency is the dollar are translated to Israeli currency as follows:

1. The assets and liabilities, both monetary and non-monetary of an autonomous foreign investee were translated according to the closing rate. Goodwill is also translated at the closing rate, beginning January 1, 2004.
2. Income and expense items are translated at the exchange rate prevailing on the transaction date.
3. All exchange rate differences created are classified as a separate item in shareholders' equity until the investee is disposed of.

Impairment in the value of an investment in an autonomous foreign investee does not constitute a partial disposal and therefore, no part of the translation differences is charged to the statement of operations at the time of the impairment.

Foreign operations classified as integrated investee

The financial statements of investees operating overseas that are an "integrated investee" of the Group, in accordance with the tests prescribed in Standard No. 13 of the IASB, are translated from foreign currency to Israeli currency – with non-monetary items translated at the historical exchange rate prevailing on the transaction date and monetary items translated at the exchange rate prevailing on the balance sheet date. Statement of operations items are translated at the average exchange rate, except for revenues and expenses related to non-monetary items that were translated at the historical exchange rates at which the related non-monetary items were translated. Differences resulting from the translation are charged to financing expenses.

Note 2 - Significant Accounting Policies (cont'd)**E. Consolidation of financial statements**

1. The consolidated financial statements include the financial statements of the Company and of all the companies in which the Company has control. Jointly controlled companies are included in the consolidated financial statements by the proportionate consolidation method. A jointly controlled entity is an entity in which all the shareholders, by way of contractual arrangement, jointly control the significant operating policies thereof.
2. The list of companies whose financial statements are included in the consolidated financial statements and the Company's holding percentage in their voting rights and equity rights is provided in Annex 1 to the financial statements. Furthermore, the list of unconsolidated companies is provided in Annex 2 to the financial statements.
Regarding companies that were consolidated in the past and are not included in the consolidation in the reporting year – see Note 3B(2) and Note 3C(1).
3. For the purpose of the consolidation, the amounts included in the financial statements of the consolidated companies were included after the adjustments necessitated by the application of the uniform accounting principles adopted by the Group.
4. The consolidated financial statements include the pro rata share of asset, liability, income and expense items of proportionately consolidated companies, based on the holding percentages in these companies.
5. As to the financial statements of subsidiaries that are adjusted according to changes in foreign currency exchange rates – see Note 2D above.
6. As from January 1, 2006, the Company implements Accounting Standard No. 20 (Revised), "The Accounting Treatment of Goodwill and Intangible Assets resulting from the acquisition of an Investee Company" (hereinafter – the Standard) of the IASB. In accordance with the Standard:
 - a. The excess cost created upon the acquisition of an investment in an investee company over the fair value of its identified assets (including intangible assets) less the fair value of the identified liabilities (after allocation of the tax deriving from temporary differences) on acquisition date, is charged to goodwill.
 - b. Goodwill is not amortized systematically. Instead, goodwill is tested for impairment at least once a year, or more frequently, should circumstances arise indicating that impairment may have occurred.
The excess cost allocated to assets and liabilities is charged to the appropriate balance sheet items. Goodwill is presented in the balance sheet under the caption " intangible assets and deferred tax assets".
 - c. The excess book value over the cost of the investment is deducted first from intangible assets. Negative excess cost remaining after the allocation to intangible assets is deducted from non-monetary assets on a pro rata basis to the fair value of these assets, based on the Company's share. The balance of the negative excess cost, after the said allocation, is negative goodwill and is immediately recognized as a gain on the date of acquisition.

Note 2 - Significant Accounting Policies (cont'd)**E. Consolidation of financial statements (cont'd)**d. Impact of the initial implementation of the Standard:

The amount of the systematic amortization of goodwill which ceased to be amortized beginning January 1, 2006 following the adoption of the Standard was approximately NIS 26 million and approximately NIS 45 million in the years ended December 31, 2005 and 2004, respectively. The financial statements for the periods prior to the inception of the Standard were not restated. Until December 31, 2005 goodwill was systematically amortized over its estimated useful life (mainly over a period of 10 to 20 years).

7. Material intercompany balances and transactions between Group companies were eliminated for consolidation purposes. Likewise, material unrealized income from intercompany sales not yet realized outside the Group were eliminated.
8. The Company's shares that were acquired by the Company and subsidiaries are recorded as treasury stock.
9. Until December 31, 2005, according to the criteria prescribed in Opinions 48 and 53 of the IACPA, when the sale and/or exercise of convertible securities that were issued by investees (including employee options) was probable, and a decline in the shareholding percentage was expected upon conversion or exercise, as a result of which the holder will sustain a loss, an appropriate provision is included in respect of the anticipated loss.

As from January 1, 2006, the Company implements Accounting Standard No. 22, "Financial Instruments: Disclosure and Presentation" (hereinafter – the Standard) of the IASB. The Standard supersedes Opinion No. 53, "The Accounting Treatment of Convertible Liabilities", and Opinion No. 48, "The Accounting Treatment of Options".

In accordance with the Standard, the provision for loss that was included in the financial statements for December 31, 2005, in respect of a loss anticipated from a decline in rate of holding following the exercise of stock options or the conversion of convertible liabilities in investee companies, was cancelled when the Standard came into effect and accounted for as a cumulative effect of change in accounting policy. The comparative figures relating to prior periods were not restated.

The transition to the Standard amounted to an increase in net earnings during the first quarter of 2006 in the amount of NIS 62,552 thousand due to the cancellation of provisions for losses in respect of convertible securities in investee companies.

During 2006, the Company recorded losses in respect of the conversion of convertible securities in investee companies in the amount of NIS 50,828 thousand.

Therefore, the net impact of the initial implementation of the Standard on the Company in 2006 amounted to income of NIS 11,724 thousand.

F. Use of estimates

Preparation of the financial statements in conformity with generally accepted accounting principles requires management to use estimates and assessments in determining the reported amounts of assets, liabilities, revenues, expenses and the disclosure relating to contingent assets and liabilities. Actual results may differ from such estimates.

Note 2 - Significant Accounting Policies (cont'd)**G. Cash and cash equivalents**

Cash and cash equivalents include short-term bank deposits and short-term government loans traded in banks, with an original maturity of three months or less, on the date of investment, and which are not restricted.

H. Marketable Securities1. Marketable securities

Investments in marketable securities held for the short-term as current investments are stated according to the stock market price as at the balance sheet date. The changes in the fair value of the securities are recorded in the statement of operations in each reporting period.

Investments in marketable securities, which are permanent investments (held to maturity), are stated at cost (debentures - including accrued interest), net of a provision for decrease in value that is not of a temporary nature (see also section (3) below).

2. Non-marketable securities

Non-marketable securities are stated at cost (debentures - including accrued interest), which, in management's opinion does not exceed realization value (see also section (3) below).

3. Decrease in value of investments

From time to time, the Group evaluates whether there has been a non-temporary decrease in value in its permanent investments in other companies. Such a review is carried out where there are indications of the possibility that the value of such investments has been impaired, including a decline in stock market prices, the investee's businesses, the industry in which the investee operates and other parameters. Any impairment in value of these investments, which is considered to be other than temporary, and which management bases on an evaluation of all the relevant aspects after giving appropriate weight to each of them, is charged to the statement of operations.

I. Allowance for doubtful accounts

The financial statements include allowances for doubtful accounts, which management believe that fairly reflect the loss inherent in accounts whose collection is doubtful. Management determines the allowances on information it has on the financial status of debtors, the volume of their activity and a valuation of the collateral received from them. The allowance is determined specifically for accounts whose collection is doubtful.

J. Sale of trade receivables

The sale of financial assets is recognized as a sale when full control over the asset has been transferred to the extent that the risks and rewards related to the asset are transferred in full to an independent third party. See Note 3B(6).

Note 2 - Significant Accounting Policies (cont'd)**K. Inventories**

Inventories are valued at the lower of cost or market value. Cost is determined as follows:

Raw materials, ancillary materials and spare parts - at "moving average" or by the "first-in, first-out" method.

Finished goods and goods in process-based on manufacturing costs (including materials, labor and subcontractor costs) plus allocated indirect manufacturing and other expenses.

Merchandise - by the "first-in, first-out" or the "moving average" method.

L. Projects in progress

Work in progress under long-term contracts is stated at cost less amounts charged to cost of revenues in the statement of operations and associated with revenue recognized on the basis of the "percentage of completion" method. Cost includes direct costs of materials, labor, subcontractor and other direct costs and allocated indirect manufacturing costs (see Note 2T(2) below).

M. Holdings of a venture capital fund in venture capital investments

1. The holdings of a venture capital fund in venture capital investments are stated at cost (at their reported amounts), net of impairment provisions, if a non-temporary decline in their value occurs. Gains from venture capital investments are charged to the statement of operations when the investment is realized. Also see Note 2H(3) above.
2. Venture capital investments that management intends to realize in the short-term are included in current assets on the basis of cost, net of impairment provision, which does not exceed the market value of the investment.

N. Investments in affiliates

1. The investments in affiliates are presented by the equity method. In determining the net asset value of such investments, the amounts taken into consideration are the amounts appearing in the financial statements of those companies.
2. Regarding goodwill– see Note 2E(6) above.
3. Regarding the decline in value of investments in affiliates – see Note 2AB.
4. Regarding provision for loss due to the expected conversion of convertible securities issued by affiliates – see Note 2E(9) above.
5. An affiliate incurred losses exceeding its shareholders' equity. The Company records its share in the affiliate's loss up to the Company's investment in the affiliate, including guarantees or subordinated loans granted to the affiliate.

Note 2 - Significant Accounting Policies (cont'd)**O. Monetary balances stated at present value**

Monetary balances – long-term debts and liabilities - that are interest free or bear interest at below-market rates, are stated at their present value, computed using the interest rate prevailing in the market on the date created.

P. Fixed assets, net

1. Fixed assets are stated at cost.
2. Financing expenses on loans and credit used to finance the construction or purchase of fixed assets, and other costs related to the purchase or construction of the fixed assets, are capitalized to the cost of these assets, in accordance with Accounting Standard No. 3 on the Capitalization of Finance Costs.
3. The cost of assets for which an investment grant was received is stated net of the grant amount.
4. Improvements and renovations are charged to the cost of assets, whereas repair and maintenance expenses are charged to the statement of operations as incurred.
5. The annual depreciation rates used are as follows:

	%	
Buildings and leasehold rights	2-10	(mainly 2%)
Machinery and equipment	5-20	(mainly 10%)
Vehicles	10-20	(mainly 15%)
Office furniture and equipment	6-33	(mainly 6% and 25%)
Computers and auxiliary equipment	20-33	
Leasehold improvements	10*	

* or the lease period, whichever is lower.

Q. Intangible assets and deferred expenses

Deferred expenses are amortized on a straight-line basis over the expected period of benefit therefrom. The remaining expected benefit period is examined each year.

See Note 2E(6) regarding goodwill deriving from the acquisition of companies that were consolidated.

R. Issuance of securities

1. Issuance of bundled securities -

Proceeds in respect of the issuance of bundled securities were allocated to the component securities according to their relative fair values. Issue costs were allocated to the securities according to the relative fair values of the securities issued.

Note 2 - Significant Accounting Policies (cont'd)**R. Issuance of securities (cont'd)**2. Issuance of stock options -

Amounts received in respect of stock options that grant the option holder the right to purchase a fixed number of shares of the Company in consideration for a fixed amount in cash, are presented within shareholders' equity. Until December 31, 2007, consideration that is linked to the CPI is deemed to be fixed, based on Standard 22.

3. Debenture issue costs -

Debenture issue costs are presented as an offset from the debentures and are amortized in accordance with the effective interest rate method during the debenture period. Issue costs allocated to the equity component of bundled securities are offset from the equity component.

4. Share-Based Payments -

As from January 1, 2006, the Company implements Accounting Standard No. 24, "Share-Based Payments" (hereinafter – the Standard) of the IASB. In accordance with the provisions of the Standard, the Company recognizes share-based payment transactions in the financial statements, including transactions with employees or other parties that are settled by equity instruments, cash or other assets. Share-based payment transactions in which goods or services are received are recognized at their fair value.

With respect to transactions settled by equity instruments, the Standard applies to grants executed after March 15, 2005 that had not yet vested by January 1, 2006. Similarly, the Standard applies to changes in the terms of share-based payment transactions being settled by means of equity instruments that were executed after March 15, 2005, even if the changes in terms relate to grants that were executed before that date. In the financial statements of 2006, comparative data for 2005 are restated in order to reflect therein the compensation expenses relating to the said grants.

The Company records compensation expenses, with a corresponding increase in shareholders' equity in respect of stock options granted to employees and directors over the vesting period of the stock options. The compensation expenses were calculated according to the Black & Scholes model on the grant date. The compensation expenses are recorded over the vesting period of the options, in accordance with the Company's estimation of the number of options expected to vest.

As a result of the first-time implementation of the provisions of the Standard, the Company adjusted by means of a restatement of the financial statements for the year ended December 31, 2005, in order to retroactively reflect therein the effect of the change in the accounting treatment of share-based payment transactions with employees and directors that are to be settled with equity instruments of the Company and of investee companies and that were granted after March 15, 2005, and which had not yet vested by December 31, 2005, or which were granted prior to March 15, 2005 and in respect of which there was a change in the terms of their grant, as well as in the respect of options granted to employees and directors settled in cash.

Notes to the Financial Statements for the year ended December 31, 2006

Note 2 - Significant Accounting Policies (cont'd)

R. Issuance of securities (cont'd)

4. Share-Based Payments (cont'd)

Set forth below is the effect of the changes on the financial statements:

	<u>As at December 31, 2005</u>		
	<u>As previously reported</u>	<u>Changes</u>	<u>As presented in the financial statements</u>
	N I S	t h o u s a n d s	
Investment in affiliates	2,668,193	(4,173)	2,664,020
Shareholders' equity	2,482,607	(4,173)	2,478,434
	<u>For the year ended December 31, 2005</u>		
	<u>As previously reported</u>	<u>Changes</u>	<u>As presented in the financial statements</u>
	N I S	t h o u s a n d s	
Group's equity in the operating results of investee companies, net	363,535	(4,173)	359,362
Administrative and general expenses	163,964	1,389	165,353
Net earnings	313,159	(5,562)	307,597

S. **Deferred taxes**

As of January 1, 2005 the Company applies Accounting Standard No. 19, "Taxes on Income" ("the Standard"). The Standard was adopted as a cumulative effect of a change in accounting method. The transition to Accounting Standard No. 19 resulted in a one-time effect of a net decrease in net earnings of NIS 3 million derived mainly from an increase in liabilities for deferred taxes relating to property.

The Group companies create deferred taxes in respect of temporary differences. The temporary differences are differences in the value of assets and liabilities for tax purposes and for financial reporting purposes. Allocation of the taxes, as stated, is executed with respect to the differences relating to assets, the amortization of which is deductible for tax purposes.

The deferred tax balances (asset or liability) are calculated according to the liability approach, i.e., the tax rates expected to be in force when the deferred tax liability is utilized, or when the deferred tax asset is realized, as they are known on the date of the financial statements.

In calculating deferred taxes, no account was taken of the taxes, which would apply in a case of sale of the investments in the investee companies, since it is the intention of the Company to hold these investments and not to sell them.

Deferred taxes were not created for taxes to be imposed on earnings distributed by subsidiaries, as it is the Group's policy not to distribute taxable dividends in the foreseeable future.

Likewise, tax benefits are not included in respect of temporary differences, the realization of which is doubtful.

Note 2 - Significant Accounting Policies (cont'd)**T. Revenue recognition**1. Sale of products and providing services

Revenues from sales and services are recognized upon delivery or shipment of the products and transfer of the risks and rewards involved in ownership of the products, or upon performance of the services.

Revenue from the sale of products that require customer acceptance are recognized after the work is performed and acceptance tests are passed, as prescribed in the product supply contract.

Revenues from sales of products to distributors are recorded at the time it is probable that the products will be sold to end users, subject to the conditions detailed in Section 1, above.

2. Revenues from long-term contracts

The revenues and costs from projects in progress under long-term contracts are recognized in accordance with Accounting Standard No. 4 ("Standard 4") published by the IASB, as follows:

a. Revenues and costs from projects in progress under long-term contracts are recognized according to the "percentage of completion" method, if all of the following conditions are fulfilled: the revenues are known or can be reliably estimated, the collection of the revenues is expected, the costs involved with execution of the work are known or capable of being reliably estimated, there is no material uncertainty regarding the ability to complete the work and comply with the contractual terms with the customer and the percentage of completion can be reliably estimated.

As long as all of the above conditions are not met, income is recognized at the level of the costs incurred and their recovery is probable ("zero margin").

b. The percentage of completion is measured on the basis of cost (the ratio of the costs incurred to the total estimated costs) or on the basis of supply of the products, in accordance with the nature of the agreement.

c. Anticipated losses on contracts are provided for in full when determined to be expected.

d. Estimated profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original forecast.

The effects of such changes in estimates are recognized in the statement of operations at the time they are identified.

3. Interest and dividend income

Interest income in respect of debentures and loans is recorded in the statement of operations on an accrual basis according to the effective interest method. Dividend income is recorded in the statement of operations on the date the Company is eligible for the dividend.

4. Sales with deferred payment conditions

Sales with deferred payment conditions that include a financing transaction are recorded according to their present value, and the difference between the present value of the transaction and the proceeds is recorded in the statement of operations as financing income, according to the effective interest method.

Note 2 - Significant Accounting Policies (cont'd)**T. Revenue recognition (cont'd)**5. Reporting of revenues on a gross basis or a net basis

The Company implements Clarification 8 of the IASB, "Reporting of Revenues on a Gross Basis or on a Net Basis" in determining whether to report revenues on a gross basis (as a primary vendor) or on a net basis (as an agent). According to Clarification 8, an entity that acts as an agent without bearing the risks and rewards of the transaction is required to present its revenues on a net basis. An entity that acts as a primary vendor and bears the risks and rewards of the transaction is required to present its revenues on a gross basis. Clarification 8 prescribes a number of indicators that the Company considers in determining whether to present its revenues on a gross basis or a net basis.

U. Research and development expenses:1. Research and development costs

Research and development costs, net of participations (mainly from the Government of Israel), are charged to the statement of operations as incurred. Research and development costs financed by the customer are charged to the cost of projects in progress, and are included in the statement of operations as part of the recognition of results from such projects.

2. In-process research and development costs

In a business acquisition, in-process research and development expenses are charged to the statement of operations immediately.

V. Derivative financial instruments:

The Group companies enter into option and forward contracts that are intended to reduce the financial risks (i.e. commitments for the import of raw materials, export of products, liabilities linked to the CPI or foreign currency) from the exposure to fluctuations in inter-currency exchange rates, interest rates and changes in the CPI.

The results of financial derivatives held to hedge existing assets and liabilities are recorded in the statement of operations concurrently with the recording of the results of the hedged assets and liabilities.

Financial derivatives that are not held for hedging are stated in the balance sheet at fair value. Changes in the fair value are included in the statement of operations in the period they occur.

The fair value of derivative financial instruments is determined according to their market values, stated quotes from financial institutions, and in the absence of such, fair value is determined based on valuation models.

W. Earnings per share:

As from January 1, 2006, the Company implements Accounting Standard No. 21, "Earnings per Share" (hereinafter – the Standard) of the IASB. In accordance with the provisions of the Standard, the Company calculates basic earnings per share with respect to earnings or loss, and basic earnings per share with respect to earnings or loss from continuing operations, which is attributable to the ordinary shareholders. The basic earning per share is calculated by dividing the earnings or loss attributable to the ordinary shareholders with the weighted average number of ordinary shares outstanding during the period. In order

Note 2 - Significant Accounting Policies (cont'd)**W. Earnings per share (cont'd)**

to calculate the diluted earnings per share the Company adjusts the earnings or loss attributable to the ordinary shareholders, and the weighted average number of outstanding ordinary shares, in respect of the effects of all the dilutive potential ordinary shares. The Company's share in the earnings of investee companies was calculated according to its share in the earnings per share of such investee companies multiplied by the number of shares held by the Company.

In accordance with the transitional provisions of the Standard, the comparative data regarding the earnings (loss) per share for prior periods were restated.

The effects of the initial implementation of the Standard (including the effect of Standard No. 24 - see Note 2R(4)) amounted to increases in the basic earnings per share of NIS 0.473 and NIS 0.123 for the years ended December 31, 2005 and 2004, respectively, and decreases in the diluted net earnings per share in the amounts of NIS 2.262 and NIS 2.268 for the year ended December 31, 2005 and 2004 respectively.

X. Dividend declared subsequent to balance sheet date

In accordance with Accounting Standard No. 7 on "Subsequent Events", the liability related to a dividend proposed or declared subsequent to the balance sheet date is expressed in the accounts only in the period in which it was declared. However, separate disclosure is provided in the statement of changes in shareholders' equity of the dividend amount to be distributed against a reduction in the retained earnings balance.

Y. Segment reporting

Segment reporting is presented in accordance with Accounting Standard No. 11. See also Note 25.

Z. Discontinued operations

Discontinued operations are presented in accordance with Accounting Standard No. 8, whereby discontinued operations are presented separately from the data relating to continuing operations.

AA. Environmental costs

The current operating and maintenance costs of facilities to prevent environmental pollution and provisions for expected costs related to the rehabilitation of the environment deriving from current or past activities, are charged to the statement of operations. Construction costs of facilities for prevention of environmental pollution, which increase the economic life or efficiency of the facility or reduce or prevent environmental pollution, are charged to the cost of the fixed assets and are depreciated in accordance with the depreciation policies practiced by the Group.

AB. Impairment of assets

The Group applies Accounting Standard No. 15 – Impairment of Assets ("the Standard"), which prescribes procedures that the Group must implement in order to assure that its assets in the consolidated balance sheet are not stated at an amount exceeding their recoverable value, which is the higher of the net sales price or the usage value (the present value of the estimated future cash flows expected to derive from the use and realization of the asset).

