

Koor Industries Limited
(An Israeli Corporation)

Consolidated Interim
Financial Statements
as at June 30, 2007
(Unaudited)

Condensed Consolidated Interim Financial Statements as at June 30, 2007

Contents

| | Page |
|--|-------------|
| Auditors' Review report | 2 |
| Condensed Consolidated Financial Statements as at June 30, 2007 (Unaudited) | |
| Condensed Consolidated Interim Balance Sheets | 3 |
| Condensed Consolidated Interim Statements of Income | 4 |
| Condensed Interim Statements of Changes in Shareholders' Equity | 5 |
| Condensed Consolidated Statements of Cash Flows | 9 |
| Notes to the Interim Financial Statements | 14-31 |



Somekh Chaikin
KPMG Millennium Tower
17 Ha'arba'a Street, PO Box 609
Tel Aviv 61006 Israel

Telephone 972 3 684 8000
Fax 972 3 684 8444
Internet www.kpmg.co.il

The Board of Directors **Koor Industries Limited**

Auditors' review report of unaudited condensed consolidated interim financial statements for the six-month and three-month periods ended June 30, 2007

At your request, we have reviewed the condensed consolidated interim balance sheet of Koor Industries Limited and its subsidiaries as at June 30, 2007, the related condensed consolidated interim statements of income, the condensed interim statements of changes in shareholders' equity and the condensed consolidated interim statements of cash flows for the six-month and three-month periods then ended.

Our review was conducted in accordance with procedures prescribed by the Institute of Certified Public Accountants in Israel, and included, inter alia, reading the said financial statements, reading the minutes of the Shareholders' Meetings and of the meeting of the Board of Directors and its committees, as well as making inquiries of persons responsible for financial and accounting matters.

We were furnished with the reports of other auditors on their review of the interim financial statements of certain subsidiaries whose assets as at June 30, 2007 constitute 5% of the total consolidated assets and whose revenues for the six-month and for the three-month periods then ended constitute 29% and 25% of the total continuing consolidated revenues, respectively, and constitute 14.5% of the total discontinuing consolidated revenues for the six-month period then ended. Furthermore, we were furnished with the reports of other auditors on their review of the interim financial statements of certain affiliates, whose Company's investments constitute NIS 170,728 thousand as at June 30, 2007 and its equity in earnings constitute NIS 14,347 thousand and NIS 5,722 thousand for the six-month and three-month periods then ended, respectively.

Since the review performed was limited in scope and does not constitute an audit in accordance with generally accepted auditing standards, we do not express an opinion on the said condensed consolidated interim financial statements.

In the course of our review, including the reading of the review reports of the other auditors as stated above, nothing came to our attention which would indicate the necessity of making any material modifications to the interim financial statements referred to above, in order for them to be in conformity with generally accepted accounting principles in Israel and in accordance with Section D of the Securities Regulations (Periodic and Immediate Report) - 1970.

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

August 15, 2007
Tel Aviv, Israel

Condensed Consolidated Interim Balance Sheets

| | June 30 | | December 31 | | Convenience translation (Note 1A3) |
|---|-------------------------|------------------|------------------|-----------|--|
| | 2007 | (1) 2006 | (2) 2006 | 2007 | June 30 |
| | Unaudited | | Audited | Unaudited | 2007 |
| | NIS thousands | | | | US\$ thousands |
| Assets | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | 1,206,289 | 175,298 | 241,586 | | 283,900 |
| Short-term deposits and investments | 584,450 | 445,406 | 695,931 | | 137,550 |
| Trade receivables | 52,854 | 32,182 | 33,010 | | 12,439 |
| Other receivables | 59,361 | 89,128 | 64,521 | | 13,971 |
| Inventories | 76,592 | 79,977 | 62,319 | | 18,025 |
| | <u>1,979,546</u> | <u>821,991</u> | <u>1,097,367</u> | | <u>465,885</u> |
| Investments and long-term receivables | | | | | |
| Investments in affiliates | 3,581,365 | 2,883,768 | 3,322,177 | | 842,873 |
| Other investments and receivables | 126,316 | 564,737 | 179,488 | | 29,728 |
| | <u>3,707,681</u> | <u>3,448,505</u> | <u>3,501,665</u> | | <u>872,601</u> |
| Investment property | <u>108,280</u> | *80,704 | * 80,080 | | <u>25,484</u> |
| Fixed assets, net | <u>8,708</u> | *10,280 | * 9,528 | | <u>2,049</u> |
| Intangible assets, deferred tax assets and deferred expenses | <u>12,297</u> | 653 | 546 | | <u>2,894</u> |
| Assets relating to discontinued operations | <u>-</u> | 895,665 | 814,645 | | <u>-</u> |
| | <u><u>5,816,512</u></u> | <u>5,257,798</u> | <u>5,503,831</u> | | <u><u>1,368,913</u></u> |

* Reclassified - see Note 1B(4).