Note 2 - Significant Accounting Policies (cont'd)**AB. Impairment of assets (cont'd)**

The Standard applies to all of the assets in the consolidated balance sheet, except for tax assets, construction contracts and monetary assets (aside from monetary assets that are investments in investees that are not subsidiaries). Likewise, the Standard prescribes the presentation and disclosure principles for assets that have declined in value. When the carrying value of an asset in the consolidated balance sheet exceeds its recoverable amount, the Group recognizes an impairment loss equal to the difference between the book value of the asset and its recoverable value. A loss so recognized will be reversed only if changes have occurred in the estimates used in determining the recoverable value of the asset since the date on which the last impairment loss was recognized.

In September 2003 the IASB published Clarification 1 regarding the accounting treatment of an impairment in the value of an affiliate. Clarification 1 stipulates that in reporting periods subsequent to the period in which the impairment was initially recorded, the investment in the affiliate will be presented according to the lower of its recoverable value and the equity basis thereof. The recoverable value is calculated during each period in which there are indications that a change has taken place in the recoverable value. Impairment losses recorded or reversed during the period are presented as the Company's equity in operating results of investee companies, net.

In February 2005 the IASB published Clarification 6 regarding the accounting treatment of an impairment in the value of an affiliate. Clarification 6 stipulates that the recoverable value be calculated in respect of each cash-generating unit or in respect of the identified assets of the affiliate, in respect of which there are indications that an impairment has occurred or that an impairment recorded in prior years has been reduced or no longer exists. The impairment or reversal thereof is determined from the perspective of the holding company.

Notes to the Financial Statements for the year ended December 31, 2006

Note 2 - Significant Accounting Policies (cont'd)

AC. Data regarding the CPI and the Dollar exchange rate:

		<u>Israeli CPI*</u>	<u>Exchange rate of one Dollar</u>
		<u>Points</u>	<u>NIS</u>
For the year ended:	December 2006	184.87	4.225
	December 2005	185.05	4.603
	December 2004	180.74	4.308
		<u>%</u>	<u>%</u>
Changes during:	2006	(0.1)	(8.2)
	2005	2.4	6.8
	2004	1.2	(1.6)

(*) According to the CPI for the month of the balance sheet date (1993 average basis = 100).

Assets and liabilities in foreign currency or linked thereto are included in the financial statements according to the representative exchange rate published by the Bank of Israel on the balance sheet date.

Assets and liabilities linked to the CPI are included in the financial statements according to the CPI of the balance sheet month, or the previous month, as relevant.

AD. Impact of new accounting standards prior to their application

1. Accounting Standard No. 29, "Adoption of International Financial Reporting Standards (IFRS)"

In July 2006, the IASB published Accounting Standard No. 29, "Adoption of International Financial Reporting Standards (IFRS) (hereinafter – "the Standard)". The Standard provides that entities that are subject to the Israeli Securities Law, 1968 and that are required to report in accordance with this Law's provisions, shall prepare their financial statements pursuant to IFRS Standards for periods commencing January 1, 2008. The Standard permits early adoption beginning with financial statements published after July 31, 2006.

Initial adoption of IFRS Standards is to be effected by means of application of the provisions of IFRS 1, "First-Time Application of IFRS Standards", for purposes of the transition.

In accordance with the Standard, the Company is required to include in a note to the annual financial statements as at December 31, 2007 the balance-sheet data as at December 31, 2007 and the income-statement data for the year then ended, after they have undergone application of the recognition, measurement and presentation rules of IFRS Standards.

The Company is examining the effect of the Standard on its financial statements and does not intend to implement the Standard earlier than required.

Note 2 - Significant Accounting Policies (cont'd)

AD. Impact of new accounting standards prior to their application (cont'd)

2. Accounting Standard No. 27, "Fixed Assets"

In September 2006 the IASB published Accounting Standard No. 27, "Fixed Assets" (hereinafter – the Standard). The Standard prescribes rules for the presentation, measurement and disposition of fixed assets and for the disclosure required in respect thereto. The Standard stipulates, inter alia, that upon the initial recognition of a fixed asset, the entity shall include in the cost of the item all the costs it will incur in respect of a liability to dismantle and remove the item and to restore the site on which it was located. Furthermore, the Standard stipulates that a group of similar fixed asset items shall be measured at cost net of accumulated depreciation, and less impairment losses, or alternatively, at its revalued amount less accumulated depreciation, whereas an increase in the value of the asset to above its initial cost as a result of the revaluation will be directly included the shareholders' equity under a revaluation reserve. Any part of a fixed asset item with a cost that is significant in relation to the total cost of the item shall be depreciated separately, including the costs of significant periodic examinations. The Standard also stipulates that a fixed asset that was purchased in consideration for another non-monetary item in a transaction of commercial substance shall be measured at fair value.

The Standard shall apply to financial statements for periods beginning on January 1, 2007. An entity that on January 1, 2007 chooses for the first time to use the revaluation method for measuring fixed assets shall on this date recognize a revaluation reserve in the amount of the difference between the revalued amount of the asset on that date and its book value. Furthermore, an entity that in the past, upon the initial recognition of a fixed asset, had not included in its cost the initial estimate of costs for dismantling and removing the asset and for restoring the site on which it is located, will measure the following:

- (a) The aforementioned liabilities as at January 1, 2007 should be measured in accordance with generally accepted accounting principles;
- (b) The amount that would have been included in the cost of the relevant asset on the date on which the liability was initially incurred should be measured according to the present value of the amount of the liability mentioned in item (a) above on the date on which the liability was initially incurred (hereinafter – the capitalized amount);
- (c) The accumulated depreciation on the capitalized amount as at January 1, 2007 should be measured on the basis of the useful life of the asset as at that date;
- (d) The difference between the amount to be charged to the asset in accordance with items (b) and (c) above, and the amount of the liability in accordance with item (a) above, shall be included in retained earnings.

Other than the aforementioned, the Standard will be adopted on a retrospective basis.

The Company is examining the effect of the Standard on its financial statements.

3. Accounting Standard No. 26, "Inventory"

In August 2006 the IASB published Accounting Standard No. 26, "Inventory" (hereinafter – the Standard). The Standard stipulates guidelines for determining the cost of inventory and its subsequent recognition as an expense as well as for determining impairment in value of inventory to its net realizable value. According to the Standard, inventory should be presented according to the lower of cost or net realizable value. The Standard also provides guidelines regarding cost formulas

Note 2 - Significant Accounting Policies (cont'd)**AD. Impact of new accounting standards prior to their application (cont'd)****3. Accounting Standard No. 26, "Inventory" (cont'd)**

used to allocate costs to various types of inventory. The Standard will apply to financial statements for periods beginning on January 1, 2007 or thereafter. The Standard shall be applied retroactively by restating comparative amounts in respect of prior periods.

The Company expects that implementation of the Standard will not have a material impact on its financial position or results of operations.

4. Accounting Standard No. 23, "Accounting for Transactions Between an Entity and its Controlling Shareholder"

In December 2006 the IASB published Accounting Standard No. 23, "Accounting for Transactions Between an Entity and its Controlling Shareholder" (hereinafter – the Standard). The Standard effectively supersedes the main provisions of Israeli Securities Regulations (Presentation of Transactions Between a Company and its Controlling Shareholder), and provides that assets (excluding intangible assets that do not have an active market) and liabilities in respect of which a transaction has taken place between the entity and its controlling shareholder will be measured according to fair value on the transaction date and the difference between the fair value and the consideration received in the transaction will be recorded within shareholders' equity. A debit amount is essentially a dividend and will therefore be recorded as a reduction of retained earnings. A credit amount is essentially an investment by the shareholder and will therefore be recorded as a separate item within shareholders' equity, "Capital reserve from transactions between the entity and its controlling shareholder".

The Standard addresses three issues pertaining to transactions between an entity and its controlling shareholder: transfer of an asset from the controlling shareholder to the entity or transfer of an asset from the entity to the controlling shareholder; assumption, fully or partially, by the controlling shareholder of a liability that the entity has to a third party, indemnification from the controlling shareholder to the entity in respect of an expense, concession, fully or partially, by the controlling shareholder of an amount owed to him by the entity; and loans granted to or by the controlling shareholder. Furthermore, the Standard provides the disclosure required in financial statements pertaining to transactions between the entity and its controlling shareholder during the period.

The Standard will apply to transactions between an entity and its controlling shareholder occurring as of January 1, 2007 or thereafter, as well as to loans granted prior to the inception of the Standard to or by the controlling shareholder, as of the date of its inception.

The impact of the Standard will be reflected in future reporting periods and is not expected to be material.

5. Accounting Standard No. 16, "Investment Property"

In February 2006, the IASB published Accounting Standard No. 16, "Investment Property" (hereinafter – the Standard). The Standard prescribes rules for recognition, measurement and disposition of investment property and for the disclosure required in respect thereto.

The Standard stipulates, inter-alia, that the initial measurement of investment property be according to cost, including transaction costs. Furthermore the Standard stipulates that in subsequent periods the entity should choose to measure all of its investment property, either according to cost, after deduction of accumulated depreciation and impairment losses, or according to fair value, in which case adjustments to fair value shall be recorded in the statement of operations.

Note 2 - Significant Accounting Policies (cont'd)**AD. Impact of new accounting standards prior to their application (cont'd)****5. Accounting Standard No. 16, "Investment Property" (cont'd)**

The Standard shall apply to financial statements for periods beginning on January 1, 2007.

An entity that on January 1, 2007 chooses for the first time to use the fair value model for measuring its investment property, shall record the difference between the fair value of the investment property and its book value as an adjustment to the opening balance of retained earnings.

An entity that chooses the cost mode shall apply the rules of the Standard retroactively. Furthermore, an entity that chooses the cost model and intends to adopt one or more of the reliefs set forth in IFRS 1, "Initial adoption of International Financial Reporting Standards concerning investment property", may adopt the relief in its financial statements for periods beginning on January 1, 2007.

The Company is examining the effect of the Standard on its financial statements.

Note 3 - Information Regarding Certain Investees**A. ECI Telecom Ltd. ("ECI") – an affiliate**

1. Due to the fact that the financial statements of an affiliated company are not made available to ECI on a timely basis that would enable ECI to apply the equity method of accounting, starting from the second quarter of 2006, the proportionate share of the results of operations of this investee company are included in ECI's consolidated financial statements with a three month lag.
Under Israeli GAAP a change in accounting principle is treated by presenting the cumulative effect of the accounting change as of the beginning of the year, however as the change in accounting principle did not have a material impact on Koor's financial position or results of operations, Koor has not presented the cumulative effect as of the beginning of the year and has recorded the impact thereof in the amount of \$ 0.4 million in the second quarter of 2006.
On March 1, 2007, the affiliated company filed a third amendment to its S-1 Registration Statement with the SEC relating to its proposed initial public offering in which ECI may also sell shares. The affiliated company originally filed its S-1 Registration Statement with the SEC on October 20, 2006. The number of shares to be offered and the price range for the offering have not yet been determined. The registration statement has been filed with the SEC but has not yet become effective.
2. In February 2005, ECI entered into a preliminary agreement with ABN Amro Bank ("ABN") to sell the balance of long-term receivables for the sum of \$96 million in cash, plus potentially a further amount of approximately \$3.3 million. In April 2005, all the approvals for the sale were obtained and the receivables were sold to ABN. As a result, during the second quarter of 2005, ECI recognized a net gain of \$10.4 million (excluding the contingent amount). The Company's share in this gain is approximately NIS 14 million.
3. On June 3, 2005, ECI acquired 100% of Laurel Networks Inc., a company incorporated and operating in the U.S., for a cash payment of \$88 million.

Notes to the Financial Statements for the year ended December 31, 2006

Note 3 - Information Regarding Certain Investees (cont'd)**A. ECI Telecom Ltd. ("ECI") – an affiliate (cont'd)**

4. Pursuant to a resolution of ECI's Board of Directors approved in June 2006, ECI distributed 2.9 million shares of ECTel Ltd. ("ECTel") to ECI's shareholders of record as of June 29, 2006. These shares constituted approximately 15.9% of ECTel's outstanding shares. Koor received 815,660 ECTel shares in this distribution.

These shares, combined with ECTel shares distributed as dividend by ECI in May 2004 and ECTel shares purchased from an affiliate, Telrad Networks Ltd., in December 2005, provide the Company with significant influence over ECTel and accordingly the Company's investment in ECTel is accounted for according to the equity method as of the third quarter of 2006.

5. ECI prepares its financial statements in conformity with U.S. generally accepted accounting principles. Below is the adjustment of the net earnings of ECI as reported in accordance with U.S. GAAP to net earnings (loss) in accordance with Israeli GAAP:

	For the year ended December 31		
	2 0 0 6	2 0 0 5	2 0 0 4
	U S \$ t h o u s a n d s		
Net earnings of ECI as reported in conformity with U.S. GAAP	22,095	39,864	10,153
Adjustment:			
Share-based payments expenses	786	(2,195) *	-
ECI's equity in results of affiliate (See Note 3A(1))	(1,704)	-	-
Financing income (expenses) from derivative financial instruments	(5,745)	19,226	(8,303)
Tax expenses	-	-	(1,529)
Amortization and realization of excess cost allocated to intangible assets	55	(2,726)	(1,233)
Gain (loss) on marketable securities	19	(212)	(1,282)
Distribution of available-for-sale securities as dividend-in-kind	(4,075)	-	-
Cumulative effect as of the beginning of the year of change in accounting method (See Note 3A(1))	1,704	-	-
Impairment in value of assets	-	-	968
Net earnings (loss) of ECI in conformity with Israeli GAAP	<u>13,135</u>	<u>53,957</u>	<u>(1,226)</u>

* Restated – See Note 2R(4)

Note 3 - Information Regarding Certain Investees (cont'd)**B. Makhteshim Agan Industries Ltd. ("M-A Industries") – an affiliate**

1. In January 2004, Koor sold 27 million shares of M-A Industries for approximately NIS 418 million. The resulting gain of NIS 160 million (before tax) is included in "other income (expenses), net". Additionally, as a result of this sale, Koor realized a tax asset of NIS 59 million which had been created in 2003, because of the expectation that carryforward tax losses would be utilized in the aforesaid sale.

As a result of this sale, and after the realization and conversion of convertible securities that were issued to the public and to employees, Koor's holding percentage in the voting rights of M-A Industries at December 31, 2004 was 38.6%.

Following the sale of the shares in January 2004, as a result of which Koor's holding percentage in the shares of M-A Industries fell below 50%, Koor evaluated the existence of effective control in M-A Industries and the resultant continuation of the consolidation of M-A Industries in the financial statements of Koor, beginning from the first quarter of 2004.

In the opinion of Koor's management, the range of circumstances that weight Koor's shareholding percentage in M-A Industries, the broad dispersal of voting rights among the other shareholders, the low level of shareholding by the other shareholders, the slim probability of the creation of a block of votes opposing Koor at shareholder meetings and past experience related to the attendance at shareholder meetings, as well as the voting percentages and opposition at the meetings – showed that the economic substance that stood and continued to stand at the basis of the relationship between the Company and M-A Industries immediately before and after the said transactions demonstrated effective control, i.e., Koor had the ability to set the financial and operational policies of M-A Industries.

2. In February 2005, Koor sold 15.9 million shares of M-A Industries for NIS 374 million. As a result of the sale, Koor's holding percentage in M-A Industries fell to 34.6% (fully diluted -28.6%) and Koor recorded a capital gain amounted to NIS 201 million (before tax), which is included in the item "other income (expenses), net". Likewise, a tax asset of NIS 69 million which had been created in 2004, because of the expectation that carryforward tax losses would be utilized, was realized as a result of this sale.

Following the sale of shares in February 2005, Koor's management reevaluated whether to continue to consolidate M-A Industries in the financial statements of Koor beginning from the first quarter of 2005.

As a result of the evaluation of the range of existing circumstances created as a result of the sale, Koor's management decided that continuing the consolidation of M-A Industries is not consistent with the economic substance.

Therefore, beginning from the first quarter of 2005, the consolidation of M-A Industries' financial statements in Koor's financial statements was ceased, and the investment is stated by the equity method.

Presented below are operating results data of M-A Industries:

	For the year ended December 31, 2004
	N I S t h o u s a n d s
Revenues	6,895,238
Operating costs and expenses	5,594,734

Note 3 - Information Regarding Certain Investees (cont'd)**B. Makhteshim Agan Industries Ltd. ("M-A Industries") – an affiliate (cont'd)**

3. On November 14, 2005, the board of directors of M-A Industries resolved to adopt a policy, whereby M-A Industries will act to buy back its shares in the amount of up to \$150 million.

The shares to be purchased will become dormant shares for as long as they will be held by M-A Industries.

As at the balance sheet date, M-A Industries holds 24,875,703 par value of its shares, representing approximately 5.4% of its total issued and paid-up share capital, in the amount of \$134 million. In August 2006, the board of directors of M-A Industries approved the termination of the buy-back policy, due to its completion.

4. During 2006, Koor purchased 35,297,993 shares of M-A Industries for an aggregate amount of NIS 818 million. Koor's holding in the voting rights of M-A Industries at December 31, 2006 was 39.6%.
5. Subsequent to the acquisition of shares of M-A Industries by Koor and by M-A Industries described in Note 3B(4) and Note 3B(3), respectively, ("the acquisition period") Koor's stake in M-A Industries has increased by 10.1% as follows: fourth quarter of 2005 – 0.8%; first quarter of 2006 – 0.7%; second quarter of 2006 – 1.9%; third quarter of 2006 – 6.7%.

Pursuant to the acquisition of shares, excess cost over book value in the amount of approximately \$113 million was derived ("excess cost"). The Company retained an independent valuation expert to prepare a valuation of M-A Industries for purposes of allocating the said excess cost in accordance with Accounting Standard No. 20. In order to allocate the excess cost derived on various dates, the Company received valuations of the tangible assets and liabilities, as well as the intangible assets of M-A Industries as of January 1, 2006, June 30, 2006 and August 18, 2006.

The independent valuation expert valued the tangible assets and liabilities, as well as the intangible assets of M-A Industries, as follows:

	<u>January 1, 2006</u>	<u>June 30, 2006</u>	<u>August 18, 2006</u>
	U S	\$	m i l l i o n
Current assets	1,184.6	1,320.6	1,305.3
Investments	22.7	26.6	42.0
Fixed assets and other assets, net	465.1	491.7	498.3
Short-term and long-term liabilities	(994.6)	(1,177.2)	(1,172.1)
Intangible assets			
Product registration	310.5	320.0	315.6
Customer relationship	513.6	513.3	460.3
Trademark	224.2	229.9	228.6
Product portfolio	94.7	94.4	89.3
In-process research and development	5.2	5.5	5.5
	<u>1,826.0</u>	<u>1,824.8</u>	<u>1,772.8</u>

Note 3 - Information Regarding Certain Investees (cont'd)**B. Makhteshim Agan Industries Ltd. ("M-A Industries") – an affiliate (cont'd)**

According to the purchase price allocation, the Company has allocated the excess cost to M-A Industries' tangible and intangible assets, as follows:

	US \$ million	Amortization method	Amortization period
Inventory	7.4		6 months
Intangible assets :			
Product registration	8.8	Over the period of future economic benefits	7 years
Customer relationship	29.2	Over the period of future economic benefits	15 years
Trademark	23.1	Over the period of future economic benefits	5 years
Product portfolio	9.2	Over the period of future economic benefits	15 years
In-process research and development	0.5	Upon acquisition	
Deferred taxes	(12.5)	According to the amortization of the related assets	
Goodwill	47.1		
	<u>112.8</u>		

In accordance with the abovementioned allocation of the excess cost, during 2006, the Company recorded amortization expenses in respect of the excess cost of NIS 34.3 million.

6. On September 28, 2004, M-A Industries entered into an agreement with Rabobank International for the sale of trade receivables in a securitization transaction. Under the terms of the securitization agreement, companies from M-A Industries Group sold their trade receivables to a foreign company established for this purpose and which is neither owned nor controlled by the M-A Industries Group ("the Purchasing Company"). The purchase of the trade receivables by the Purchasing Company is financed by an American company of the Rabobank International Group. This agreement replaces a previous agreement with Bank of America from 2001, which was similar in principle to the current agreement.

The maximum amount of financial resources expected to be made available to the Purchasing Company to purchase the trade receivables of the companies is \$250 million on a current basis, so that the proceeds received from the customers whose receivables have been sold will be used to purchase new trade receivables. Subsequent to the balance sheet date, the aforesaid maximum expected volume is \$275 million.

The period in which the companies will sell their trade receivables to the Purchasing Company will be one year from the closing date of the transaction. This period may be extended, with the consent of all the parties, for additional one-year periods, up to a maximum of four extensions.

On the date of purchasing the debt, the Purchasing Company will pay in cash the major part of the debt price. The balance of the debt price will be included in a subordinated capital note to be paid after the debt is collected. M-A Industries will bear all the losses sustained by the Purchasing Company as a result of the non payment of the trade receivables included in the securitization transaction up to the total balance of the subordinated note.

Note 3 - Information Regarding Certain Investees (cont'd)**B. Makhteshim Agan Industries Ltd. ("M-A Industries") – an affiliate (cont'd)**

The accounting treatment of the sale of trade receivables in a securitization transaction is the recognition of the sale of the trade receivables only for that part for which the control and risks were transferred finally and absolutely to the purchaser. Accordingly, the trade receivable balances included in the securitization transaction, for which the consideration of cash and/or non recourse liabilities was received, were written off. For the part of the trade receivables included in the securitization transaction which was not recognized as a sale, a subordinated note was recorded.

A loss from the sale of trade receivables is charged at the time of sale to the statement of operations. Under the terms of the agreement, M-A Industries undertook to meet certain financial covenants, mainly a ratio of liabilities to capital and profitability ratios. As at the balance sheet date, M-A Industries is in compliance with the covenants.

The balance of trade receivables sold for cash as at the balance sheet date amounted to \$176 million (December 31, 2005 – \$147 million). The balance of the subordinated note as at the balance sheet date amounted to \$65 million (December 31, 2005 - \$55 million).

7. On March 8, 2006, the board of directors of M-A Industries resolved to change its dividend policy such as beginning in the fourth quarter of 2005, M-A Industries will distribute dividends amounting to up to 50% of net earnings for the period.
In May 2006, M-A Industries' board of directors resolved to distribute a dividend of \$ 28.8 million that was paid on August 31, 2006. The Company's share of the dividend was NIS 42 million.
On March 12, 2007 the board of directors of M-A Industries resolved to rescind the abovementioned resolution regarding the dividend payment as a fixed percentage of net earnings. The board of directors will examine the possibility of distributing dividends and the amount thereof from time to time, in accordance with the investment policy and the needs of M-A Industries, and the existence of sufficient distributable earnings.
8. Acquisition of companies:
 - a. During 2006, M-A Industries, through wholly owned and controlled subsidiaries, acquired distribution companies and a manufacturing company at a total cost of approximately \$35.4 million.
The excess cost created as at acquisition date amounted to approximately \$14 million, of which approximately \$2.8 million was allocated to tangible and intangible assets and the remainder of approximately \$11.2 million was allocated to goodwill.
 - b. During 2005, M-A Industries, through wholly owned and controlled subsidiaries, acquired distribution companies at a total cost of approximately \$22.3 million.
The excess cost created as at acquisition date amounted to approximately \$14.7 million, of which approximately \$9 million was allocated to intangible assets, approximately \$0.5 million was allocated to inventory and the remainder of approximately \$5.2 million was allocated to goodwill.
 - c. During 2004, M-A Industries, through wholly owned and controlled subsidiaries, acquired distribution companies at a total cost of approximately \$108 million.
The excess cost created as at acquisition date amounted to approximately \$82.5 million, of which approximately \$43.4 million was allocated to intangible assets, approximately \$4 million was allocated to deferred tax liabilities, approximately \$1.3 million was allocated to inventory and the remainder of approximately \$41.8 million was allocated to goodwill.

Note 3 - Information Regarding Certain Investees (cont'd)**B. Makhteshim Agan Industries Ltd. ("M-A Industries") – an affiliate (cont'd)**

9. On March 8, 2005, the board of directors of M-A Industries resolved to adopt a new option plan for its officers and employees and those of its subsidiaries. Under the terms of the plan, on March 14, 2005, 14,900 thousand stock options were allotted, exercisable for up to 14,900 thousand ordinary shares of par value NIS 1 of M-A Industries. Of these, 2,500 thousand options were deposited with a trustee for future distribution. On March 8, 2006, the board of directors of M-A Industries resolved to issue the balance of the abovementioned options to employees. The fair value of the stock options granted is approximately \$3.7 million.

In November and December 2006, M-A Industries' Board of Directors decided to issue 3,551,500 options to its new CEO, certain of its officers and an external director. The cost of the benefit embedded in the options issued, based on the fair value as at their issuance date amounted to a total of \$5.4 million.

10. Seasonality

Sales of crop protection products are directly dependent on the agricultural seasons and the cycle of crop production. Therefore, M-A Industries' revenues are not distributed evenly throughout the year. Countries in the Northern Hemisphere are characterized by similar timing of the agricultural seasons and the highest sales to these countries usually take place during the months February-April. The seasonality in the Southern Hemisphere is opposite and most of the sales take place during the months August-November, with the exception of Australia where most of the sales take place in April-July. M-A Industries' worldwide activities are conducive to balancing the seasonality impact even though M-A Industries has higher sales in the Northern Hemisphere.

11. Reorganization Plan

On March 12, 2007, the Board of Directors of M-A Industries approved commencement of a reorganization plan for M-A Industries, based on recommendations of internal teams assisted by the McKinsey research and consulting company. In the estimation of M-A Industries' management, the write-offs and costs, to the extent required, in connection with implementation of the reorganization plan, will not be material.

C. Telrad Networks Ltd. ("Telrad") – an affiliate

1. In September 2004, Koor and Telrad Holdings Ltd., a wholly-owned subsidiary of Koor ("the Koor group"), entered into an agreement for the sale of 39% of the shares of Telrad to Fortissimo Capital Fund GP L.P. ("Fortissimo").

This sale was executed in two stages.

In the first stage, which was completed in November 2004, the Koor group transferred 19.5% of Telrad's shares to Fortissimo for \$10.5 million. According to the sale agreement, Telrad's board of directors shall be comprised of three directors nominated by Koor, three directors nominated by Fortissimo and an external expert nominated by mutual agreement of the parties.

Note 3 - Information Regarding Certain Investees (cont'd)**C. Telrad Networks Ltd. ("Telrad") – an affiliate (cont'd)**

The agreement includes a number of matters, the approval of which requires mutual agreement of the Koor group and Fortissimo ("joint control rights"). The agreement included the granting of Fortissimo with joint control rights, as Fortissimo is a strategic investor who will assist the Koor Group with the active management of Telrad and bring about its recovery. The joint control rights were granted upon completion of the first stage of the transaction as from the outset, the intention of the parties was the sale of 39% of Telrad's shares, and the agreement stipulated that the second closing would take place within a relatively short period from the first closing (180 days). These matters include: approval of Telrad's budget, election of Telrad's executive officers and the remuneration thereof and the distribution of dividends. These rights grant Fortissimo (the minority shareholder) the right to participate actively in significant decisions relating to Telrad's ordinary course of business and therefore prevent the Koor group, the majority shareholder, from having control of Telrad, and require mutual agreement of Koor and Fortissimo in decisions crucial to Telrad's operations.

Therefore, as of the fourth quarter of 2004 and through the end of the second quarter of 2005, Telrad was proportionately consolidated in Koor's financial statements according to a shareholding of 80.5%.

On June 22, 2005 ("the completion date") the Company completed the second stage of the sale of 19.5% of Telrad's shares, after certain changes were made to the original agreement. According to the amendment to the original agreement, the international investment fund HarbourVest and the Israeli investment fund Poalim Ventures joined Fortissimo and together purchased 19.5% of Telrad's shares for \$6.25 million. Furthermore, in the amendment to the agreement, Koor's obligation to extend an additional loan to Telrad was cancelled, and Koor was released from certain of the indemnifications granted to Fortissimo under the original agreement. Subsequent to the sale, the Koor group's shareholding in Telrad decreased to 61% and a capital gain of approximately NIS 4 million was recorded.

The rights granted to Fortissimo under the original agreement described above, whereby mutual agreement of the Koor group and Fortissimo is required on significant matters relating to Telrad's ordinary course of business, are still in effect. However, due to the presence of two additional shareholders who are not party to these rights, the proportionate consolidation of Telrad has been discontinued as of the completion date. Beginning the end of the second quarter of 2005, Koor's investment in Telrad is presented according to the equity method.

Below are the operating results data of Telrad as included in Koor's financial statements:

	For the six months ended June 30, 2005	For the year ended December 31, 2004
	N I S t h o u s a n d s	
	(A u d i t e d)	
Revenues	177,631	470,252
Operating costs and expenses	201,179	531,369

Note 3 - Information Regarding Certain Investees (cont'd)**C. Telrad Networks Ltd. ("Telrad") – an affiliate (cont'd)**

2. During 2004, Telrad recorded a valuation allowance in the amount of NIS 67 million due to changes in the management's estimation relating to the probability of the realization of carry forward losses for tax purposes.
3. In 2004, Telrad's board of directors approved a reorganization plan that included employee layoffs. In the 2005 financial statements, expenses in the amount of NIS 38 million were recorded under the item "other income (expenses), net" (in 2004 – NIS 29 million).
In 2006, Telrad's Board of Directors approved a reorganization program which includes various efficiency measures including, inter alia, the retirement of employees. The financial statements for 2006 include Koor's share in these employee retirement expenses in the amount of NIS 38 million.
4. In November 2005, the board of directors of Telrad resolved to sell the subsidiary Telrad Connegy Communication Inc. Therefore, Telrad Connegy was classified as a discontinued operation in Telrad's financial statements and Telrad recorded a loss in the amount of NIS 58 million. Koor's share in this loss was NIS 35 million included in "Group's equity in the operating results of investee companies, net".

D. Defense Electronics Segment

1. In November 2004, the Company acquired 33% of the shares of Tadiran Communications Ltd. ("Tadiran Communications") for approximately NIS 637 million (approximately \$144 million).
On December 27, 2004, and July 6, 2005 Koor entered into a series of agreements with Elbit Systems Ltd. ("Elbit") and with Federmann Enterprises Ltd. ("Federmann"). Under the terms of the agreements, Koor sold its entire holdings in Tadiran Communications to Elbit for \$146 million and recorded a capital gain of NIS 72 million. Concurrently, Koor acquired 7.7% of Elbit's share capital from Federmann for \$77.7 million.
The abovementioned agreements granted Koor the right to appoint 20% of the members of Elbit's board of directors. Koor announced that as long as it holds Elbit shares it will not invoke its right to appoint 20% of the Elbit directors and therefore Koor's investment in Elbit was stated by the cost method.
Furthermore, the agreement stipulated that Koor would sell to Elbit all of its holdings in Elisra (70%) for \$70 million and for additional consideration contingent on future insurance receipts in respect of a fire that occurred in the plants of Elisra's subsidiaries in 2001.
On November 30, 2005, after all the requisite approvals for closing the sale were received, the transaction was completed. The said sale generated a capital gain to Koor of NIS 148 million in respect of the sale of Elisra, which was recorded in the statement of operations in the fourth quarter of 2005. Moreover, as a result of the sale, the financial statements were reclassified, such that the operating results of Elisra and the capital gains generated from its sale were reported as discontinued operations.

Note 3 - Information Regarding Certain Investees (cont'd)**D. Defense Electronics Segment (cont'd)**

2. On November 22, 2006, the Company entered into an agreement for the sale of the majority of its investment in Elbit to Federmann for total consideration of approximately \$70 million, to be received in five equal quarterly installments, bearing interest according to the LIBOR rate. The first installment was received on November 27, 2006. The Company expects to record a capital gain of approximately \$12 million as a result of the transaction of which approximately \$3 million were recorded in 2006 and the remainder will be recorded in 2007. The Company did not record the entire gain in 2006 since the control over part of the transferred shares has not been surrendered. The shareholders' agreement entered into on December 27, 2004 and amended on July 6, 2005 between the Company and Federmann was nullified upon receipt of the first payment.

On December 5, 2006 the Company sold the remainder of its shares in Elbit Systems Ltd. in a block trade for total consideration of approximately NIS 112 million. The Company recorded capital gains of approximately NIS 24 million during the fourth quarter of 2006 in respect of the block trade.

E. Tourism Segment

1. Knafaim Holdings Ltd. ("Knafaim") – former affiliate

During the third and fourth quarters of 2004, the Company sold 19% of the shares of Knafaim for approximately NIS 144 million. As a result of the sale, the Company's shareholding in Knafaim decreased from approximately 28.3% to approximately 9% and the Company recorded a gain of approximately NIS 51 million. Accordingly, the investment in Knafaim is stated by the cost method, beginning from the date of the sale.

Pursuant to the requirements of Israel's anti-trust commissioner in connection with the acquisition of the Company's shares by Discount Investments Corp. Ltd. (see Note 26A), the Company is required to reduce its holding in Knafaim to 5% by July 2, 2007.

2. Sheraton-Moriah (Israel) Ltd. ("Sheraton-Moriah") – a former subsidiary

On December 17, 2006 the Company signed an agreement for the sale of its entire holding in Sheraton-Moriah to Azorim Development and Construction Co. Ltd. ("Azorim"), for total consideration of \$23.8 million. The sale is linked with the sale by a related party, Clal Tourism Ltd. ("Clal Tourism") to Azorim of its entire holdings (100%) in its subsidiaries Accor-Clal Israel Hotels (1995) Ltd. and Accor-Clal Israel Hotel Management Company Ltd., together with outstanding shareholders' loans (amounting to approx. \$16.7 million) and capital notes, for total consideration of \$44.2 million. Clal Tourism is wholly owned by IDB Development Corporation Ltd. ("IDBD"), which is the Company's ultimate parent, holding directly and through Discount Investment Corporation Ltd. approximately 52% of the Company's outstanding shares.

The closing date of the transaction is scheduled for April 9, 2007 (subject to each party's right to postpone this date by up to 90 days) and it is subject to several conditions precedent, inter alia, the receipt of all requisite corporate approvals of the parties (including the approval of the Company's shareholders, by the requisite majority applicable under law to a transaction in which a controlling shareholder has an interest) and the approvals of the Israel Antitrust Authority; the Investment Center at the Ministry of Industry, Trade and Labor; the Ministry of Tourism and the Israel Land Administration, if and as required.

Note 3 - Information Regarding Certain Investees (cont'd)**E. Tourism Segment (cont'd)**

The board of directors of Azorim approved the transaction on December 19, 2006 and on February 14 and February 28, 2007 the transaction was approved by the shareholders' meeting of the IDBD and of the Company, respectively. The approval of the Israel Antitrust Authority has also been received.

Furthermore, the closing of the transaction is subject to the approvals of the other shareholders of Sheraton Moriah as per the existing agreements among them; to the right of first offer of Starwood Hotels and Resorts Worldwide, Inc., a shareholder of Sheraton Moriah, with respect to the transaction; and provided there will not be a material adverse change in the terms under which credit is provided by financial institutions to the sold companies.

Azorim is also obligated to purchase Bank Hapoalim Ltd.'s holdings in Sheraton Moriah under the same conditions, mutatis mutandis, if Bank Hapoalim Ltd. exercises its tag along right with respect to the transaction.

The consideration due to the Company is payable in three installments: the first, in the amount of \$6.3 million, was received on December 21, 2006 and is presented within other liabilities; the second, in the amount of \$8.4 million, to be received by the closing date; and the remainder, in the amount of \$9.1 million, by March 27, 2008. In the event that the transaction will not be consummated by the closing date due to a breach of the agreement by Azorim, Koor will be entitled to retain the first installment as damages.

Upon the closing of the transaction, Koor will be released from guaranties that it provided to Sheraton Moriah, in the amount of approximately \$9.2 million.

Subsequent to the balance sheet date, Bank Hapolaim exercised its tag along right and Starwood reached an agreement with Azorim for the sale of its holdings in Sheraton-Moriah to Azorim.

Upon fulfillment of the various other conditions stipulated in the agreement, Sheraton-Moriah will be presented as a discontinued operation.

3. Isram Wholesale Tours and Travel Ltd. ("Isram")

Isram is a group tour operator, located primarily in the US, with international operations.

On December 28, 2006 the Company sold its entire holding in Isram for total consideration of \$1.26 million. The Company recorded a capital gain of approximately NIS 8 million in respect of the sale. Pursuant to the sale, Isram's operations have been presented as a discontinued operation. See Note 24(3).

F. Koor Corporate Venture Capital ("Koor CVC") – a consolidated partnership

1. In June 2004, Cisco Systems purchased all the shares of Riverhead Inc. from its shareholders for consideration of \$39 million. As a result, in 2004 Koor CVC recorded a gain of approximately NIS 17 million.
2. Koor CVC's management recorded impairment provisions in 2005 and 2004 of NIS 9 million and NIS 58 million, respectively.

Notes to the Financial Statements for the year ended December 31, 2006

Note 3 - Information Regarding Certain Investees (cont'd)**F. Koor Corporate Venture Capital ("Koor CVC") – a consolidated partnership (cont'd)**

3. In December 2005, one of Koor CVC's portfolio investments, Scopus, Video Networks Ltd. raised approximately \$31 million in an IPO. As a result, Koor CVC recorded a gain of approximately NIS 31 million. See also Note 28 – Events Subsequent to the Balance Sheet Date.
4. On November 27, 2006 a merger took place between one of Koor CVC's portfolio companies, Followap Inc. and NeuStar Inc. As a result of the merger, Koor CVC received consideration of approximately \$12 million in January 2007 and recorded a gain of approximately NIS 43 million.

G. Epsilon Investment House Ltd. – an affiliate

In January 2006, Koor signed an agreement for the acquisition of 50% of the issued and paid share capital, of Epsilon Investment House Ltd. ("Epsilon"). Epsilon is engaged in providing a wide range of financial services including portfolio management, mutual funds' management, underwriting, provident fund management and consulting in mergers and acquisitions.

The transaction was completed on April 11, 2006 after receipt of approvals under all applicable laws, including the approval of the Israeli capital market commissioner.

According to the agreement, Koor was allocated new shares, and also purchased shares from certain of the existing shareholders of Epsilon, for total consideration of NIS 106 million.

Subsequent to the acquisition of Epsilon's shares, excess cost in the amount of NIS 75 million was derived. Of the excess cost of the investment, NIS 10 million was allocated to intangible assets (trademark and customer base, product portfolio) and NIS 65 million was allocated to goodwill.

The Company's investment in Epsilon is accounted for according to the equity method, as there is no joint control agreement, as defined by Israeli accounting standards, between all of Epsilon's shareholders.

Note 4 - Short-Term Deposits and Investments

	Consolidated		Company	
	December 31		December 31	
	2 0 0 6	2 0 0 5	2 0 0 6	2 0 0 5
	N I S t h o u s a n d s			
Marketable securities ⁽¹⁾ :				
Linked debentures and treasury notes	190,964	198,123 *	178,015	179,269 *
Unlinked debentures and treasury notes	167,385	124,320	167,385	119,528
Shares and options	313,402	155,789	311,885	153,948
	671,751	478,232	657,285	452,745
Deposits in banks and financial institutions	24,180	52,564	-	32,398
Short-term loans and current maturities of long-term loans	-	33	-	-
	695,931	530,829	657,285	485,143

⁽¹⁾ Presented at market value, except for shares in investees in the amount of NIS 201,159 thousand that are presented according to the historical cost method (2005 – NIS 56,609 thousand).

* Reclassified.

Notes to the Financial Statements for the year ended December 31, 2006

Note 5 - Trade Receivables

Consolidated:

	December 31	
	2006	2005
	N I S t h o u s a n d s	
Open accounts	76,318	73,298
Post-dated checks received and credit card companies	4,799	3,974
Current maturities of long-term trade receivables	924	1,285
	<u>82,041</u>	<u>78,557</u>
Net of allowance for doubtful accounts	<u>4,106</u>	<u>3,517</u>

Note 6 - Other Receivables

	Consolidated		Company	
	December 31		December 31	
	2006	2005	2006	2005
	N I S	t h o	u s a n	d s
Receivable in respect of sold investments *	56,235	-	-	-
Government agencies	3,650	3,722	1,046	748
Deferred taxes	241	129	-	-
Accrued income	2,929	10,704	246	1,190
Prepaid expenses	6,200	10,993	-	3,263
Employees	60	43	-	-
Affiliates - current accounts	6,173	35,960 **	572	4,714
Others	6,968	17,916 **	646	6,180
	<u>82,456</u>	<u>79,467</u>	<u>2,510</u>	<u>16,095</u>

* See Note 3F(4).

** Reclassified.

Note 7 - Inventories

Consolidated:

	December 31	
	2006	2005
	N I S t h o u s a n d s	
Raw and auxiliary materials	50,793	66,169
Goods and work in progress	7,445	4,497
Finished goods	7,490	20,243
	<u>65,728</u>	<u>90,909</u>

Notes to the Financial Statements for the year ended December 31, 2006

Note 8 - Investments in Investee companies

A. Consolidated balance sheet - affiliates

	December 31	
	2006	2005
	N I S t h o u s a n d s	
Net asset value of the investments (1)(2)	2,700,520	2,516,674 *
Goodwill and original differences:		
Original amount	658,203	153,997
Less - accumulated amortization	(117,212)	(88,496)
	540,991	65,501
Total investment in share capital	3,241,511	2,582,175
Long-term loans (3)	82,709	81,845
	3,324,220	2,664,020
(1) As follows:		
Net asset value of investments as at January 1	2,516,674	839,741
Changes during the year:		
Companies that ceased being consolidated	-	1,499,387
Net asset value acquired	458,906	34,821
Accumulated earnings (losses), net	(52,788)	317,807 *
Changes in capital reserves and foreign currency translation adjustments	(215,495)	176,600
Disposals, net	(6,777)	(351,682)
	2,700,520	2,516,674
(2) Including investments in companies traded on the Stock Exchange in Tel Aviv or abroad, in NIS millions:		
Carrying value in the balance sheet	3,173	2,526
Market value as at balance sheet date	5,372	4,851

* Restated – See Note 2R(4).

	Interest rate as at December 31	December 31	
	2006	2006	2005
	%	N I S t h o u s a n d s	
(3) Linkage terms and interest rates relating to long-term loans:			
Linked to the CPI - without maturity date	5.5	26,707	24,792
Linked to the Dollar **	LIBOR* + 2	56,002	57,053
		82,709	81,845

* As of December 31, 2006, the LIBOR rate is 5.3%.

** The loan is to be repaid by 2029.

Notes to the Financial Statements for the year ended December 31, 2006

Note 8 - Investments in Investee companies (cont'd)

B. Company balance sheet - investees

	December 31	
	2 0 0 6	2 0 0 5
	N I S t h o u s a n d s	
Presented as:		
Investments in investees	2,579,219	2,962,192
Excess of accumulated losses over investments in subsidiaries	(56,583)	(47,580)
	<u>2,522,636</u>	<u>2,914,612</u>
Net asset value of the investments	<u>1,983,869</u>	<u>1,601,299 (*) (**)</u>
Goodwill and original differences:		
Original amount, net	467,316	12,834
Less - accumulated amortization	(26,078)	(3,546)
	<u>441,238</u>	<u>9,288</u>
Book value (1)	2,425,107	1,610,587
Payments on account of shares (1)	58,830	60,927
Long-term loans and capital notes (2)	36,477	1,240,583
Non-current accounts (3)	2,222	2,515
	<u>2,522,636</u>	<u>2,914,612</u>

(1) As follows:

	December 31	
	2 0 0 6	2 0 0 5
	N I S t h o u s a n d s	
Cost of shares including accumulated earnings as at January 1	1,671,514	2,289,547
Changes during the year:		
Cost of acquired shares	1,628,617	70,028
Accumulated earnings (losses), net	(550,813)	95,035 (*)
Changes in capital reserves and foreign currency translation adjustments	(235,386)	208,657
Disposals	(29,995)	(991,753)
Book value, including payments on account of shares (4)	<u>2,483,937</u>	<u>1,671,514</u>

(*) Restated – See Note 2R(4).