(1) Reclassified with respect to discontinued operations - see Note 7(2) and Note 7(3).

(2) Reclassified with respect to discontinued operations - see Note 7(3).

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

| | June 30 | | December 31 | Convenience translation (Note 1A3) |
|--|-------------------------|-------------------------|-------------------------|--|
| | 2007 | (1) 2006 | (2) 2006 | June 30 |
| | Unaudited | | Audited | 2007 |
| | NIS thousands | | | Unaudited |
| | | | | US\$ thousands |
| Liabilities and shareholders' equity | | | | |
| Current liabilities | | | | |
| Credit from banks and others | 154,301 | 39,960 | 33,800 | 36,315 |
| Trade payables | 62,612 | 42,895 | 40,473 | 14,736 |
| Other payables | 180,098 | 152,414 | 161,228 | 42,386 |
| Customer advances | 3,646 | 1,190 | 1,779 | 858 |
| | <u>400,657</u> | <u>236,459</u> | <u>237,280</u> | <u>94,295</u> |
| Long-term liabilities | | | | |
| Long-term bank loans | 1,218,344 | 1,361,829 | 1,299,174 | 286,736 |
| Other long-term loans | 32,955 | 51,487 | 47,467 | 7,756 |
| Debentures | 1,610,862 | 398,329 | 988,482 | 379,116 |
| Deferred taxes | 1,428 | 44 | 34 | 336 |
| Liability for employee severance benefits, net | 1,461 | - | 2,137 | 344 |
| | <u>2,865,050</u> | <u>1,811,689</u> | <u>2,337,294</u> | <u>674,288</u> |
| Liabilities relating to discontinued operations | - | 823,726 | 737,721 | - |
| Minority interest | <u>3,112</u> | <u>1,965</u> | <u>2,348</u> | <u>732</u> |
| Shareholders' equity | <u>2,547,693</u> | <u>2,383,959</u> | <u>2,189,188</u> | <u>599,598</u> |
| | <u><u>5,816,512</u></u> | <u><u>5,257,798</u></u> | <u><u>5,503,831</u></u> | <u><u>1,368,913</u></u> |

Jonathan Kolber
Chairman of the Board of
Directors

Raanan Cohen
Chief Executive Officer

Michal Yageel
Corporate Controller

Date of approval: August 15, 2007

Condensed Consolidated Interim Statements of Income

| | Six months ended June 30 | | Three months ended June 30 | | Year ended | Convenience translation |
|---|--------------------------|-----------------|----------------------------|------------------|------------------|-------------------------|
| | 2007 | (1) 2006 | 2007 | (1) 2006 | December 31 | (Note 1A3) |
| | Unaudited | | Unaudited | | (2) 2006 | Six months ended |
| | | | NIS thousands | | Audited | June 30 |
| | | | | | | 2007 |
| | | | | | | Unaudited |
| | | | | | | US\$ thousands |
| Revenues and earnings | | | | | | |
| Revenue from sales and services | 118,213 | 141,656 | 64,595 | 64,557 | 270,452 | 27,821 |
| Group's equity in the operating results of investee companies, net | 233,989 | 60,544 | 121,109 | (3,767) | (37,555) | 55,069 |
| Other income, net | 49,962 | 4,109 | 16,352 | (393) | 99,492 | 11,759 |
| | <u>402,164</u> | <u>206,309</u> | <u>202,056</u> | <u>60,397</u> | <u>332,389</u> | <u>94,649</u> |
| Costs and losses | | | | | | |
| Cost of sales and services | 86,869 | 103,823 | 45,844 | 49,374 | 210,097 | 20,445 |
| Selling and marketing expenses | 22,896 | 25,175 | 11,213 | 12,570 | 47,315 | 5,389 |
| General and administrative expenses | 21,505 | 60,523 | 8,522 | 44,805 | 87,514 | 5,060 |
| Financing expenses, net | 6,527 | 57,684 | (1,609) | 43,774 | 97,480 | 1,536 |
| | <u>137,797</u> | <u>247,205</u> | <u>63,970</u> | <u>150,523</u> | <u>442,406</u> | <u>32,430</u> |
| Earnings before income tax | <u>264,367</u> | <u>(40,896)</u> | <u>138,086</u> | <u>(90,126)</u> | <u>(110,017)</u> | <u>62,219</u> |
| Income tax | 917 | (15,367) | 432 | (15,407) | (4,671) | 215 |
| | <u>265,284</u> | <u>(56,263)</u> | <u>138,518</u> | <u>(105,533)</u> | <u>(114,688)</u> | <u>62,434</u> |
| Minority interest in consolidated companies' results, net | (408) | (2,324) | (744) | (355) | (2,430) | (96) |
| Net earnings (loss) from continuing operations | <u>264,876</u> | <u>(58,587)</u> | <u>137,774</u> | <u>(105,888)</u> | <u>(117,118)</u> | <u>62,338</u> |
| Net earnings (loss) from discontinued operations (Note 7) | 10,355 | 3,398 | 13,678 | 11,389 | 13,918 | 2,437 |
| Cumulative effect as of the beginning of the year of change in accounting method | - | 62,552 | - | - | 62,552 | - |
| Net earnings (loss) for the period | <u>275,231</u> | <u>7,363</u> | <u>151,452</u> | <u>(94,499)</u> | <u>(40,648)</u> | <u>64,775</u> |
| Basic earnings (loss) per ordinary share: | | | | | | |
| From continuing operations | 15.762 | (3.351) | 8.299 | (6.667) | (6.623) | 3.710 |
| From discontinued operations | 0.625 | 0.209 | 0.825 | 0.697 | 0.849 | 0.147 |
| From cumulative effect of change in accounting method | - | 3.840 | - | - | 3.815 | - |
| Net earnings (loss) for the period | <u>16.387</u> | <u>0.698</u> | <u>9.124</u> | <u>(5.970)</u> | <u>(1.959)</u> | <u>3.857</u> |
| Diluted earnings (loss) per ordinary share: | | | | | | |
| From continuing operations | 15.638 | (3.842) | 8.198 | (6.667) | (7.161) | 3.680 |
| From discontinued operations | 0.623 | 0.209 | 0.823 | 0.697 | 0.849 | 0.147 |
| From cumulative effect of change in accounting method | - | 3.840 | - | - | 3.815 | - |
| Net earnings (loss) for the period | <u>16.261</u> | <u>0.207</u> | <u>9.021</u> | <u>(5.970)</u> | <u>(2.497)</u> | <u>3.827</u> |