(**) Reclassified.

Notes to the Financial Statements for the year ended December 31, 2006

Note 8 - Investments in Investee companies (cont'd)

B. Company balance sheet – investees (cont'd)

(2) Long-term loans and capital notes:

	December 31	
	2 0 0 6	2 0 0 5
	N I S t h o u s a n d s	
Long-term loans (a) (b)	21,177	52,854
Capital notes - unlinked and not bearing interest (c)	15,300	1,187,729
	<u>36,477</u>	<u>1,240,583</u>

(a) Long-term loans classified by linkage terms and interest rates:

	Interest rate at	December 31	December 31
	December 31	2 0 0 6	2 0 0 5
	2 0 0 5	N I S t h o u s a n d s	
	%		
Linked to the Dollar	-	13,952	-
Linked to the CPI	2	-	43,707
Linked to the CPI	-	7,225	9,147
		<u>21,177</u>	<u>52,854</u>

(b) The loans mature in the years subsequent to the balance sheet date (excluding current maturities) as follows:

	December 31	December 31
	2 0 0 6	2 0 0 5
	N I S t h o u s a n d s	
Sixth year or thereafter	21,177	52,854
	<u>21,177</u>	<u>52,854</u>

(c) Capital notes are not presented at their present value, since their repayment date has not yet been fixed by the parties.

(3) Non-current inter-company accounts:

	December 31	
	2 0 0 6	2 0 0 5
	N I S t h o u s a n d s	
Linked to the Dollar	154	640
Unlinked-bears interest at the rate of the increase in the CPI	2,068	1,875
	<u>2,222</u>	<u>2,515</u>

Notes to the Financial Statements for the year ended December 31, 2006

Note 8 - Investments in Investee companies (cont'd)**B. Company balance sheet – investees (cont'd)**

- (4) Including investments in marketable shares traded on the Tel Aviv Stock Exchange or abroad in NIS millions:

	December 31	
	2 0 0 6	2 0 0 5
	N I S m i l l i o n s	
Carrying value in balance sheet	748	-
Market value as at balance date	833	-

Note 9 - Other Investments and Receivables**A. Composition:**

	Consolidated		Company	
	December 31		December 31	
	2 0 0 6	2 0 0 5	2 0 0 6	2 0 0 5
	N I S t h o u s a n d s			
Debentures held-to-maturity	9,213	10,330 *	9,213	10,330 *
Deposits in banks and in financial institutions	7,706	13,459	-	-
Non-current trade receivables	6,449	3,802	-	-
Long-term loans receivable	16,734	23,745	-	-
Total (see B and C below)	40,102	51,336	9,213	10,330
Other companies - marketable securities (1)	46,927	386,364	46,927	353,001
Venture capital investments (2)	115,643	114,764	-	-
Excess of amounts funded over amounts accrued for severance pay (see Note 17)	-	3,449	-	3,449
Others	-	214	6,659	214
	<u>202,672</u>	<u>556,127</u>	<u>62,799</u>	<u>366,994</u>
(1) Market value as at balance sheet date	<u>42,385</u>	<u>411,472</u>	<u>42,385</u>	<u>364,197</u>

(2) The fair value is similar to the book value.

* Reclassified.

Notes to the Financial Statements for the year ended December 31, 2006

Note 9 - Other Investments and Receivables (cont'd)

B. Classification by linkage terms and interest rates of deposits, non - current debts of customers and long - term loans receivable:

Consolidated:

	Interest rates at December 31	December 31	
		2006	2005
		N I S t h o u s a n d s	
	%		
Linked to the CPI	Mainly 5.4	6,419	3,802
Linked to foreign currency (mainly to the dollar)	No interest	-	6,790 *
Linked to dollar, interest bearing	5.3 – 8.5	33,683	40,744 *
		40,102	51,336

* Reclassified

C. Repayment schedule of deposits, non-current customer balances and long-term loans receivable in the years subsequent to the balance sheet date:

	Consolidated		Company	
	December 31		December 31	
	2006	2005	2006	2005
	N I S t h o u s a n d s			
Second year	5,315	12,743	-	-
Third year	13,638	7,920	-	-
Fourth year	16,884	2,929	-	-
Fifth year and thereafter	4,265	27,744	-	-
	40,102	51,336	-	-

Notes to the Financial Statements for the year ended December 31, 2006

Note 10 - Fixed Assets

A. Consolidated

	Land (including leasehold land)	Buildings	Machinery and equipment	Vehicles	Office furniture and equipment	Tools and instruments	Total
	N	I	S	t	h	o	u
	s	a	n	d	s	a	n
	d	d	d	d	d	d	d
Cost as at January 1, 2006	31,224	1,028,779	381,342	629	15,224	3,167	1,460,365
Additions	-	11,943	15,635	417	1,411	-	29,406
Disposals	-	(5,294)	(94)	(580)	(2,111)	-	(8,079)
Adjustments resulting from foreign currency translation differences*	-	(507)	(1,914)	-	(798)	-	(3,219)
Newly consolidated companies	-	92,281	35,953	-	-	-	128,234
Balance as at December 31, 2006	31,224	1,127,202	430,922	466	13,726	3,167	1,606,707
Accumulated depreciation as at January 1, 2006	-	405,822	305,848	629	11,309	-	723,608
Additions	-	16,650	16,679	-	1,154	-	34,483
Disposals	-	(267)	-	(257)	(1,592)	-	(2,116)
Adjustments resulting from foreign currency translation differences*	-	(478)	(1,418)	-	(673)	-	(2,569)
Newly consolidated companies	-	53,141	32,975	-	-	-	86,116
Balance as at December 31, 2006	-	474,868	354,084	372	10,198	-	839,522
Write down for decline in value	-	(11,707)	-	-	-	-	(11,707)
Net book value as at December 31, 2006	31,224	640,627	76,838	94	3,528	3,167	755,478
Net book value as at December 31, 2005	31,224	611,250	75,494	-	3,915	3,167	725,050

* See Note 2D.

Notes to the Financial Statements for the year ended December 31, 2006**Note 10 - Fixed Assets (cont'd)****A. Consolidated (cont'd)**

1. Certain of the real estate properties have not yet been registered in the Land Registry Office in the name of the Group's subsidiaries, primarily due to the absence of formal parceling in the areas in which the properties are located.
Leasehold rights are generally for a period of 49 years. Certain leases provide an option for extension for another 49 years.
The cost of leasehold real estate as at December 31, 2006 is approximately NIS 547 million.
2. Fixed assets are presented after deduction of investment grants (net of depreciation), which have been received from the State of Israel by certain subsidiaries under the terms of the Law for the Encouragement of Capital Investments, 1959. These grants amount to NIS 115 million as at December 31, 2006 (see also Note 16A).
3. Includes capitalized interest amounting to NIS 55 million at December 31, 2006 and 2005.
4. As for amounts charged to cost of fixed assets, see Notes 23B and 23E.
5. See Note 22 regarding liens.

B. Company

	Offices and land	Office Equipment	Total
	N I S t h o u s a n d s		
Cost as at January 1, 2006	80,004 *	5,947	85,951
Additions	83	117	200
Disposals	(267)	(2,111)	(2,378)
Balance as at December 31, 2006	79,820	3,953	83,773
Accumulated depreciation as at January 1, 2006	8,421	3,456	11,877
Additions	1,453	452	1,905
Disposals	(267)	(1,592)	(1,859)
Balance as at December 31, 2006	9,607	2,316	11,923
Write down for decline in value	(11,707)	-	(11,707)
Net book value as at December 31, 2006	58,506	1,637	60,143
Net book value as at December 31, 2005	59,876	2,491	62,367

* Represents the ownership of two stories in an office building in Tel Aviv and well as a plot of land and manufacturing facility in Holon. The properties have not yet been registered in the name of the Company at the Land Registry Office. The offices are on land leased for a period of 49 years ending in 2044.

Notes to the Financial Statements for the year ended December 31, 2006**Note 11 - Intangible Assets, Deferred Expenses and Deferred Tax Assets****Consolidated**

	December 31	
	2 0 0 6	2 0 0 5
	N I S t h o u s a n d s	
<u>Goodwill:</u>		
Original amounts	17,735	566
Less - accumulated amortization	50	55
	<u>17,685</u>	<u>511</u>
<u>Deferred expenses:</u>		
Original amounts	16,865	16,940
Less - accumulated amortization	16,442	16,153
	<u>423</u>	<u>787</u>
Deferred tax assets (see Note 16G)	<u>-</u>	<u>14,518</u>
	<u><u>18,108</u></u>	<u><u>15,816</u></u>

Note 12 - Credit from Banks and Others**A. Composition:**

	Consolidated		Company	
	December 31		December 31	
	2 0 0 6	2 0 0 5	2 0 0 6	2 0 0 5
	N I S		t h o u s a n d s	
Credit from banks (B)	35,996	51,862	-	7,290
Current maturities of long-term loans and debentures (Note 15)	17,971	220,265	-	197,425
	<u>53,967</u>	<u>272,127</u>	<u>-</u>	<u>204,715</u>

Notes to the Financial Statements for the year ended December 31, 2006**Note 12 - Credit from Banks and Others (cont'd)****B. Credit from banks classified by linkage terms and interest rates:**

	Interest rates at December 31 2 0 0 6	Consolidated December 31	
	%	2 0 0 6	2 0 0 5
		N I S t h o u s a n d s	
Linked to foreign currency (mainly to the Dollar)	LIBOR + 1.5	29,575	27,618
Linked to foreign currency	6-7.5	6,421	24,244
		<u>35,996</u>	<u>51,862</u>
	Interest rates at December 31 2 0 0 5	Company December 31	
	%	2 0 0 6	2 0 0 5
		N I S t h o u s a n d s	
Linked to foreign currency	5.5	-	7,290
		<u>-</u>	<u>7,290</u>

C. See Note 22 regarding liens to secure credit.**Note 13 - Trade Payables**

	Consolidated		Company	
	December 31		December 31	
	2 0 0 6	2 0 0 5	2 0 0 6	2 0 0 5
	N I S t h o u s a n d s			
Open debts	61,179	59,875	266	558
Cheques and notes payable	6,666	11,215	1,080	665
	<u>67,845</u>	<u>71,090</u>	<u>1,346</u>	<u>1,223</u>

Notes to the Financial Statements for the year ended December 31, 2006**Note 14 - Other Payables**

	Consolidated		Company	
	December 31		December 31	
	2 0 0 6	2 0 0 5	2 0 0 6	2 0 0 5
	N I S	t h o	u s a n	d s
Employees and withholdings payable	16,711	20,529	2,314	9,403
Provision for vacation pay and vacation expense allowance	5,884	10,695	544	5,099
Accrued expenses	24,734	35,546	7,902	9,748 **
Government agencies (including taxes)	31,233	49,600	253	2,077 **
Provision for warranty and repairs and provision for losses in respect of long-term contracts	1,073	921	-	-
Severance pay payable and current portion of early retirement pensions (Note 17)	11,875	364	11,875	364
Deferred income	4,777	24,427	-	-
Affiliated company	2,197	12,349	21	-
Accrued interest	21,233	5,588	17,266	5,100 **
Liabilities regarding forward transactions	17,404	1,001	17,404	1,001
Advance on account of sale of subsidiary *	26,321	-	26,321	-
Others	27,693	36,968	11,988	15,215 **
	<u>191,135</u>	<u>197,988</u>	<u>95,888</u>	<u>48,007 **</u>

* See Note 3E(2).

** Reclassified

Notes to the Financial Statements for the year ended December 31, 2006

Note 15 - Long Term Liabilities

A. Loans

	Consolidated		Company	
	December 31		December 31	
	2006	2005	2006	2005
	N I S	t h o	u s a n	d s
1. Loans from banks	1,885,903	1,774,414	300,579	1,219,470
Less - current maturities	16,971	219,265	-	197,425
	<u>1,868,932</u>	<u>1,555,149</u>	<u>300,579</u>	<u>1,022,045</u>
2. Loans and liabilities from others:				
Shareholders in subsidiaries	7,669	7,691	-	-
Investees	-	-	6,382	6,713
Receipts from time-sharing units	33,193	34,107	-	-
Others	7,605	13,349	-	-
	<u>48,467</u>	<u>55,147</u>	<u>6,382</u>	<u>6,713</u>
Less - current maturities	1,000	1,000	-	-
	<u>47,467</u>	<u>54,147</u>	<u>6,382</u>	<u>6,713</u>
	<u>1,916,399</u>	<u>1,609,296</u>	<u>306,961</u>	<u>1,028,758</u>

3. Loans classified by linkage terms and interest rates:

Consolidated:

	Interest rate at December 31	December 31	
		2006	2005
		NIS thousands	
	%		
Linked to the foreign currency (mainly Dollar)	Mainly LIBOR + 1.75% – LIBOR +2.15%	259,947	253,996
Linked to the CPI	3.6-6.2 (mainly 4.4-4.8)	1,458,423	1,359,565
Unlinked	Prime* + 0.25% – Prime* + 0.5%	216,000	216,000
		<u>1,934,370</u>	<u>1,829,561</u>
Less - current maturities		17,971	220,265
		<u>1,916,399</u>	<u>1,609,296</u>

* Prime interest rate at December 31, 2006 - 6%

Notes to the Financial Statements for the year ended December 31, 2006**Note 15 - Long Term Liabilities (cont'd)****A. Loans (cont'd)**

3. Loans classified by linkage terms and interest rates (cont'd)

Company:

	Interest rate at December 31 2 0 0 6 %	December 31	
		2 0 0 6	2 0 0 5
		N I S t h o u s a n d s	
a. From banks:			
Linked to the CPI	4.8	292,070	1,210,200
Linked to the Dollar	7.65	8,509	9,270
		300,579	1,219,470
Less - current maturities		-	197,425
		300,579	1,022,045
		December 31	
		2 0 0 6	2 0 0 5
		N I S t h o u s a n d s	
b. From investees:		6,382	6,713
Unlinked capital note, non-interest bearing		6,382	6,713

B. DebenturesPresented as long-term liabilities:

	Consolidated		Company	
	December 31		December 31	
	2 0 0 6	2 0 0 5	2 0 0 6	2 0 0 5
	N I S t h o u s a n d s			
Debentures (1)(2)	988,482	390,854	988,482	390,854

- (1) On April 10, 2005, as part of a private placement to Israeli institutional investors, the Company issued NIS 400 million par value in debentures, as well as 800,000 options (see Note 20D) for NIS 400 million in cash.

The debentures bear annual interest of 3.75%, linked to the CPI, which is paid on April 30 and October 31 of each year. The debentures are linked to the CPI and will be repaid in a balloon payment on April 30, 2010. The issue proceeds were allocated to the components of the package according to the fair value of the securities issued. Accordingly, the discount in respect of the debentures amounted to approximately NIS 22 million which is being amortized as finance expenses over the life of the debentures. The debentures are presented net of the discount and deferred issue costs of approximately NIS 16 million.

Note 15 - Long Term Liabilities (cont'd)

B. Debentures (cont'd)

- (2) On August 20, 2006, pursuant to completion of a public offering in Israel the Company issued debentures with a par value of NIS 600 million. The debentures are linked to the Israeli CPI and bear annual interest of 5.1%. The debentures will be repaid in five equal installments on September 1 of each year from 2012 through 2016. The interest is payable on the outstanding balance of the debentures, on September 1 of each year from 2007 through 2016.

The debentures are presented net of deferred issue costs of approximately NIS 6 million which are amortized based on the effective interest rate method.

The Israeli Securities Authority and the Tel Aviv Stock Exchange approved the listing of the debentures for trading on the Tel Aviv Stock Exchange.

The debentures have not been and will not be registered under the US Securities Act of 1933, as amended, and may not be offered or sold in the United States or to U.S. persons, absent registration or an applicable exemption from registration requirements.

- C. See Note 18A3 regarding the Koor's commitment to comply with financial covenants.
See Note 22 regarding liens provided in connection with liabilities.

Notes to the Financial Statements for the year ended December 31, 2006

Note 15 - Long Term Liabilities (cont'd)

D. 1. Consolidated Liabilities - (net of current maturities) that will mature in the following years subsequent to balance sheet date are as follows:

	Loans from banks		Loans from others		Debentures		Total	
	December 31		December 31		December 31		December 31	
	2 0 0 6	2 0 0 5	2 0 0 6	2 0 0 5	2 0 0 6	2 0 0 5	2 0 0 6	2 0 0 5
			N I S		t h o		u s a n d s	
Second year	418,273	17,061	4,955	6,000	-	-	423,228	23,061
Third year	253,327	224,902	12,169	14,691	-	-	265,496	239,593
Fourth year	836,051	124,065	1,150	3,000	394,278	-	1,231,479	127,065
Fifth year	22,122	831,965	1,000	1,349	-	390,854	23,122	1,224,168
Sixth year	22,122	19,190	1,000	1,000	594,204	-	617,326	20,190
Subsequent years	317,037	337,966	27,193	28,107	-	-	344,230	366,073
	<u>1,868,932</u>	<u>1,555,149</u>	<u>47,467</u>	<u>54,147</u>	<u>988,482</u>	<u>390,854</u>	<u>2,904,881</u>	<u>2,000,150</u>

2. The Company Liabilities - (net of current maturities) that will mature in the following years subsequent to balance sheet date are as follows:

	Loans from banks		Loans and capital notes from investees		Debentures		Total	
	December 31		December 31		December 31		December 31	
	2 0 0 6	2 0 0 5	2 0 0 6	2 0 0 5	2 0 0 6	2 0 0 5	2 0 0 6	2 0 0 5
			N I S		t h o		u s a n d s	
Second year	179,182	-	-	-	-	-	179,182	-
Third year	121,397	100,000	-	-	-	-	121,397	100,000
Fourth year	-	109,270	-	-	394,278	-	394,278	109,270
Fifth year	-	812,775	-	-	-	390,854	-	1,203,629
Sixth year	-	-	-	-	594,204	-	594,204	-
Subsequent years	-	-	6,382	6,713	-	-	6,382	6,713
	<u>300,579</u>	<u>1,022,045</u>	<u>6,382</u>	<u>6,713</u>	<u>988,482</u>	<u>390,854</u>	<u>1,295,443</u>	<u>1,419,612</u>

3. See Note 22 for details of security pledged to secure loans.

Note 16 - Taxes on Income

A. Tax benefits under the Law for Encouragement of Capital Investments, 1959

Under this law, by virtue of the "approved enterprise" status granted to certain enterprises of several investees, these companies are entitled to various tax benefits. The income derived from these enterprises during a period of 7 to 10 years, from the year in which these enterprises first had taxable income (limited to 12 years from commencement of production or 14 years from the date of the approval, whichever is earlier), is subject to a corporate tax rate of 0 - 25%.

According to the alternative track, some of the plants of subsidiaries were granted a tax exemption for a two to four year period and are taxed at the reduced rate of 25% during the remaining benefits period.

Fixed assets owned by investees who are approved enterprises are entitled to an accelerated amortization deduction.

In the event that an investee distributes a dividend to shareholders out of income attributable to revenues which received the approved enterprise tax exemption, the distributing investee will be required to pay the company tax (25%) it had saved in the period of the benefits.

Deferred taxes in respect of income from approved enterprises were not provided, since it is the Group's policy not to initiate a distribution of dividends from its subsidiaries that would result in an additional tax liability to the Group.

Benefits are conditional upon the fulfillment of terms set out in law or in deeds of approval. Non-fulfillment of terms could cause cancellation of the benefit, in whole or in part, and the return of benefit sums, plus interest and linkage differentials. The investees met all terms set out as above as at the dates of the financial reports.

As security for the implementation of the approved projects and compliance with the conditions of the approval, a pledge has been registered on the above subsidiaries' assets in favor of the State of Israel.

B. Measurement of results for tax purposes in accordance with the Income Tax (Inflationary Adjustments) Law, 1985 (hereinafter - "the Adjustments Law")

The Company and its subsidiaries in Israel are subject to the Income Tax Law (Inflationary Adjustments), 1985. Under this Law, the results for tax purposes are adjusted principally for the changes in the Consumer Price Index. However, the adjusted income under the tax laws is not always identical to the reported income according to the accounting standards of the IASB. As a result, there are differences between the earnings reported according to financial statements and the adjusted income for tax purposes. See Note 2S and Note 16G regarding deferred taxes on such differences.

C. Law for the Encouragement of Industry (Taxation), 1969

Certain companies qualify as "industrial companies" under the above law. By virtue of this status and certain regulations published under the inflationary adjustments law, the companies are entitled to claim, and have claimed, accelerated rates of depreciation.

D. Tax rates applicable to income from other sources

Income not eligible for "approved enterprise" benefits, is subject to tax at the statutory tax rate of 31% (or if the investee is registered and operates outside of Israel, at the tax rate prescribed for that territory).

Note 16 - Taxes on Income (cont'd)**E. Losses for tax purposes carried forward to future years and tax assessments**

1. The consolidated balance of carryforward tax losses at December 31, 2006 amounted to approximately NIS 2,250 million, of which NIS 1,734 million relates to Koor. Carryforward tax losses of the Israeli companies are linked to the CPI, according to the Adjustments Law and there is no statute of limitations as to their utilization.
2. The Company has received final assessments up to and including the year ended 2002.

F. Amendment to the Income Tax Ordinance

1. On June 29, 2004, the Knesset passed the "Law for the Amendment of the Income Tax Ordinance (No. 147 and Temporary Order) – 2004 (hereinafter – the Amendment)". The amendment provides for a gradual reduction in the company tax rate from 36% to 30% in the following manner: in 2004 the tax rate will be 35%, in 2005 the tax rate will be 34%, in 2006 the tax rate will be 32% and from 2007 onward the tax rate will be 30%.
Current taxes and deferred tax balances as at December 31, 2004 were calculated based on the new tax rates prescribed in the Amendment. The effect of the change in the consolidated financial statements as at the beginning of 2004 is a decrease in income tax expenses of NIS 5 million.
2. On July 25, 2005 the Israeli Knesset passed the Law for the Amendment of the Income Tax Ordinance (No.147 and Temporary Order) - 2005 (hereinafter - the Amendment). The Amendment provides for a gradual reduction in the statutory company tax rate in the following manner: in 2006 the tax rate will be 31%, in 2007 the tax rate will be 29%, in 2008 the tax rate will be 27%, in 2009 the tax rate will be 26% and from 2010 onward the tax rate will be 25%. Furthermore, as from 2010, upon reduction of the company tax rate to 25%, real capital gains will be subject to tax of 25%.
The current taxes and deferred tax balances at December 31, 2005 were calculated in accordance with the new tax rates specified in the Amendment. The effect of the change in the new tax rate on the Company's equity as at December 31, 2005 was approximately NIS 8 million.

Notes to the Financial Statements for the year ended December 31, 2006**Note 16 - Taxes on Income (cont'd)****G. Deferred taxes:**

1. Deferred taxes are presented in the consolidated balance sheet as follows:

	December 31	
	2 0 0 6	2 0 0 5
	N I S t h o u s a n d s	
<u>Within current assets:</u>		
Provision for vacation pay and severance benefits	232	161
Inventory, net of customer advances	-	(74)
Timing differences in respect of recognition of income and expenses, net	8	42
	<u>240</u>	<u>129</u>
<u>Within long-term assets:</u>		
Depreciation	-	(16,085)
Operating loss and capital loss carried forwards	577,316	531,154
Liability in respect of employee severance benefits	-	1,837
Timing differences in respect of recognition of income and expenses, net	-	2,274
	<u>557,316</u>	<u>519,180</u>
Balance not expected to be realized (1)	<u>(577,316)</u>	<u>(504,662)</u>
	<u>-</u>	<u>14,518</u>
<u>Within long-term liabilities:</u>		
Depreciation	(26,691)	(78)
Operating loss and capital loss carried forwards	10,063	-
Liability in respect of employee severance benefits	2,055	-
Timing differences in respect of recognition of income and expenses, net	3,562	-
	<u>(11,011)</u>	<u>(78)</u>

- (1) The Company and certain subsidiaries have deferred tax assets, that management of the companies believe are not likely to be realized, arising from accumulated tax loss carryforwards and other timing differences and, accordingly, no deferred taxes were recorded in respect thereof.

Notes to the Financial Statements for the year ended December 31, 2006

Note 16 - Taxes on Income (cont'd)

G. Deferred taxes (cont'd)

2. Balances and movement of deferred taxes in the consolidated balance sheet:

	Depreciable fixed assets	Inventories net of customer advances	Provisions for employee rights	Losses and deductions carried forward	Timing differences in respect of recognition of income and expenses	Total
	N	I S	t h o	u s a n	d s	
Balance as at December 31, 2004	(389,483)	75,928	51,099	189,883	(2,310)	(74,883)
Translation differences in subsidiaries	131	-	(6)	308	64	497
Amounts charged to statement of operations	4,579	(117)	305	(76,615)	248	(71,600)
Other differences, net *	368,610	(75,885)	(49,400)	(87,084)	4,314	160,555
Balances as at December 31, 2005	(16,163)	(74)	1,998	26,492	2,316	14,569
Translation differences in subsidiaries	31	6	(15)	(84)	(195)	(257)
Amounts charged to statement of operations	(609)	68	304	(16,345)	1,449	(15,133)
Other differences, net *	(9,950)	-	-	-	-	(9,950)
Balances as at December 31, 2006	(26,691)	-	2,287	10,063	3,570	(10,771)

* Mainly subsidiaries that were sold/acquired, net.

Deferred taxes were computed at tax rates of 22% - 35%.

Notes to the Financial Statements for the year ended December 31, 2006**Note 16 - Taxes on Income (cont'd)****H. Taxes on income included in consolidated statements of operations**

1. Composition of income tax on continuing operations:

	Year ended December 31		
	2 0 0 6	2 0 0 5	2 0 0 4
	N I S t h o u s a n d s		
Current taxes	5,152	5,322	236,088
Deferred taxes	15,133	71,600	40,665
In respect of previous years, net	(10,916)*	3,057	(4,473)
	<u>9,369</u>	<u>79,979</u>	<u>272,280</u>

* Relating to final tax assessments received by a subsidiary.

2. Below is the adjustment between the theoretical tax amount which would have been applicable if all the income of Koor Group and the consolidated companies were taxable at the statutory tax rate effective in Israel at that time, and the tax amount charged in the statement of income.

	Year ended December 31		
	2 0 0 6	2 0 0 5	2 0 0 4
	N I S t h o u s a n d s		
Earnings (loss) from continuing operations before taxes on income	(98,891)	327,646	823,829
Statutory tax rate	31%	34%	35%
Theoretical tax expense (income)	(30,656)	111,400	288,340
Decrease in taxes resulting from the following factors - the tax effect:			
Tax relating to Koor's equity in operating results of investee companies	11,330	(122,183)	12,271
Tax benefits under various encouragement laws	(5,643)	(6,344)	(49,676)
Non-deductible expenses for tax purposes, net of tax-free income	65	282	15,724
Losses for which deferred taxes were not recorded	57,529	145,023	114,564
Utilization of tax loss carry forwards and temporary differences from prior years for which deferred taxes were not created and which were utilized during the current year	(26,812)	(61,531)	(18,534)
Deferred taxes in respect of prior years and which were written-off at the reporting year	14,305	9,951	75,601
Tax losses from prior years, for which deferred taxes were recorded this year	-	-	(77,483)
Differences between the measurement basis according to the financial statement to measurement basis for tax purposes	-	-	11,460
Taxes in respect of prior years	(10,916)	3,057	(4,473)
Effect of foreign subsidiaries *	(308)	-	(92,839)
Others **	475	324	(2,675)
Total taxes on income	<u>9,369</u>	<u>79,979</u>	<u>272,280</u>

* Relates to territories of operations in which the statutory tax rate is lower than that used in Israel.

** Including influence of changes in tax rate.

Note 17 - Liabilities for Employee Severance Benefits, Net**A. Pension, severance pay and retirement grants**

Under current labor laws and existing labor agreements, the companies in the Group are required to make severance payments, to employees who are dismissed or who retire, computed on the basis of their latest salary.

In respect of these liabilities, regular deposits are made by Group companies with pension and severance pay funds. The balance sheet amount represents the unfunded balance of the liabilities. As the funds deposited are not under the control and management of the Group companies, the funded amounts are not reflected in the balance sheets. These deposits and the amount stated in the balance sheet fully cover the Group's liability for employee severance benefits.

Investees in which irregular severance has been planned or agreed upon have recorded provisions to record their liability for the supplementary amounts.

B. Funds for severance pay and retirement grants

The funds for severance pay and retirement include accrued CPI adjustments and interest, and they are deposited in severance pay funds in banks and insurance companies. Withdrawals of the funded amount is permitted on fulfillment of the provisions of the Severance Pay Law.

C. Early retirement pension

Under agreements with certain employees who retired from service, Koor Group companies have undertaken to make pension payments until they reach retirement age. The entire liability for such pensions is included in the accounts on the basis of the present value of future pension payments, computed at a monthly discount rate of 0.3%-0.4% per month (3.6% - 5% per annum).

D. Subsequent to the change in control of the Company described in Note 26A and the ensuing managerial changes, the Company recorded a provision for retirement of employees in the second quarter of 2006 in the amount of NIS 26 million.

E. Liabilities for severance benefits, which are presented in the balance sheet, and the amount funded in severance pay funds, are as follows:

	Consolidated		Company	
	December 31		December 31	
	2006	2005	2006	2005
	N I S	t h o	u s a n	d s
Severance pay and retirement grants	8,876	10,354	4,045	6,030
Amount accrued for early retirement	1,448	1,602	1,448	1,602
	10,324	11,956	5,493	7,632
Less – amount funded	4,085	11,771	3,356	11,081
	6,239	185	2,137	(3,449)
Classification of excess of amount funded over amount accrued (see Note 9)	-	3,449	-	3,449
	6,239	3,634	2,137	-

Note 18 - Contingent Liabilities and Commitments**A. Contingent liabilities**1. The Company

- a. On September 21, 2004 a suit was filed with the Tel Aviv District Court against the Company, Bezeq - the Israel Telecommunications Company Ltd. ("Bezeq"), Tadiran Ltd. (a subsidiary of Koor - "Tadiran"), Tadiran Telecommunications Ltd. (a former subsidiary of Koor which was merged with ECI - "Telecommunications"), Tadiran Public Switching Ltd., (a former subsidiary in Telecommunications), and Telrad Networks Ltd. (an affiliate of Koor - "Telrad Networks") in connection with the public switches. A motion for recognition of the suit as a class action was filed together with the suit in accordance with the Anti-Trust Law, 1988 ("the Anti-Trust Law"), and according to Civil Procedure regulations. In the Statement of Claim, the plaintiff alleges that during the previous decade, the defendants had engaged in activities prohibited by the Anti-Trust Law that resulted in damages to Bezeq's customers. In respect of the actions alleged by the Plaintiff, the Plaintiff is asking for damages for the group that he is seeking to represent in the amount of NIS 1.7 billion.
- On March 10, 2005, the Company and the other defendants submitted to the District Court their clarified objection to the request of the plaintiff to certify the claim as a class action. On December 5, 2005 the Plaintiff filed his response to the said objection.
- In the opinion of the management which is based on the opinion of its legal counsel, the chances of the claim and of the certification of the claim as a class action are remote.
- Further to the sale of shares of Telrad Networks (as described in Note 3C(1)), Koor committed to indemnify the purchasers in the event that a court ruling will increase the amount of expenses to be paid by Telrad Networks to an amount exceeding that stated in the share purchase agreement.
- b. On June 1, 2005, an indictment was filed with the Jerusalem District Court prosecuting Koor, and seven other companies that are not members of the Koor Group (including two companies that had been owned by Koor on the relevant dates and were later sold to third parties) and nine executives (including two who had been salaried employees of Koor on the relevant dates) for violations of the Anti-Trust Law. The indictment is the outcome of an investigation that had been opened by the Anti-Trust Commission in other companies during 2001, with respect to price fixing and collusion, and the lack of competition in the frozen and canned vegetable industry. The Anti-Trust Authority claimed that two companies that belonged to the Koor Group in the past had colluded with other companies in the years 1992-1998.
- On June 18, 2006, the Jerusalem District Court issued a verdict imposing a penalty of NIS 400,000 on Koor, which was paid during 2006.
- c. On February 20, 2007 a suit was filed with the Tel Aviv District Court against the Company and several directors and officers of the Company and of United Steel Mills Ltd. (in liquidation) ("Steel Mills"), a former subsidiary of the Company, and various other parties. A motion for recognition of the suit as a class action was filed together with the suit.
- Steel Mills issued convertible bonds by means of a prospectus to the public in February 1993. The bonds were to be repaid in three installments on January 31, 1999, 2000 and 2001. The first installment was repaid by Steel Mills, but the other two installments have not been repaid. In March 2000 Steel Mills began to be managed under a stay of proceedings order by the Haifa District Court, which was later altered to a liquidation order. The convertible bonds were unsecured and the assets of the company were insufficient, thus the last two installments of the bonds were not repaid.

Note 18 - Contingent Liabilities and Commitments (cont'd)**A. Contingent liabilities (cont'd)**1. The Company (cont'd)

In the Statement of Claim, the plaintiff alleges that the defendants are responsible for false representations made by Koor and Steel Mills in quarterly financial reports and relevant immediate reports. The plaintiff claims that on the basis of these representations, he purchased bonds of Steel Mills on December 28, 1999, and that these representations imply that Koor is committed to repay the bonds.

In the event that the suit will be recognized as a class action, the Plaintiff is asking for damages for the group that he is seeking to represent in the amount of NIS 25 million.

The Company's directors' and officers' insurance carrier has been informed of the matter. Due to the preliminary stage of the proceedings, the Company is unable to assess the chances of the claim and the request for recognition as a class action, therefore no provision has been made in the financial statements in respect of this matter.

2. Indemnification in connection with the agreement for the sale of 30% of the Company's holdings in Elisra in 2002

As part of the agreement for the sale of 30% of Koor's holdings in Elisra to Elta Electronic Industries Ltd. ("Elta") in 2002, Koor undertook to indemnify Elta in connection with the insurance indemnity rights to which the Elisra Group is entitled relating to the fire that occurred at Elisra's subsidiaries' plants. Koor shall indemnify Elta for 30% of a certain amount should there be a discrepancy between actual insurance proceeds received by Elisra and the receivable recorded in Elisra's financial statements for 2001 and provided such discrepancy exceeds a certain amount. Elta's right to demand payment of the indemnity in this matter carries no time limit.

3. Pursuant to agreements with the banks, Koor undertook to maintain certain financial covenants, including a minimum equity and maximum debt of Koor and certain affiliates, a ratio of shareholders' equity to debt capital, prohibition against creating liens without prior consent of the banks and limitations stipulated in the agreement. Additionally, Koor undertook, under certain circumstances to repay part of the existing debt by using the proceeds to be received from the divestiture of certain assets, if sold.

As at balance sheet date, Koor is in compliance with these conditions.

4. M-A Industries and its investees

- (1) The operations of M-A Industries and of its investee companies are exposed to risks related to environmental contamination, since they produce, store and sell chemicals. M-A Industries invests substantial sums in order to comply with environmental laws and regulations, and M-A Industries' management believes that the M-A Industries Group companies are in compliance with those laws. In accordance with the estimate of M-A Industries' insurance advisors, M-A Industries' insurance policies cover any sudden, unexpected environmental contamination caused in Israel and the rest of the world, subject to the conditions of the relevant policies. As at balance sheet date, M-A Industries did not have any coverage against ongoing environmental contamination. Such insurance is difficult to obtain, and in cases when it can be obtained, M-A Industries' Management believes that the terms of the policy, including the amount of the insurance coverage, do not presently justify obtaining such a policy.

Note 18 - Contingent Liabilities and Commitments (cont'd)**A. Contingent liabilities (cont'd)**4. M-A Industries and its investees (cont'd)

- (2) In May 2004, a subsidiary of M-A Industries and other factories in the Ramat Hovav area received a notification from the Ministry of Environmental Protection of an addition of terms to the business license (hereinafter – “the Additional Terms”), dealing with the treatment and discharge of waste produced as a result of their activities.

Pursuant to the notification, the factories were requested to discontinue flowing their waste into the central treatment system – the evaporation pools and waste treatment facilities of the Ramat Hovav Council, and to treat the factory’s waste in an independent manner by means of construction of an appropriate waste treatment facility and separate evaporation pools for each factory.

In October 2004, the subsidiary of M-A Industries, together with the Israeli Union of Industrialists and other companies, filed an administrative petition against the Ministry of Environmental Protection wherein the District Court was requested to declare that the additional terms to the business license are null and void.

In March 2005, the Court approved the Parties’ consent to settle the dispute through “out of court” mediation.

The mediation was concluded and the Parties reached agreement regarding the terms of the new business license.

On December 28, 2006, the agreement was given the force of a court judgment.

The highlights of the agreement are as follows:

- (1) Commencing from January 1, 2008, flowing of waste into the central treatment system operated by the Ramat Hovav Council will no longer be permitted and each factory will be required to treat its own waste based on certain parameters determined (commencing from 2007 interim parameters were determined for the waste treatment and commencing from 2010 an improvement of 30% was determined as the fixed parameter).
In 2006, the subsidiary of M-A Industries completed construction of the biological waste treatment facility as required by the agreement.
- (2) The waste of the factories will be removed to the evaporation pools and basins of the Ramat Hovav Council by January 1, 2010. After this date, each factory will remove its waste to evaporation pools built and operated by it, by means of an independent flow and discharge system that will also be built and operated by it.
- (3) At the end of the usage period of the pools, the mud will be left for final burial in those pools, if it is found by the Ministry of Environmental Protection, in accordance with risks’ study to be conducted in 2007, that the burial will not cause any environmental damage whatsoever. At the end of the operation period of the evaporation pools (estimated by the Company to be in 2025), the Ministry of Environmental Protection will re-examine the possibility of damage being caused as a result of the burial in the pools with no additional significant treatment.
- (4) Regarding the air quality it was agreed that the generally accepted principles in the European standards shall constitute the basis for negotiations to be held for purposes of setting the permissible emissions’ parameters that will also comply with environmental parameters beyond the factory’s borders. For purposes of implementing these demands, construction of a thermal oxidizing facility was begun (at an estimated cost of \$10 million).

Note 18 - Contingent Liabilities and Commitments (cont'd)**A. Contingent liabilities (cont'd)**4. M-A Industries and its investees (cont'd)

- (3) In 1995, an action amounting to approximately US\$ 56.6 million, as of the date of balance sheet (including interest and linkage differentials), was filed in Brazil against Millenia, a subsidiary of M-A Industries, by a group that acquired the rights of two banks that went into bankruptcy. Millenia was sued as a guarantor for the debts of agricultural cooperatives, which were its former shareholders. On March 9, 2007 a settlement was reached between Millenia and the plaintiffs, for the dismissal of all of the plaintiffs' claims in consideration for payment of approximately \$12 million. This amount was provided in full in the financial statements for 2006.
- (4) Administrative proceedings and fiscal claims are pending against Millenia in Brazil, all of which deal with demands for payment of various taxes, totaling some US\$ 73 million (including interest and linkage differences as at the balance sheet date). On the basis of the opinion of its legal advisors, Millenia estimates that its chances of prevailing in all the proceedings and fiscal claims pending against it are good.
- (5) In 2002, an action was filed against Millenia by a private environmental protection organization, claiming that Millenia's plant in Londrina pollutes the environment and causes damage to its vicinity and neighbors. The plaintiff demands that Milenia prepare an environmental impact study, examinations for Millenia's employees and neighbors, and cessation of the production activity at the plant. The lower court instructed that an environmental impact study be conducted, but the court of appeals granted a stay of implementation of the decision pending a decision by the court of appeals (expected within two years). The plaintiff's request for examination of the Company's employees and neighbors was denied. The proceeding is at a preliminary stage. Millenia's legal advisors estimate that Millenia has good defenses against the claim and, therefore, no provisions were included in the books in respect of this action.
- (6) In 2004, six identical actions were filed against a subsidiary of M-A Industries in the United States and against six other agrochemical companies in the State of Illinois, USA, by a local water supplier (hereinafter – "the Plaintiff"). In these actions, the Plaintiff seeks to represent all the water suppliers in the State of Illinois. The water supplier claims that the product "atrazine", which is sold by the defendant companies, pollutes its water source, and that water having an atrazine content is a health hazard. The Plaintiff does not indicate the concentration of atrazine in the water or that the quantity of atrazine in its water exceeds the amount permitted by the Federal Water Standard, but claims that atrazine is a health hazard even at concentrations below the Federal Standard.

One of the principal contentions in the claim is that the subsidiary of M-A Industries (as well as the other defendants) is aware of the danger of atrazine to human beings, and is concealing this information from the authorities and the public. The subsidiary contends that it received its license for atrazine pursuant to U.S. law by means of referring to studies submitted by the original license holder without it having been permitted to review such studies. In addition, the subsidiary contends that it did not conduct its own independent studies and it is not aware of studies indicating that atrazine at the concentration permitted by the Federal Water Standard is hazardous to human health.

In light of that stated above the subsidiary of M-A Industries estimates, based on the opinion of its legal advisors, that the chances that it will be found responsible for concealing information are remote.

Additional causes of action claimed by the Plaintiff are encroachment, nuisance, negligence and violation of the environmental protection and water pollution laws.

Note 18 - Contingent Liabilities and Commitments (cont'd)**A. Contingent liabilities (cont'd)**4. M-A Industries and its investees (cont'd)

Among the remedies the Plaintiff is requesting are: obligating the defendants to prepare and implement a plan for cleaning the Plaintiff's water, compensation of the Plaintiff for decline in value of its properties as a result of the presence of atrazine in the water and damage to its reputation. As is customary for claims of this type in the United States, the claim does not state the amount of the damages sought or the compensation requested.

The claim is in the very preliminary stages, the stage of certification of the claim as a class action has not yet started nor has the document discovery stage gotten underway.

The cumulative share of the subsidiary of M-A Industries in sales of atrazine in Illinois is low in relation to the other defendants.

Taking into account the fact that the Plaintiff does not state that the concentration of atrazine in the water exceeds that permitted by the Federal Water Standard, and the fact that the chances are remote that M-A Industries subsidiary will be found responsible for concealing information (as described above), M-A Industries the subsidiary estimates, based on the opinion of its legal advisors, that the chances that the claim will be rejected are higher than the chances it will prevail.

No provision has been included in the financial statements in respect of this claim.

- (7) In 2005, arbitration proceedings were started in the United States between a multi-national company and a subsidiary of M-A Industries for determining the amount the subsidiary is required to pay to the multi-national company for use of its studies in order for the subsidiary to obtain a license for the Pendimetlin product. The arbitration is mandatory arbitration under the Federal law, which governs the area of licensing for crop protection products. In December 2006, the arbitrators handed down a draft arbitration decision pursuant to which the subsidiary was held liable to pay the multi-national company an amount ranging between \$9 million and \$10 million for use of the studies. In February 2007, the draft arbitration decision became a final arbitration decision and the subsidiary was held liable to pay the multi-national company the amount of \$9.3 million. M-A Industries has recorded a full provision for this amount.
- (8) On the matter of undertakings in securitization transactions and financial covenants in respect of those transaction, see Note 3B6.