(1) Reclassified with respect to discontinued operations - see Note 7(2) and Note 7(3).

(2) Reclassified with respect to discontinued operations - see Note 7(3).

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

Condensed Interim 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 a subsidiary | Cumulative foreign currency translation adjustments | Dividend proposed subsequent to the balance sheet date | Retained deficit | Total Shareholders' equity |
|--|--|------------------|---------------------|---|--|---|--|---------------------|----------------------------------|
| | NIS thousands | | | | | | | | |
| Balance as at January 1, 2007 (Audited) | 16,567,070 | 564,515 | 2,566,724 | 21,715 | (6,071) | (233,851) | - | (723,844) | 2,189,188 |
| Changes during the six months ended June 30, 2007 (Unaudited): | | | | | | | | | |
| Net earnings for the period | - | - | - | - | - | - | - | 275,231 | 275,231 |
| Dividend proposed subsequent to the balance sheet date | - | - | - | - | - | - | 149,857 | (149,857) | - |
| Adjustment to retained earnings in respect of investment properties (see Note 1B(4)) | - | - | - | - | - | - | - | 52,246 | 52,246 |
| Adjustment to retained earnings in respect of in-process research and development (see Note 1B(5)) | - | - | - | - | - | - | - | 1,728 | 1,728 |
| Stock-based compensation expenses | - | - | 102 | - | - | - | - | - | 102 |
| Exercise of stock options granted to employees | 22,034 | * - | - | - | - | - | - | - | * - |
| Cumulative foreign currency translation adjustments | - | - | - | - | - | 29,198 | - | - | 29,198 |
| Balance as at June 30, 2007 (Unaudited) | 16,589,104 | 564,515 | 2,566,826 | 21,715 | (6,071) | (204,653) | 149,857 | (544,496) | 2,547,693 |
| | Number of ordinary shares ⁽¹⁾ | Share capital | Capital reserves | Amounts received in respect of stock options | Company shares held by a subsidiary | Cumulative foreign currency translation adjustments | Dividend proposed subsequent to the balance sheet date | Retained deficit | Total Shareholders' equity |
| | NIS thousands | | | | | | | | |
| Balance as at January 1, 2006 (Audited) | 16,146,668 | 564,515 | 2,565,488 | 21,715 | (6,071) | 15,983 | - | (683,196) | 2,478,434 |
| Changes during the six months ended June 30, 2006 (Unaudited): | | | | | | | | | |
| Net earnings for the period | - | - | - | - | - | - | - | 7,363 | 7,363 |
| Stock-based compensation expenses | - | - | 1,070 | - | - | - | - | - | 1,070 |
| Exercise of stock options granted to employees | 334,095 | * - | - | - | - | - | - | - | * - |
| Cumulative foreign currency translation adjustments | - | - | - | - | - | (102,908) | - | - | (102,908) |
| Balance as at June 30, 2006 (Unaudited) | 16,480,763 | 564,515 | 2,566,558 | 21,715 | (6,071) | (86,925) | - | (675,833) | 2,383,959 |

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

* Represents an amount lower than NIS 1,000.