5. ECI Telecom Ltd. ("ECI")

In January 2005, ECI was named one of the defendants in a purported class action complaint filed in the United States against ECtel, certain directors and officers of ECtel, and against ECI. The complaint alleges violations of U.S. Federal Securities laws by ECtel and breach of fiduciary duties by the individual defendants, in connection with disclosure of ECtel's financial results, between April 2001 and April 2003. It also alleges that ECI was the controlling shareholder of ECtel during this period and, as such, influenced and controlled the purported actions by its subsidiary. Damages claimed by the plaintiff were not quantified. In July 2006, the United States District Court for the District of Maryland granted ECI's and ECtel's motions to dismiss the securities class action lawsuit. In August 2006, the plaintiff filed a motion for reconsideration, alleging new evidence against ECtel. On March 6, 2007 the Court denied the plaintiffs' motion. The Plaintiffs have 30 days in which they may appeal this decision to the Appellate Court. No liability has been recorded in respect of this matter.

Note 18 - Contingent Liabilities and Commitments (cont'd)**A. Contingent liabilities (cont'd)**

6. A number of claims, in the total amount of NIS 39.4 millions, have been filed against the Company and certain investees concerning various matters arising in the normal course of business, including litigation with tax, customs and VAT authorities, which are in various legal proceedings. In the estimation of the managements of these companies, based on the opinions of their legal counsel, the provisions for these claims included in their financial statements, are adequate in light of the circumstances.
7. On fulfillment of conditions relating to an investment grant – see Note 16A.
8. On the indemnity granted to Claridge as advisor - see Note 26B(5).
9. The liability of directors and officers in the Company and in investee companies is insured by Clal Insurance Company Ltd., a member of the IDB Group, which is an interested party, in directors and officers (D&O) insurance, subject to the terms of the insurance policy. Additionally, in accordance with a resolution by the general meeting of the Company's shareholders, the Company resolved to indemnify its directors and officers against various events that the insurance does not cover, and in monetary amounts exceeding the insured amounts, all as provided in the said resolution.
10. With respect to liens and guarantees - see Note 22.

B. Commitments

1. Certain companies in the Group have research and development contracts with the Government of Israel. Under these contracts, the companies are required to pay royalties to the Government of Israel if they generated income from such research (at rates of 2% - 5% of sales proceeds from products resulting from the research and development), in amounts not exceeding 100% - 150% of the amounts of the grants, linked to the dollar, received by the companies as participation in the research and development projects.
Royalty expenses paid to the Government of Israel in respect of these research and development contracts, were as follows:
In the year ended December 31, 2005 – NIS 2,919 thousand.
In the year ended December 31, 2004 – NIS 29,758 thousand (mainly M-A Industries).
2. At December 31, 2006 and 2005, the Company and subsidiaries were not committed for the purchase of fixed assets.
3. Certain companies in the Group lease and rent industrial and office premises under long-term contracts. The lease contracts are non-cancelable and in most cases include renewal options. The expenses of these companies were NIS 14 million in 2006, (NIS 11 million in 2005, NIS 43 million in 2004).

Note 18 - Contingent Liabilities and Commitments (cont'd)**B. Commitments (cont'd)**

Future minimum payments under the non-cancelable operating leases and rental fees for the years subsequent to balance sheet date, are as follows:

	December 31, 2006
	(NIS thousands)
First year	18,910
Second year	16,510
Third year	13,704
Fourth year	13,121
Fifth year and thereafter	47,775
	<u>110,020</u>

4. Koor Corporate Venture Capital's commitment for additional investments in venture capital funds as at December 31, 2006 is approximately \$1.2 million. Subsequent to the balance sheet date, approximately \$0.8 million were invested in respect of this commitment.
5. The Company's commitment for additional investments in Indivision India Partners, a private equity fund investing in businesses catering to consumers in India, as at December 31, 2006 is \$13.5 million.
6. Pursuant to the transaction for the sale of Sheraton-Moriah described in Note 3E(2), the Company is obliged to facilitate the repayment of a loan in the amount of NIS 17 million granted by Sheraton-Moriah to another subsidiary of the Company, in which the Company holds 55%, no later than March 27, 2008.
7. In connection with the valuation of M-A Industries described in Note 3B(5), the Company undertook to indemnify the valuation expert against any expense or financial damage he may sustain, with respect to any claim filed against him by any third party, in respect of the said valuation.

Note 19 - Convertible Securities of Investee Companies**Option warrants to employees**

Certain investees issued options to their employees. Employee entitlement to such options is usually accrued over a number of years from their date of issue, subject to continued employment. The exercise term of the options varies according to the terms of the different plans.

Convertible debentures and options

Certain investees issued convertible debentures on the Tel-Aviv Stock Exchange or in a private placement to institutional investors.

See Note 2E(9).

Notes to the Financial Statements for the year ended December 31, 2006**Note 20 - Share Capital and Stock Options****A. Share capital is composed as follows:**

	December 31, 2006		December 31, 2005	
	Authorized	Issued and Outstanding	Authorized	Issued and outstanding
Number of shares:				
Ordinary shares, par value of NIS 0.001 ^{(1) (3) (4)}	<u>83,932,787</u>	<u>16,582,869</u>	<u>83,932,757</u>	<u>16,162,467</u>
Deferred shares, par value of NIS 0.001 ⁽²⁾	<u>15,792,243</u>	<u>15,156,533</u>	<u>15,792,243</u>	<u>15,156,533</u>
Amount in nominal NIS:				
Ordinary shares, par value of NIS 0.001	<u>83,933</u>	<u>16,583</u>	<u>83,933</u>	<u>16,162</u>
Deferred shares, par value of NIS 0.001	<u>15,792</u>	<u>15,157</u>	<u>15,792</u>	<u>15,157</u>

- (1) These shares are listed on the Tel Aviv Stock Exchange (TASE). On December 31, 2006, the share price on the TASE was NIS 220.
The ADS (American Depositary Shares) of the Company, each of which represents 0.2 ordinary shares, par value of NIS 0.001 ("Ordinary Shares"), are traded on the New York Stock Exchange (NYSE). The ADS price on the NYSE on December 29, 2006 was \$10.39.
- (2) The holders of the deferred shares are entitled to recovery of paid up capital upon liquidation in its nominal amount, after payment of the nominal amount to the holders of the Ordinary Shares. The holders of the deferred shares do not have voting rights, and they are not entitled to participate in a dividend distribution of any kind.
- (3) On the balance sheet date, a subsidiary held 15,799 Ordinary Shares of Koor.
- (4) During 2006 options in the employee stock option plans (See C below) were exercised for 420,402 ordinary shares.

B. Buy-back of Company shares

In 2000, the Company purchased 538,592 ordinary shares (approximately 3.4% of the ordinary share capital), at a cost of approximately NIS 219 million. This amount was deducted from the shareholders' equity of the Company.

On December 31, 2001, the Company purchased 154,637 of its ordinary shares from a subsidiary.

On May 27, 2003, a foreign institutional investor (hereinafter – "the Buyer") purchased 500,000 of the aforementioned Company shares. The Purchaser declared that the sale was concluded without his requesting or receiving any information from the Company, and undertook not to trade the shares to be purchased within a specified period. The sale was concluded on that day in an off-market transaction, at the market price, for total consideration of approximately NIS 43 million.

On April 15, 2005, the Company sold to the foreign institutional investor 193,229 shares of the Company it had held, in an off-market transaction for consideration of approximately NIS 50 million.

As at the balance sheet date, the Company had sold all of its holdings in its shares. The total holdings of subsidiaries in Koor's shares is 15,799 ordinary shares, and the amount deducted from shareholders' equity for the shares held is NIS 6,071 thousand.

Note 20 - Share Capital and Stock Options (cont'd)**C. Stock options to senior employees**1. 1998 and 2000 plans

During 1998 and 2000 stock option plans were approved with the following main points:

1. A total framework was approved for the allotment of 800,000 stock options theoretically exercisable for up to 800,000 ordinary shares of the Company.
2. The options are designated for Company employees who are not related parties in the Company and will not become related parties in the Company as a result of allotment of the stock options.
3. All of the options allotted under these plans were exercised by the balance sheet date.

2. 2003 Plan

On July 27, 2003, a general meeting of shareholders approved Stock Option Plan 2003, which had been approved previously by the Audit Committee and by the Board of Directors, on May 25, 2003 and June 5, 2003, respectively. The key points of the Plan are:

- 1) A total framework was approved for the allotment of 1,200,000 stock options, theoretically exercisable for up to 1,200,000 ordinary shares of the Company, i.e. about 6.8% of the ordinary shares (fully diluted) of the Company.
- 2) The options allotted to the trustee will be exercised for shares in a quantity reflecting the amount of the financial benefit inherent in the options, according to the Benefit Component Method. Under the terms of the Plan, each stock option is theoretically exercisable for one share, subject to adjustments. However, in practice, offerees who exercise the options will not be allotted the full quantity of shares underlying each option, but only shares which reflect the amount of the financial benefit inherent in their option, computed on the date of exercise. Accordingly, the exercise price of each stock option is intended only for computation of the benefit component ("benefit component method").
- 3) The exercise price of every option will be NIS 96 linked to the CPI, unless the Company decides to prescribe a higher exercise price for options that will be allotted on dates subsequent to the approval date of the plan.
- 4) The options are designated for Company employees who are not related parties in the Company and will not become related parties in the Company as a result of allotment of the stock options. In any event, the total number of offerees under Plan 2003 will not exceed 35 offerees.
- 5) The right of every offeree to exercise the options for shares will vest in six stages during the three-year period from the record date, whereby at the end of every calendar half-year, one-sixth of the number of options allotted to the trustee on his behalf will vest.
- 6) Options not exercised by December 31, 2010 will expire.
- 7) The Plan will be taxed under the Capital Gains Track, under the provisions of Section 102 of the Income Tax Ordinance and the regulations promulgated hereunder. Any tax to be imposed in respect of the exercise of the options will be borne solely by the offerees. The Company will be unable to claim any tax deduction for the expense.

Note 20 - Share Capital and Stock Options (cont'd)**C. Stock options to senior employees (cont'd)**2. 2003 Plan (cont'd)

8) Also approved within the framework of the approval of Plan 2003 was the granting of 350,000 options out of the total number, to seven directors (except for two directors who are controlling shareholders in the Company, directly or indirectly), divided equally, as well as 175,000 options to the Company's CEO. The balance of the options is intended for other employees and officers of the Koor Group.

9) The balance of options outstanding as at December 31, 2006:

<u>Balance of stock option not exercised</u>	<u>Exercise price</u>	<u>Exercise date</u>
	<u>NIS</u>	
72,278	96.00	12/2010
40,000	200.00	12/2010
10,000	209.69	12/2010
10,000	225.00	12/2010
<u>132,278</u>		

3. Changes in the options in respect of all stock option plans during 2006:

	<u>1998 Plan</u>	<u>2000 Plan</u>	<u>2003 Plan</u>	<u>Total</u>
Balance as at beginning of year	670	1,734	852,648	855,052
Granted	-	-	-	-
Exercised	<u>(670)</u>	<u>(1,734)</u>	<u>(720,370)</u>	<u>(722,774)*</u>
Balance as at end of the year	<u>-</u>	<u>-</u>	<u>132,278</u>	<u>132,278</u>

* Due to the benefit component method, a total of 420,402 ordinary shares of the Company were issued.

4. During 2005 the Company granted a total of 60,000 employee stock options in respect of which the Company applies the provisions of Standard 24 pertaining to recognition of compensation expenses based on fair value on the grant date. The total compensation expense in respect of these stock options amounted to NIS 2,773 thousand, of which NIS 2,625 thousand have been recorded as compensation expenses through December 31, 2006, and the remaining NIS 148 thousand will be recorded as compensation expenses in 2007.

The weighted-average of the balance of the contract life of the outstanding options as at December 31, 2006, is 4 years.

The fair value of the options granted, as stated, was estimated through use of the Black and Scholes Model for pricing options. The parameters used in application of the Model are as follows:

Risk-free interest rate – 2.6% to 2.7% based on the yield to maturity of CPI linked government bonds;

Volatility - 33% to 35% based on the historical fluctuations in prices of the Company's shares;

Expected life of the options - 2.75 to 4 years.

Notes to the Financial Statements for the year ended December 31, 2006**Note 20 - Share Capital and Stock Options (cont'd)****D. Option warrants to institutional investors**

In the framework of a private placement to Israeli institutional investors, as described in Note 15B(1), 800,000 option warrants were issued on April 10, 2005.

Each option warrant is exercisable until April 30, 2010 into one share of the Company of a par value of NIS 0.001 for an exercise price of NIS 300 linked to the CPI. The Company intends to register the underlying shares for trading on the Tel Aviv Stock Exchange.

Note 21 - Financial Instruments and Linkage Terms of Monetary Balances**A. Derivative financial instruments**

The Company has entered into forward transactions, in order to reduce the overall exposure of its CPI-linked debt. As at December 31, 2006 the Company had open CPI-NIS forward contracts in the amount of NIS 1.2 billion, which are intended to hedge exposure with respect to debt linked to the CPI, as described below:

<u>Average expiration date</u>	<u>Amount receivable</u>	<u>Amount payable</u>	<u>Fair value</u>	<u>Book value</u>
N I S t h o u s a n d s				
October 5, 2007	1,191,127	1,208,531	(19,983)	(17,404)

B. Fair value of financial instruments:

The carrying amounts of cash and cash equivalents, short-term investments, trade receivables, other accounts receivable, credits from banks and others, trade payables and other accounts payable and other financial instruments is approximate or similar to at their fair value. With respect to the market value of certain affiliated and other companies whose shares are traded on the stock exchange, see Notes 8A(2) and 9.

The fair value of the long-term loans and debentures, and the market interest rates for computation of the fair values as at December 31, 2006 are as follows:

	<u>Market interest rate</u>	<u>Consolidated</u>		<u>Company</u>	
		<u>Fair value</u>	<u>Book value</u>	<u>Fair value</u>	<u>Book value</u>
		N I S m i l l i o n s			
	%				
<u>Long – term financial liabilities:</u>					
Long-term bank loans, including current maturities	mainly 4.9	1,843	1,886	301	301
Other long-term loans, including current maturities	mainly 6	38	48	-	-
Debentures	4.85	1,001	988	1,001	988

Note 21 - Financial Instruments and Linkage Terms of Monetary Balances (cont'd)**C. Credit risk of trade receivables:**

	<u>NIS millions</u>
Condensed data of credit risk of trade receivables as at December 31, 2006:	
Receivables insured by credit risk companies	8,405
Receivables - Government authorities	517
Other receivables	<u>79,568</u>
Total (including non-current receivables)	<u><u>88,490</u></u>

In Management's opinion, the financial statements include suitable provisions in respect of exposure to doubtful debts.

The exposure to credit risks relating to trade receivables is limited, due to the relatively large number of customers.

Notes to the Financial Statements for the year ended December 31, 2006

Note 21 - Financial Instruments and Linkage Terms of Monetary Balances (cont'd)

D. Linkage terms of monetary balances:

(1) Consolidated

	December 31, 2006				December 31, 2005			
	In foreign currency or linked thereto	Linked to the CPI	Unlinked	Total	In foreign currency or linked thereto	Linked to the CPI	Unlinked	Total
<u>Assets</u>								
Cash and cash equivalents	83,182	-	194,015	277,197	24,685	-	284,981	309,666
Short-term deposits and investments	23,832	177,765	180,932	382,529	91,549	186,931	106,890	385,370
Trade receivables	42,537	924	38,580	82,041	37,350	1,285	39,922	78,557
Other accounts receivable	56,425	1,075	18,515	76,015	32,467	275	35,603	68,345
Other investments and receivables	89,685	33,126	-	122,811	94,371	28,594	100	123,065
	<u>295,661</u>	<u>212,890</u>	<u>432,042</u>	<u>940,593</u>	<u>280,422</u>	<u>217,085</u>	<u>467,496</u>	<u>965,003</u>
<u>Liabilities</u>								
Credits from banks and others (not including current maturities of long-term liabilities)	35,996	-	-	35,996	27,618	-	24,244	51,862
Trade payables	31,999	-	35,846	67,845	28,704	-	42,386	71,090
Other accounts payable	26,582	19,295	140,481	186,358	49,435	7,672	116,965	174,072
Long-term loans and debentures (including current maturities)	259,947	2,446,905	216,000	2,922,852	215,645	1,788,770	216,000	2,220,415
	<u>354,524</u>	<u>2,466,200</u>	<u>392,327</u>	<u>3,213,051</u>	<u>321,402</u>	<u>1,796,442</u>	<u>399,595</u>	<u>2,517,439</u>

Notes to the Financial Statements for the year ended December 31, 2006

Note 21 - Financial Instruments and Linkage Terms of Monetary Balances (cont'd)

D. Linkage terms of monetary balances (cont'd):

(2) Company

	December 31, 2006				December 31, 2005						
	In foreign currency or linked thereto	Linked to the CPI	Unlinked	Total	In foreign currency or linked thereto	Linked to the CPI	Unlinked	Total			
									N	I	S
<u>Assets</u>											
Cash and cash equivalents	72,847	-	165,360	238,207	740	-	266,222	266,962			
Short-term deposits and investments	5,269	172,746	167,385	345,400	69,665	179,358	82,172	331,195			
Other receivables	115	-	3,509	3,624	2,865	-	12,573	15,438			
Short term loans to investee companies	-	39,307	-	39,307	-	37,212	-	37,212			
Other investments and receivables	9,213	-	-	9,213	10,444	-	-	10,444			
Investments and other long-term receivables: Investee companies (including current maturities of loans)	13,952	9,447	15,300	38,699	640	52,854	1,189,604	1,243,098			
	<u>101,396</u>	<u>221,500</u>	<u>351,554</u>	<u>674,450</u>	<u>84,354</u>	<u>269,424</u>	<u>1,550,571</u>	<u>1,904,349</u>			
<u>Liabilities</u>											
Credits from banks and others (not including current maturities of long-term liabilities)	-	-	-	-	-	-	7,290	7,290			
Trade payables	-	-	1,346	1,346	10	-	1,213	1,223			
Other accounts payable	4,359	18,163	73,366	95,888	7,159	5,955	34,893	48,007			
Long-term liabilities (including current maturities of loans)	8,509	1,280,552	6,382	1,295,443	9,270	1,601,054	6,713	1,617,037			
	<u>12,868</u>	<u>1,298,715</u>	<u>81,094</u>	<u>1,392,677</u>	<u>16,439</u>	<u>1,607,009</u>	<u>50,109</u>	<u>1,673,557</u>			

Notes to the Financial Statements for the year ended December 31, 2006**Note 21 - Financial Instruments and Linkage Terms of Monetary Balances (cont'd)****E. Interest rate risk:**

The Company's interest rate risk results mainly from long-term liabilities.

The following table presents the book values of the Company's financial instruments that are exposed to fair value risk and/or cash flow risk due to interest rates, according to the earlier of the payment dates or the date of renegotiation of the terms:

Consolidated:

D e c e m b e r 3 1 , 2 0 0 6									
Note	Average effective interest %	Total N	Up to 1 year I S	2 years t h	3 years o u s	4 years a n	5 years d s	Over 5 years	
Fixed interest:									
Long-term deposits, loans, receivables and debentures held-to-maturity									
9									
Dollar-linked	6.71	33,988	-	4,391	12,713	16,884	-	-	
CPI-linked	5.40	6,937	924	924	925	-	4,164	-	
Loans from banks	15								
Dollar-linked	7.65	8,509	-	-	8,509	-	-	-	
CPI-linked	4.87	1,408,018	5,159	286,083	219,789	820,791	6,902	69,294	
Unlinked	7.34	9,500	-	9,500	-	-	-	-	
Loans from others	15								
CPI-linked	-	33,193	1,000	1,000	1,000	1,000	1,000	28,193	
Unlinked	-	15,274	-	3,955	11,169	150	-	-	
Debentures issued	15	988,482	-	-	-	394,278	-	594,204	
Variable interest:									
Cash and cash equivalents									
Dollar-linked	5.01	8,238	8,238	-	-	-	-	-	
Unlinked	4.45	268,959	268,959	-	-	-	-	-	
Marketable securities, debentures and treasury notes									
4		354,923	354,923	-	-	-	-	-	
Long-term deposits	9	101	-	-	-	-	101	-	
Credit from banks	12								
Dollar-linked	6.86	29,575	29,575	-	-	-	-	-	
Foreign currency - unlinked	6.00	6,421	6,421	-	-	-	-	-	
Loans from banks	15								
Dollar-linked	7.38	203,532	7,777	111,378	13,719	3,949	3,912	62,797	
Unlinked	6.36	216,000	-	7,269	7,269	7,269	7,269	186,924	
Other	3.46	40,340	4,034	4,034	4,034	4,034	4,034	20,170	

Notes to the Financial Statements for the year ended December 31, 2006**Note 21 - Financial Instruments and Linkage Terms of Monetary Balances (cont'd)****E. Interest rate risk (cont'd)****Company:**

D e c e m b e r 3 1 , 2 0 0 6								
Note	Average effective interest %	Total N	Up to 1 year I S	2 years t h	3 years o u s	4 years a n	5 years d s	Over 5 years
Fixed interest:								
Short-term loans to investee companies								
	5.82	39,307	39,307	-	-	-	-	-
Debentures held-to-maturity								
9	8.25	9,213	-	-	9,213	-	-	-
Loans from banks								
15	7.65	8,509	-	-	8,509	-	-	-
Dollar-linked								
	4.95	292,070	-	179,182	112,888	-	-	-
CPI-linked								
15	5.06	988,482	-	-	-	394,278	-	594,204
Debentures issued								
Variable interest:								
Cash and cash equivalents								
	4.50	238,207	238,207	-	-	-	-	-
Marketable securities – debentures and treasury notes								
4		345,400	345,400	-	-	-	-	-

F. Sensitivity analysis

As part of management of the interest and currency risks, the Company and its subsidiaries strive to reduce the impact of interest and currency fluctuations on their results of operations.

As at December 31, 2006, the Company estimates that an increase of 1% in the interest rate will give rise to a pre-tax increase in the fair value of its assets and liabilities in the amount of NIS 96.3 million for the year ended December 31, 2006.

In addition, as at December 31, 2006, the Company estimates that an increase of one percent in the exchange rate of the US dollar will not have a material impact on the fair value of its assets and liabilities for the year ended December 31, 2006.

Note 22 - Liens and Guarantees

- A.** In order to secure some liabilities, certain subsidiaries have mortgaged their real estate and have placed fixed charges on plant, equipment and bank deposits, as well as floating charges on all of their assets. In addition, pledged a portion of their shares in investee companies.

For additional information regarding assets pledged relating to fixed asset investment grants, see Note 10A(2).

Notes to the Financial Statements for the year ended December 31, 2006**Note 22 - Liens and Guarantees (cont'd)**

B. The balances of secured liabilities are as follows:

	Consolidated	
	December 31	
	2 0 0 6	2 0 0 5
	N I S t h o u s a n d s	
Credit from banks	6,422	16,433
Loans from banks and others and debentures (including current maturities), see Note 15, and also C below	550,311	539,034
	<u>556,733</u>	<u>555,467</u>

C. Guarantees to banks and others for loans and for assuring credit lines and other guarantees given by the Company in favor of:

	Consolidated		Company	
	December 31		December 31	
	2 0 0 6	2 0 0 5	2 0 0 6	2 0 0 5
	N I S t h o		u s a n d s	
Subsidiaries (1)	135,729 *	153,130	1,252,834	260,794
Others	5,200	12,893	40	40
	<u>140,929</u>	<u>166,023</u>	<u>1,252,874</u>	<u>260,834</u>

(1) Includes NIS 133 million (NIS 132 million in 2005) that Koor granted to Bezeq in connection with Bezeq's agreement to transfer ownership of the public switching activities to a third party. (See Note 18A(1)(a))

* Excluding guarantees in the amount of NIS 1,117 million granted to banks in respect of loans of subsidiaries consolidated in these financial statements, of which NIS 1,028 million relates to a wholly-owned subsidiary.

Notes to the Financial Statements for the year ended December 31, 2006**Note 23 - Data concerning Items in Statements of Operations****A. Revenues from sales and services, net – consolidated:**

	Year ended December 31		
	2 0 0 6	2 0 0 5	2 0 0 4
	N I S t h o u s a n d s		
<u>Local:</u>			
Industrial operations	6,710	24,580	266,785
Trading operations	322,869	281,198	498,802
<u>Abroad:</u>			
Industrial operations - export and international operations	253,674	427,853	6,446,300
Trading operations	-	-	603,895
Total	<u>583,253</u>	<u>733,631</u>	<u>7,815,782</u>

B. Cost of sales and services - consolidated:

	Year ended December 31		
	2 0 0 6	2 0 0 5	2 0 0 4
	N I S t h o u s a n d s		
<u>Industrial operations:</u>			
Materials	123,958	240,726 *	3,333,428 *
Labor	29,481	65,334 *	458,294 *
Subcontracted work	-	7,146	41,640
Depreciation and amortization	2,611	11,908	146,204
Research and development expenses, net (*)	30,944	52,294 *	159,769 *
Other	14,702	17,281 *	539,128 *
	<u>201,696</u>	<u>394,689</u>	<u>4,678,463</u>
Less - expenses charged to fixed assets	-	-	(3,949)
	<u>201,696</u>	<u>394,689</u>	<u>4,674,514</u>
(Decrease) increase in inventory of goods and work in process	(3,335)	(2,660)	(16,506)
	<u>198,361</u>	<u>392,029</u>	<u>4,658,008</u>
Increase in inventory of finished goods	11,736	(13,335)	(175,467)
	<u>210,097</u>	<u>378,694</u>	<u>4,482,541</u>
<u>Trading operations:</u>			
Merchandise	31,355	26,362	438,594
Labor	73,849	63,311	55,394
Depreciation	27,995	25,365	26,155
Others	94,423	88,426	108,672
	<u>227,622</u>	<u>203,464</u>	<u>628,815</u>
	<u>437,719</u>	<u>582,158</u>	<u>5,111,356</u>
(*) Net of grants and participations that were received and royalties that were paid	-	924	8,219

* Reclassified.

Notes to the Financial Statements for the year ended December 31, 2006

Note 23 - Data concerning Items in Statements of Operations (cont'd)

C. Selling and marketing expenses - consolidated:

	Year ended December 31		
	2006	2005	2004
	NIS thousands		
Salaries	29,990	34,218	282,044
Commissions	5,839	16,462	149,584
Advertising expenses	9,666	9,707	36,135
Depreciation and amortization	216	596	112,093
Other	17,835	23,167	482,511
	<u>63,546</u>	<u>84,150</u>	<u>1,062,367</u>

D. General and administrative expenses:

	Consolidated			Company		
	Year ended December 31			Year ended December 31		
	2006	2005	2004	2006	2005	2004
	NIS			u s a n d s		
	N	I	S	t	h	o
Salaries (1)	74,068	57,916 *	177,750	44,116	28,576 *	22,399
Bad and doubtful debts	4,428	3,733	54,766	-	-	-
Depreciation and amortization	3,314	3,895	21,578	1,145	1,283	1,262
Other	52,791	75,096	184,729	20,512	28,825	22,987
	<u>134,601</u>	<u>140,640 *</u>	<u>438,823</u>	<u>65,773</u>	<u>58,684 *</u>	<u>46,648</u>

* Restated – See Note 2R(4).

- (1) Subsequent to the transfer of shares and the ensuing managerial changes described in Note 26A, the Company recorded a provision for retirement of employees in the second quarter of 2006 in the amount of NIS 26 million.

Notes to the Financial Statements for the year ended December 31, 2006**Note 23 - Data concerning Items in Statements of Operations (cont'd)****E. Financing expenses, net:**

	Consolidated			Company		
	Year ended December 31			Year ended December 31		
	2006	2005	2004	2006	2005	2004
	N I S	t h o	u s a	n d s		
In respect of convertible debentures	-	-	18,942	-	-	-
In respect of debentures	30,279	26,512	-	30,279	26,512	-
In respect of long-term loans	50,082	155,387	199,326	27,129	122,391	111,396
In respect of short-term loans and credit	6,690	36,783	77,267	2,483	23,800	10,756
In respect of derivative financial instruments	21,291	11,551	1,967	21,291	10,558	4,491
Amortization of capital raising expenses	-	-	4,334	-	-	-
Gains from marketable securities, net	(20,632)	(27,549)	(22,393)	(18,275)	(25,540)	(18,568)
Expenses (income) from deposits and others, net	26,225	(20,663)	(7,488)	(11,525)	(12,885)	2,731
	<u>113,935</u>	<u>182,021</u>	<u>271,955</u>	<u>51,382</u>	<u>144,836</u>	<u>110,806</u>

Notes to the Financial Statements for the year ended December 31, 2006**Note 23 - Data concerning Items in Statements of Operations (cont'd)****F. Other income (expenses), net**

	Year ended December 31		
	2 0 0 6	2 0 0 5	2 0 0 4
	N I S t h o u s a n d s		
1. Consolidated:			
Sale of investments and activities in investees (including changes in rates of holding)	80,136	308,025	223,095
Income (expenses) relating to the termination of activities and sale and write-down of assets, net	1,504	(68,392)	(73,523)
Supplemental severance pay and pensions	-	(38,531)	(45,356)
Management services – affiliated companies	6,751	13,820	455
Securitization costs (see Note 3B(4))	-	-	(27,783)
Compensation for damages	4,510	-	-
Amortization of intangible assets	-	(507)	(131,934)
Dividend	6,509	10,389	4,701
Miscellaneous, net	4,796	(1,182)	(22,047)
	<u>104,206</u>	<u>223,622</u>	<u>(72,392)</u>
2. Company:			
Profit from sale of investments in investee companies	48,745	424,261	212,024
Write-down in value of long-term assets	-	-	-
Rental income, net*	7,515	7,202	8,135
Loss from sale of fixed assets	(453)	(7)	-
Dividend	6,921	10,389	4,701
Miscellaneous, net	(814)	(3,712)	10,099
	<u>61,914</u>	<u>438,133</u>	<u>234,959</u>
	<u>760</u>	<u>760</u>	<u>760</u>
* Depreciation included in the item			

G. Koor's equity in the operating results of investee companies, net**1. Consolidated:**

	Year ended December 31		
	2 0 0 6	2 0 0 5	2 0 0 4
	N I S t h o u s a n d s		
Affiliated companies, net	3,459	426,319 *	(10,779)
Amortization of excess cost	(40,008)	(66,957)	(24,281)
	<u>(36,549)</u>	<u>359,362</u>	<u>(35,060)</u>

* Restated – see Note 2R(4).

Note 23 - Data concerning Items in Statements of Operations (cont'd)**G. Koor's equity in the operating results of investee companies, net (cont'd)****2. Company:**

	Year ended December 31		
	2 0 0 6	2 0 0 5	2 0 0 4
	N I S t h o u s a n d s		
Equity of Koor in operating results	35,417	190,942	57,192
Amortization of excess cost	(28,323)	(60,499)	(30,992)
Total (1)	<u>7,094</u>	<u>130,443</u>	<u>26,200</u>

(1) Composition:

	Year ended December 31		
	2 0 0 6	2 0 0 5	2 0 0 4
	N I S t h o u s a n d s		
Subsidiaries	(19,411)	(152,995) *	122,172
Proportionately consolidated companies	1,082	(75,199)	(61,114)
Affiliates	25,423	358,637 *	(34,858)
	<u>7,094</u>	<u>130,443 *</u>	<u>26,200</u>

* Reclassified

Notes to the Financial Statements for the year ended December 31, 2006**Note 24 - Discontinued Operations****1. Elisra Electronic Systems Ltd. ("Elisra")**

On November 30, 2005 the closing of the transactions for the sale of Elisra to Elbit took place, in accordance with the agreements from July 6, 2005. See Note 3D.

Following are the results of operations of the discontinued operation, as included in the financial statements for the year ended December 31:

	<u>2 0 0 5</u>	<u>2 0 0 4</u>
	<u>N I S t h o u s a n d s</u>	
Revenues and earnings		
Revenue from sales and services	969,235	1,109,524
Other income, net	142,734	-
	<u>1,111,969</u>	<u>1,109,524</u>
Costs and losses		
Cost of sales and services	894,249	940,111
Selling and marketing expenses	91,817	85,454
General and administrative expenses	50,996	55,795
Finance expenses, net	3,271	(675)
Finance expenses, net	-	12,265
	<u>1,040,333</u>	<u>1,092,950</u>
Earnings before income tax	71,636	16,574
Income tax	(15,874)	(9,485)
	<u>55,762</u>	<u>7,089</u>
Minority interest in subsidiaries' results, net	44,116	(1,821)
	<u>99,878</u>	<u>5,268</u>
Net earnings for the year	<u><u>99,878</u></u>	<u><u>5,268</u></u>

2. Koor Trade Ltd.

During August 2005, a valuation was conducted in respect of an affiliated company of Koor Trade Ltd., in order to examine the necessity of writing down the value of the affiliated company in the financial statements of Koor Trade Ltd. as prescribed by the Israel Accounting Standards Board Accounting Standard No. 15. The valuation was performed by an independent external expert and as a result, Koor Trade Ltd. included a loss from write down of value of approximately NIS 44 million in 2005.

In 2005, the Board of Directors of the Group granted the Group's management the authority to sell the Group's entire holding in Koor Trade Ltd. The Company recorded a provision in the amount of approximately NIS 20 million for impairment in value of its investment in Koor Trade, based on indicators relating to the fair value of the investment, including a valuation by an external valuation expert.

On April 25, 2006, the Company signed an agreement for the sale of its entire holdings in Koor Trade, including shareholder loans, to a group of managers, including one of the Company's senior executives, for \$8.3 million. The transaction was completed in the second quarter of 2006, and the entire cash proceeds of \$8.3 million were received.

In the event that the buyers sell their holding in Koor Trade or a certain affiliated company of Koor Trade during a period stipulated in the agreement, at a price that exceeds the sale price (or the price fixed in the agreement of the value of the aforesaid affiliated company), the sale price will be increased by an increment amount.

Note 24 - Discontinued Operations (cont'd)**2. Koor Trade Ltd. (cont'd)**

Following the resolution of the Company's Board of Directors from 2005 to sell Koor Trade, Koor Trade has been presented as a discontinued operation commencing from the Company's financial statements for the year ended December 31, 2005.

The sale of Koor Trade did not have a significant impact on the Company's financial results.

Following are the assets and liabilities relating to the discontinued operation as at December 31:

	2 0 0 5 *
	NIS thousands
Assets related to discontinued operation	
Cash and cash equivalents	30,379
Short-term deposits and investments	4,713
Trade receivables	59,769
Other accounts receivable	13,732
Inventories	19,567
Investments in affiliates	18,530
Other long-term investments and receivables	37,575
Fixed assets, net	6,989
Intangible assets, deferred tax assets and deferred expenses, net	7,562
	<u>198,816</u>
Liabilities related to discontinued operation	
Credit from banks and others	9,629
Other long-term liabilities	120,096
Other loans, net of current maturities	27,999
Liability for employee severance benefits, net	1,645
Minority interest	679
	<u>160,048</u>

* Reclassified.

Notes to the Financial Statements for the year ended December 31, 2006**Note 24 - Discontinued Operations (cont'd)****2. Koor Trade Ltd. (cont'd)**

Following are the results of operations of the discontinued operation, as included in the financial statements, for the year ended December 31:

	<u>2 0 0 6</u>	<u>2 0 0 5</u>	<u>2 0 0 4</u>
	<u>N I S t h o u s a n d s</u>		
Revenues and earnings			
Revenue from sales and services	41,203	157,171	111,536
Group's equity in the operating results of affiliates, net	-	(33,674)	7,373
Other income	4,599	-	5,898
	<u>45,802</u>	<u>123,497</u>	<u>124,807</u>
Costs and losses			
Cost of sales and services	27,309	110,160	69,953
Selling and marketing expenses	7,431	28,827	20,686
General and administrative expenses	4,495	11,524	9,864
Other expenses	2,840	18,068	-
Finance expenses, net	(318)	1,409	(47)
	<u>41,757</u>	<u>169,988</u>	<u>100,456</u>
Earnings before income tax	4,045	(46,491)	24,351
Income tax	(1,459)	(2,855)	(5,285)
	<u>2,586</u>	<u>(49,346)</u>	<u>19,066</u>
Minority interest in subsidiaries' results, net	(253)	(151)	(146)
Net earnings (loss) for the year	<u>2,333</u>	<u>(49,497)</u>	<u>18,920</u>

Note 24 - Discontinued Operations (cont'd)**3. Isram Wholesale Tours and Travel Ltd.**

On December 28, 2006 the Company sold its entire holding in Isram Wholesale Tours and Travel Ltd. ("Isram") for total consideration of \$1.26 million. The Company recorded a capital gain of approximately NIS 8 million in respect of the sale.

Pursuant to the sale, Isram has been presented as a discontinued operation.

Following are the assets and liabilities relating to the discontinued operation as at December 31:

	<u>2 0 0 5</u>
	<u>NIS thousands</u>
<u>Assets related to discontinued operation:</u>	
Cash and cash equivalents	9,132
Trade receivables	14,987
Other accounts receivable	8,470
Other long-term investments and receivables	1,216
Fixed assets, net	1,556
Intangible assets, deferred tax assets and deferred expenses, net	3,645
	<u>39,006</u>
<u>Liabilities related to discontinued operation:</u>	
Trade and other payables	20,516
Customer advances	16,377
Other loans, net of current maturities	5,301
Liability for employee severance benefits, net	226
Minority interest	(1,178)
Deferred tax liabilities	-
	<u>41,242</u>

Notes to the Financial Statements for the year ended December 31, 2006**Note 24 - Discontinued Operations (cont'd)****3. Isram Wholesale Tours and Travel Ltd. (cont'd)**

Following are the results of operations of the discontinued operation, as included in the financial statements, for the year ended December 31:

	<u>2 0 0 6</u>	<u>2 0 0 5</u>	<u>2 0 0 4</u>
	<u>N I S t h o u s a n d s</u>		
Revenues and earnings			
Revenue from sales and services	253,473	254,751	191,831
Other income	8,001	-	-
	<u>261,474</u>	<u>254,751</u>	<u>191,831</u>
Costs and losses			
Cost of sales and services	219,573	219,499	166,259
Selling and marketing expenses	5,143	4,996	3,697
General and administrative expenses	23,413	24,713	21,522
Other expenses	-	417	-
Finance expenses, net	(262)	936	129
	<u>247,867</u>	<u>250,561</u>	<u>191,607</u>
Earnings before income tax	13,607	4,190	224
Income tax	(5,240)	(722)	(50)
	<u>8,367</u>	<u>3,468</u>	<u>174</u>
Minority interest in subsidiaries' results, net	(226)	(1,040)	(61)
Net earnings for the year	<u><u>8,141</u></u>	<u><u>2,428</u></u>	<u><u>113</u></u>

Note 25 - Business Segments**A. The Koor Group operates in the following business segments:**

The Group's agrochemical activities are carried out through M-A Industries considered one of the world's foremost manufacturer of generic crop protection solutions. M-A Industries produces a full range of products, including insecticides, fungicides and herbicides, as well as plant growth regulators. In addition, M-A Industries is engaged in specialty aroma chemicals and other different kinds of chemicals. As of 2005, M-A Industries is included in the financial statements according to the equity method.

Most of the Group's telecommunication activities are focused in three companies – ECI Telecom Ltd., an affiliated company, that provides solutions for broadband access networks and transmission optical networks, ECTel Ltd., an affiliated company as of the third quarter of 2006 that provides solutions for revenue management and fraud prevention at telecom providers, and Telrad Networks Ltd., which develops and markets telecom products and provides end-user solutions and appears as an affiliated company as of the end of the second quarter of 2005. In addition, the telecommunications segment includes a number of subsidiaries that develop and market equipment in the fields of microwave and cellular communications.

Notes to the Financial Statements for the year ended December 31, 2006**Note 25 - Business Segments (cont'd)****A. The Koor Group operates in the following business segments (cont'd)**

Activities in venture capital investments are carried out through the Koor Corporate Venture Capital partnership, which invests in high-tech companies and venture capital funds with high growth potential. Most of the investments are in the fields of communication and life sciences.

The Group's tourism activities are conducted primarily by Sheraton Moriah, which holds the Sheraton Hotel chain in Israel, and Knafayim (an affiliated company until the third quarter of 2004) which holds 40% of the EL-AL airline company and provides aviation and holiday services and leases aircrafts to other companies. See also Note 3E(2) regarding the expected sale of Sheraton-Moriah.

B. Segment sales include products sold and services rendered to unrelated customers, which are not part of the group.

Inter-industry segment sales are immaterial and are based primarily on prices determined in the ordinary course of business. Accordingly, these sales are not presented separately.

Segment operating earnings include all costs and expenses directly related to the relevant segment and for those that benefit more than one segment, are charged on a proportionate basis. Identifiable assets and liabilities by industry segments are those that are used by Koor in its activities in each segment.

C. Data regarding business segments of the Koor Group - consolidated:

	Year ended December 31		
	2006	2005	2004
	N I S	t h o u s a n d s	a n d s
Revenues from sales and services			
Telecommunications *	260,384	452,433	671,531
Agro-chemicals	-	-	6,895,238
Tourism	312,801	271,443	238,449
Others	10,068	9,755	10,564
Total	<u>583,253</u>	<u>733,631</u>	<u>7,815,782</u>
* Including sales to major customer	<u>141,866</u>	<u>180,130</u>	<u>586,114</u>
Earnings (losses) before income tax			
Telecommunications	(121,613)	(33,517)*	(110,617)
Defense electronics	-	56,180	(20,000)
Agro-chemicals	65,925	557,824*	1,263,541
Venture capital investments	39,585	(41,472)	(43,327)
Tourism	27,581	22,520	36,298
Others	(146)	(5,006)	(3,414)
Earnings before joint general and financing expenses and income tax	<u>11,332</u>	<u>556,529</u>	<u>1,122,481</u>
Joint general income (expenses), net	3,712	(46,862) *	(26,697)
Financing expenses, net	<u>(113,935)</u>	<u>(182,021)</u>	<u>(271,955)</u>
Earnings (losses) before income tax	<u>(98,891)</u>	<u>327,646</u>	<u>823,829</u>

* Restated – see Note 2R(4).

Notes to the Financial Statements for the year ended December 31, 2006**Note 25 - Business Segments (cont'd)****C. Data regarding business segments of the Koor Group - consolidated (cont'd)****The Koor Group's equity in the results of investee companies, net:**

	Year ended December 31		
	2006	2005	2004
	N I S	t h o	u s a n d s
Telecommunications	(106,781)	27,050 *	(15,919)
Defense electronics	-	(23,288)	(20,000)
Agro-chemicals	65,925	359,200 *	-
Venture capital investments	(4,739)	(755)	(329)
Tourism	1,006	(1,769)	(907)
Others	8,040	(1,076)	2,095
	<u>(36,549)</u>	<u>359,362</u>	<u>(35,060)</u>

* Restated – see Note 2R(4).

	Year ended December 31	
	2006	2005
	N I S	t h o u s a n d s
Identifiable assets		
Telecommunications	124,830	175,618
Venture capital investments	169,831	121,444
Tourism	812,319	766,675
Others	10,758	110,508
Total	<u>1,117,738</u>	<u>1,174,245</u>
Joint assets	1,061,873	1,212,176
Affiliated companies ⁽¹⁾	3,324,220	2,664,020 *
Assets relating to discontinued operations	-	237,822
	<u>5,503,831</u>	<u>5,288,263</u>

⁽¹⁾ Investments in affiliated companies are as follows:

Telecommunications	801,975	903,333*
Venture capital investments	37,547	44,964
Agro-chemicals	2,348,103	1,689,128*
Tourism and others	136,595	26,595
	<u>3,324,220</u>	<u>2,664,020</u>

* Restated – see Note 2R(4).

Notes to the Financial Statements for the year ended December 31, 2006**Note 25 - Business Segments (cont'd)****C. Data regarding business segments of the Koor Group - consolidated (cont'd)**

	Year ended December 31	
	2006	2005
	N I S t h o u s a n d s	
Identifiable liabilities		
Telecommunications	58,400	91,124
Venture capital investments	1,056	-
Tourism	60,542	74,417
Others	9,174	10,363
Total segments	<u>129,172</u>	<u>175,904</u>
Joint liabilities	102,846	54,908
Financing commitments	2,958,848	2,272,277
Others	49,254	47,543
Liabilities relating to discontinued operations	-	201,290
	<u>3,240,120</u>	<u>2,751,922</u>

	Year ended December 31		
	2006	2005	2004
	N I S t h o u s a n d s		
Capital investments			
Telecommunications	3,365	7,529	21,825
Agro-chemicals	-	-	816,287
Tourism	85,049	18,410	12,614
Others	-	239	148
Total segments	<u>88,414</u>	<u>26,178</u>	<u>850,874</u>
Corporate assets	200	177	423
	<u>88,614</u>	<u>26,355</u>	<u>851,297</u>
Depreciation and amortization			
Telecommunications	3,723	13,243	32,281
Agro-chemicals	-	-	364,995
Tourism	29,879	26,978	27,489
Others	-	-	17
Total segments	<u>33,602</u>	<u>40,221</u>	<u>424,782</u>
Corporate assets	1,035	1,954	1,183
	<u>34,637</u>	<u>42,175</u>	<u>425,965</u>

Notes to the Financial Statements for the year ended December 31, 2006**Note 25 - Business Segments (cont'd)****D. Revenues from sales and services by geographic destinations according to customer location**

	Year ended December 31		
	2 0 0 6	2 0 0 5	2 0 0 4
	N I S t h o u s a n d s		
North America	200,634	333,202	1,302,993
Europe	10,306	51,473	3,018,700
South America	23,670	10,558	1,945,241
Asia and Australia	5,481	17,486	566,408
Africa	13,583	15,134	216,853
Israel	329,579	305,778	765,587
	583,253	733,631	7,815,782

Note 26 - Related Parties and Interested Parties**A. Change in controlling shareholders of the Company**

On May 1, 2006, Discount Investments Corp. Ltd., a subsidiary of IDB Development Corporation Ltd., signed an agreement to acquire from the Claridge Group ("Claridge"), as well as from Anfield Ltd. (a company registered in Israel and owned by Jonathan B. Kolber, Koor's former Chief Executive Officer ("CEO") and current Chairman of the Board of Directors) and another company related to the family of Jonathan B. Kolber, all of Koor's shares held by those entities totaling 5,753,207 shares, or approximately 34.9% of Koor's outstanding shares, for \$445.8 million. All approvals, to which the transaction was subject, including Israel's anti-trust commissioner, have been granted. On July 3, 2006, this transaction closed and 5,081,033 of Koor's shares, or approximately 30.9% of Koor's outstanding shares, were transferred to Discount Investments Corp. for approximately \$394 million, and a put option, exercisable during December 2006, was granted to Anfield Ltd. in respect of the remaining 672,174 shares. Subsequent to the transfer of shares, all of Koor's directors resigned from the Board of Directors and new directors were nominated. Furthermore, Koor's CEO resigned and a new CEO was appointed. Discount Investments is held 74.2% by IDB Development, which also directly holds 10% of Koor's outstanding ordinary shares.

On September 28, 2006 Discount Investments completed a special tender offer, whereby it purchased an additional 890,000 shares, or approximately 5.4% of Koor's outstanding shares, from the public.

On December 27-28, 2006 Discount Investments purchased an additional 1,004,453 shares, or approximately 6.1% of Koor's outstanding shares, from Jonathan B. Kolber and former directors and employees, as well as certain present employees.

As of December 31, 2006 the Company's ultimate parent company, IDB Development Corp. Ltd., holds 52% of the Company's shares, directly and indirectly through Discount Investments. IDB Development Corp. Ltd. is Israel's major investment holding company, with a diversified investment portfolio spanning a large number of entities throughout the Israeli economy ("IDB Group"). Subsequent to the change in control, companies in the IDB Group are related parties of the Company.

Note 26 - Related Parties and Interested Parties (cont'd)**B. Description of Transactions with Related Parties and Interested Parties**1. Inconsequential transactions that are not unusual

- (1) To the best of the Company's knowledge, the Company and its subsidiaries have conducted inconsequential transactions, that are not unusual, with interested parties, and have committed to conduct such transactions, of the following types and with the following characteristics: transactions between the Company or its subsidiaries and banks and financial institutions that are interested parties as set forth in (2) below; insurance policies issued by Clal Insurance Company Ltd. ("Clal Insurance") or subsidiary thereof; transactions for the purchase of goods and services (such as communications and food products) conducted by interested parties within the ordinary course of business with companies in the IDB Group that are engaged in the sale of said goods and services; purchase of shopping vouchers; transactions for the purchase of travel services from companies that are interested parties; financial advisory transactions; financial management by Clal Finances Mutual and Provident Fund Ltd. of funds deposited by employers and employees in mutual funds and provident funds.
- (2) Banks may be considered to be interested parties as well as related parties of the Company and companies within the Koor Group. Epsilon Investment House Ltd. ("Epsilon") Clal Finances Betucha Investment Management Ltd. ("Clal Finances Betucha") and Clal Insurance Business Holdings Ltd are considered interested parties of companies within the Koor Group and related parties of the Company and of companies within the Koor Group. The Company and companies within the Koor Group, as well as interested parties in the Company, receive financial services from the abovementioned banks and financial institutions, and companies owned by them. Furthermore, the Company and companies in the Koor Group, occasionally hold investment trust units managed by related parties, and manage securities accounts with Clal Finances Batucha.

2. Arrangements between the Company and its controlling shareholders

On September 1, 2006 the Company relocated its premises to premises that accommodate other companies within the IDB Group, in the Triangular Tower at the Azrieli Center in Tel-Aviv.

In accordance with the agreement for the allocation of the costs of the office premises according to which all the IDB Group companies that are located in the Azrieli Center operate, IDB Development Ltd. (the Company's controlling shareholder in accordance with Section 268 of the Companies Ordinance – 1999), leases all the office premises at the Azrieli Center as the primary lessee of the IDB Group in respect of the entire group, engages the management and administration services of the Azrieli property management company in respect of the entire group, and bears all the general expenses in respect of other services to all of the companies in the group ("the leasing and management services"). According to this arrangement, each of the companies in the IDB Group that are located in the Azrieli Center participate in IDB Development Ltd.'s expenses in respect of the leasing and management services, in accordance with each company's relative part, as determined by the number of its employees relative to the total number of employees of the companies in the IDB Group that are located in the Azrieli Center. The participation in the expenses is based on the expenses borne by IDB Development Ltd. without a profit markup.

The Company's participation in this arrangement was approved by the Audit Committee of the Company's Board of Directors, by the Company's Board of Directors and by the extraordinary general shareholders' meeting of the Company.

Note 26 - Related Parties and Interested Parties (cont'd)**B. Description of Transactions with Related Parties and Interested Parties**3. Directors' and officers' insurance and indemnification and exemption of liability for officers (cont'd)

(1) In 2006 the liability of officers of the Company and its subsidiaries was insured by Clal Insurance, a company controlled by the Company's controlling shareholders. The total insurance premium paid in 2006 by the Company and its subsidiaries covered by the policy amounted to approximately \$700 thousand. The transaction was approved by an extraordinary general meeting of the Company's shareholders as required by law.

(2) The Company resolved in the past to indemnify its officers (including previous officers) and its representatives on the boards of directors of its investee companies, under certain circumstances, in respect of any amount that they may be charged within the framework of any legal proceeding filed against them in connection with their actions or omissions in fulfilling their duties as officers. The Company issued such letters of indemnification to certain of its officers (as well as previous directors).

Subsequent to the Companies Ordinance (Amendment 3) – 2005, the Company updated its articles of association in accordance with this amendment. On December 28, 2006, following the approval of the Company's Audit Committee and Board of Directors, the Company's general shareholders' meeting approved the issuance of new letters of indemnification to the directors and officers of the Company (including controlling shareholders serving as directors or officers of the Company). Subsequent to the approval, the Company issued new letters of indemnification whereby the Company committed to indemnify them in respect of any liability or expense set forth in the letter of indemnification (including financial liability towards a third party in accordance with a court ruling as well as legal expenses, as set forth in the letter of indemnification) that they may be charged with or that they may incur due to their actions in fulfilling their duties as officers of the Company and/or due to their fulfilling, at the Company's request, the roles of officers in another company, related to events set forth in the appendix to the letter of indemnification.

According to the letters of indemnification, the maximum amount of the indemnification that the Company may pay (in addition to amounts that may be received from insurers under the insurance purchased by the Company) in respect of all the officers of the Company for a particular event, shall not exceed 25% of the Company's shareholders' equity according to its most recent annual or quarterly financial statements, prior to the payment of the indemnification amounts.

The liability of the Company's officers in fulfilling their duties is partially insured by insurance policies, including policies described in item 3(1) above.

4. Compensation of the Chairman of the Board of Directors and Chief Executive Officer

(1) On August 1, 2006 Mr. Jonathan Kolber ceased to serve as the Company's Chief Executive Officer and began to serve as its active and full-time Chairman. On December 28, 2006, following the approval of the Company's Audit Committee on November 20, 2006 and Board of Directors on November 22, 2006, the Company's general shareholders' meeting approved Mr. Kolber's compensation package, which includes a monthly salary of NIS 120 thousand linked to the Israeli CPI, in respect of which the Company will deposit an additional 23.3% in executive insurance policies or other pension arrangements and provident funds in respect of social benefits. Mr. Kolber will also have at his disposal a company car and telephone, and the Company will bear the related taxes in respect thereof. The arrangement may be terminated by Mr. Kolber or by the Company at any time, subject to a three month advance notification period. Mr. Kolber will be entitled to an annual bonus to be decided upon by the

Note 26 - Related Parties and Interested Parties (cont'd)**B. Description of Transactions with Related Parties and Interested Parties (cont'd)**4. Compensation of the Chairman of the Board of Directors and Chief Executive Officer (cont'd)

Board of Directors, of no less than six and no more than twelve monthly salaries. This arrangement replaces the previous employment contract that was in effect since April 2003, and under which Mr. Kolber was granted a special retirement bonus of approximately NIS 8.4 million upon cessation of his employment as the Company's Chief Executive Officer.

- (2) On August 1, 2006 Mr. Ra'anan Cohen was appointed as the Company's CEO. Mr. Cohen is employed by Discount Investments. The Company and Discount Investments have agreed that the Company will bear 80% of the compensation expenses incurred by Discount Investments in respect of Mr. Cohen. These financial statements include a provision of NIS 866 thousand in respect of the Company's said participation in the compensation expenses for Mr. Cohen. This participation arrangement has been approved by the Company's Audit Committee and Board of Directors and shall be presented for approval of the Company's general shareholders' meeting.

- (3) See Note 20C regarding options granted to interested parties.

5. General and administrative expenses

Until the end of June 2006 the Company had agreements with Claridge for the receipt of consultancy services. These services included, inter alia, advice in respect of investment strategies, monetary policies, international activities, strategic partnerships and company structuring. The agreements included instructions regarding the indemnification of the consultants in respect of claims connected to the consultancy, except for cases of gross negligence and/or intentional damage. In consideration for the consultancy the Company paid an annual sum not exceeding \$400,000.

6. Management services to subsidiaries and affiliates

The Company has agreements with certain of its subsidiaries and affiliates, whereby the Company receives management fees in respect of consultancy services provided to these companies.

Telrad Networks and Dekolink pay the Company annual management fees of 1% and 0.8% of sales, respectively. Furthermore, Makhteshim-Agan paid the Company an annual management fee of \$2.5 million in accordance with a management fee agreement that ended in May 2006. The new management fee agreement between the Company and Makhteshim-Agan has not yet been approved by Makhteshim-Agan Board of Directors or general shareholders' meeting.

7. Transaction in which related party has an interest

See Note 3E(2) in connection with the sale of Sheraton-Moriah, that is linked with a sale by a company in the IDB Group.

Notes to the Financial Statements for the year ended December 31, 2006

Note 26 - Related Parties and Interested Parties (cont'd)

C. Balances with Related Parties and Interested Parties

	Consolidated		Company	
	Year ended		December 31,	
	2006	2005	2006	2005
	NIS thousands			
Receivables	6,173	35,960	1,686	7,320
Short-term loans to investee companies	-	-	39,308	37,212
Long-term loans, capital notes and non-current accounts with investee companies	103,607	98,910	38,699	1,243,098
Payables	2,197	13,481	21	-
Capital note payable to subsidiary	-	-	6,382	6,713
Highest balance of long-term loans, capital with notes and non-current accounts with investee companies during the year	-	-	1,243,098	1,243,098

D. Summary of Transactions with Related Parties and Interested Parties

1. Consolidated:

	December 31,		
	2006	2005	2004
	NIS thousands		
Income			
Revenues	7,218	29,312	24,289
Management and directors' fees from investee companies	8,267	18,957	6,826
Interest	2,494	4,548	1,488
Rental	-	7,200	-
Expenses			
Selling and marketing expenses	4,584	5,998	8,026
Interest	840	-	800
Portfolio management commissions	3,266	-	-
Office rental expenses	1,630	366	-
Directors' and officers' insurance	3,263	2,326	-
Management fees to interested parties	649	1,830	1,788
Compensation of an interested party employed by the Company	15,617	4,764	3,870
Compensation of an interested party not employed by the Company	866	-	-
Directors' fees	1,158	1,259	1,221
Other transactions			
Deferred debenture issue costs	793	-	-
Capitalized commissions in respect of securities purchased	355	-	-

Number of directors: in 2006 – 20 *; in 2005 – 9; in 2004 – 10 *.

* including directors replaced during the year.

Notes to the Financial Statements for the year ended December 31, 2006**Note 26 - Related Parties and Interested Parties (cont'd)****D. Summary of Transactions with Related Parties and Interested Parties (cont'd)****2. Company:**

	D e c e m b e r 3 1 ,		
	2 0 0 6	2 0 0 5	2 0 0 4
	N I S t h o u s a n d s		
Income			
Management and directors' fees from investee companies	7,767	20,367	22,800
Interest	3,025	3,735	3,098
Rental	-	7,200	-
Expenses			
Interest	66	3,777	4,530
Portfolio management commissions	3,266	-	-
Office rental expenses	1,630	732	714
Insurance (including directors' and officers' insurance from 2005)	3,772	3,042	817
Management fees to interested parties	649	1,830	1,788
Compensation of an interested party employed by the Company	15,617	4,764	3,870
Compensation of an interested party not employed by the Company	866	-	-
Directors' fees	572	665	632
Other transactions			
Deferred debenture issue costs	793	-	-
Capitalized commissions in respect of securities purchased	355	-	-

Number of directors: in 2006 – 20 *; in 2005 – 9; in 2004 – 10 *.

* including directors replaced during the year.

Notes to the Financial Statements for the year ended December 31, 2006**Note 27 - Earnings Per Share****1. Basic earnings per share:**

The basic earnings (loss) per share are calculated according to the earnings (loss) for the year, divided by the weighted average number of ordinary shares outstanding during the year.

	For the year ended December 31		
	2 0 0 6	2 0 0 5	2 0 0 4
Net earnings (loss) for the year:			
From continuing operations	(113,674)	257,842	120,689
Adjustment in respect of equity in operating results of affiliates	8,521	3,214	(3,231)
	<u>(105,153)</u>	<u>261,056</u>	<u>117,458</u>
From discontinued operations	10,474	52,809	24,301
From cumulative effect of change in accounting method	62,522	(3,054)	-
	<u>(32,127)</u>	<u>310,811</u>	<u>141,759</u>
	D e c e m b e r 3 1 ,		
	2 0 0 6	2 0 0 5	2 0 0 4
Weighted average number of ordinary shares:			
As at January 1	16,146,668	15,824,185	15,741,160
Shares resulting from exercise of stock options	250,654	84,720	54,519
Shares issued during the year	-	120,768	-
Weighted average number of ordinary shares for the calculation of basic earnings (loss) per share as at December 31	<u>16,397,322</u>	<u>16,029,673</u>	<u>15,795,679</u>

2. Diluted earnings per share:

The diluted earnings (loss) per share are calculated according to the earnings (loss) for the year, divided by the weighted average number of ordinary shares outstanding, as well as all potentially dilutive ordinary shares.

	For the year ended December 31		
	2 0 0 6	2 0 0 5	2 0 0 4
Net earnings (loss) for the year:			
From continuing operations	(113,674)	257,842	120,689
Adjustment in respect of equity in operating results of affiliates	(301)	(32,066)	(37,842)
	<u>(113,975)</u>	<u>225,776</u>	<u>82,847</u>
From discontinued operations	10,474	52,809	24,301
From cumulative effect of change in accounting method	62,552	(3,054)	-
	<u>(40,949)</u>	<u>275,531</u>	<u>107,148</u>

Notes to the Financial Statements for the year ended December 31, 2006**Note 27 - Earnings Per Share (cont'd)****2. Diluted earnings per share (cont'd)**

	December 31		
	2 0 0 6	2 0 0 5	2 0 0 4
Weighted average number of ordinary shares:			
Weighted average number of ordinary shares for the calculation of basic earnings (loss) per share	16,397,322	16,029,673	15,795,679
Impact of stock options	-	513,935	481,925
Weighted average number of ordinary shares for the calculation of diluted earnings (loss) per share	<u>16,397,322</u>	<u>16,543,608</u>	<u>16,277,604</u>

Note 28 - Events Subsequent to the Balance Sheet Date

On January 11, 2007, the Company sold all shares held by Koor and Koor Corporate Venture Capital in Scopus Video Networks Ltd. The Company's total proceeds from the transaction amounted to approximately \$16 million in cash. As a result of this transaction, the Company expects to record a capital gain of approximately NIS 30 million in the first quarter of 2007.

Annex 1 – Subsidiaries (included in continuing operations) as at December 31, 2006

Name of subsidiary	Percentage held in share capital	
	Voting rights	Equity rights
	%	%
Telrad Holdings Ltd.	100	100
Koor Corporate Venture Capital (partnership)	100	100
Koor Holdings Ltd. (in voluntary liquidation)	100	100
Koor Investments Ltd.	100	100
Koor Properties Ltd.	100	100
Koor Shevel Ltd.	55	55
MAGAM Chemical Holdings Ltd.	100	100
Solkoor Marketing and Purchasing Ltd.	100	100
Sheraton Moriah (Israel) Ltd.	56.5	56.5
Dekolink Wireless Ltd.	70	70
Microwave Networks Inc.	97.5	97.5
Korin Insurance Limited	100	100
Tadiran Limited (in voluntary liquidation)	100	100
Koor Tadiran Gemel Ltd.	100	100

Annex 2 – Affiliated companies as at December 31, 2006 – Consolidated

	Percentage of share capital		Investment in equity	Excess cost, net	Long- term loans	Total
	Voting rights	Equity rights				
	%		N I S t h o u s a n d			
Makhteshim-Agan Industries Ltd. *	39.6	37.1	1,889,166	458,937	-	2,348,103
ECI Telecom Ltd. *	28.1	27.7	746,759	(4,929)	-	741,830
Ectel Ltd. *	21.4	21.4	33,333	12,146	-	45,479
A.K.A. Development Ltd.	33.3	33.3	7,314	-	26,707	34,021
Scopus Video Networks Ltd. *	22.2	22.2	36,714	833	-	37,547
Joint-Venture - Sheraton City Tower	33.3	33.3	2,043	-	-	2,043
Telrad Networks Ltd.	61	61	(47,719)	-	56,002	8,283
Epsilon Investment House Ltd.	50	50	33,280	74,004	-	107,284
Mashal Alluminia Industries Ltd.	-	-	(370)	-	-	(370)
			<u>2,700,520</u>	<u>540,991</u>	<u>82,709</u>	<u>3,324,220</u>

* Publicly traded company.

Annex 3 – Affiliated companies as at December 31, 2006 – Company

	Percentage of share capital		Par value of shares	Investment in equity	Excess cost, net	Payment on account of shares	Long-term loans and capital notes	Non-current accounts	Total
	Voting rights	Equity rights							
	%								
					N I S t h o u s a n d				
Telrad Holdings Ltd.	100	100	17,895	12,812	-	750	-	-	13,562
Koor Corporate Venture Capital Ltd. (partnership)	100	100	-	206,347	-	-	-	-	206,347
Koor Holdings Ltd. (in voluntary liquidation)	100	100	15	(116)	-	-	-	116	-
Koor Investments Ltd.	100	100	1	(46,646)	-	46,175	-	416	(55)
Koor Properties Ltd.	100	100	597	13,039	-	11,905	-	-	24,944
Koor Shevel Ltd.	55	55	6	(8,362)	6,874	-	7,225	-	5,737
MAGAM Chemical Holdings Ltd.	100	100	20	1,371,908	-	-	-	-	1,371,908
Makhteshim-Agan Industries Ltd.	8.1	8.1	35,298	386,149	357,209	-	-	-	743,358
ECtel Ltd.	2.2	2.2	15	3,420	1,318	-	-	-	4,738
Solkoor Marketing and Purchasing Ltd.	100	100	71	(17,344)	-	-	15,300	1,536	(508)
Sheraton-Moriah (Israel) Ltd.	56.5	56.5	6,013	84,872	1,364	-	-	-	86,236
Korin Insurance Limited	100	100	563	6,828	-	-	-	-	6,828
Tadiran Limited (in voluntary liquidation)	100	100	98,138	(36,446)	-	-	-	-	(36,446)
Microwave Networks Ltd.	97.5	97.5	384	(32,090)	470	-	13,952	-	(17,668)
Epsilon Investment House Ltd.	50	50	-	33,279	74,004	-	-	-	107,283
Dekolink Wireless Ltd.	70	70	1,008	6,741	-	-	-	-	6,741
Subsidiaries located abroad	-	-	-	(154)	-	-	-	154	-
Mashal Alluminia Industries Ltd.				(370)	-	-	-	-	(370)
				<u>1,983,869</u>	<u>441,238</u>	<u>58,830</u>	<u>36,477</u>	<u>2,222</u>	<u>2,522,636</u>