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

Condensed Interim Statement of Changes in Shareholders' Equity (cont'd)

| | Number of ordinary shares ⁽¹⁾ | Share capital | Capital reserves | Proceeds from issuance of stock options | Company shares held by a subsidiary | Cumulative foreign currency translation adjustments | Dividend proposed subsequent to the balance sheet date | Retained deficit | Total Shareholders' equity |
|---|--|------------------|---------------------|--|--|---|--|---------------------|----------------------------------|
| | NIS thousands | | | | | | | | |
| Balance as at April 1, 2007 (Unaudited) | 16,570,625 | 564,515 | 2,566,776 | 21,715 | (6,071) | (281,377) | - | (546,091) | 2,319,467 |
| Changes during the three months ended June 30, 2007 (Unaudited): | | | | | | | | | |
| Net earnings for the period | - | - | - | - | - | - | - | 151,452 | 151,452 |
| Dividend proposed subsequent to the balance sheet date | - | - | - | - | - | - | 149,857 | (149,857) | - |
| Stock-based compensation expenses | - | - | 50 | - | - | - | - | - | 50 |
| Exercise of stock options granted to employees | 18,479 | * - | - | - | - | - | - | - | * - |
| Cumulative foreign currency translation adjustments, net | - | - | - | - | - | 76,724 | - | - | 76,724 |
| Balance as at June 30, 2007 (Unaudited) | 16,589,104 | 564,515 | 2,566,826 | 21,715 | (6,071) | (204,653) | 149,857 | (544,496) | 2,547,693 |
| Balance as at April 1, 2006 (Unaudited) | 16,240,301 | 564,515 | 2,565,835 | 21,715 | (6,071) | 50,571 | - | (581,334) | 2,615,231 |
| Changes during the three months ended June 30, 2006 (Unaudited): | | | | | | | | | |
| Net loss for the period | - | - | - | - | - | - | - | (94,499) | (94,499) |
| Stock-based compensation expenses | - | - | 723 | - | - | - | - | - | 723 |
| Exercise of stock options granted to employees | 240,462 | * - | - | - | - | - | - | - | * - |
| Cumulative foreign currency translation adjustments, net | - | - | - | - | - | (137,496) | - | - | (137,496) |
| Balance as at June 30, 2006 (Unaudited) | 16,480,763 | 564,515 | 2,566,558 | 21,715 | (6,071) | (86,929) | - | (675,833) | 2,383,959 |

⁽¹⁾ Net of the holdings by the Company and subsidiaries.

* Represents an amount lower than NIS 1,000.

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

Condensed Interim Statement of Changes in Shareholders' Equity (cont'd)

| | Number of ordinary shares ⁽¹⁾ | Share capital | Capital reserves | Amounts received in respect of stock options | Company shares held by A subsidiary NIS thousands | Cumulative foreign currency translation adjustments | Retained deficit | Total Shareholders' equity |
|--|--|------------------|---------------------|---|--|---|---------------------|----------------------------------|
| Balance as at January 1, 2006 (Audited) | 16,146,668 | 564,515 | 2,565,488 | 21,715 | (6,071) | 15,983 | (683,196) | 2,478,434 |
| Changes during 2006 (Audited): | | | | | | | | |
| Net loss for the year | - | | - | - | - | - | (40,648) | (40,648) |
| Stock-based compensation expenses | - | - | 1,236 | - | - | - | - | 1,236 |
| Issuance of stock options to employees | | | | | | | | |
| Exercise of stock options granted to employees | 420,402 | * - | - | - | - | - | - | * - |
| Cumulative foreign currency translation adjustments, net | - | - | - | - | - | (249,834) | - | (249,834) |
| Balance as at December 31, 2006 (Audited) | 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.

* Represents an amount lower than NIS 1,000.

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

Condensed Interim Statement of Changes in Shareholders' Equity (cont'd)

Convenience translation into U.S. dollars (Note 1A(3))

| | Share capital | Capital reserves | Amounts received in respect of stock options | Shares held by the company and subsidiaries US\$ thousands | Foreign currency translation adjustments | Retained loss | Total Shareholders' equity |
|---|------------------|---------------------|--|---|--|------------------|----------------------------------|
| Balance as at January 1, 2007 (Audited) | 132,858 | 604,077 | 5,111 | (1,429) | (55,037) | (170,356) | 515,224 |
| Changes during the six months ended June 30, 2007 (Unaudited): | | | | | | | |
| Net earnings for the period | - | - | - | - | - | 64,775 | 64,775 |
| Adjustment to retained earnings in respect of investment properties (see Note 1B(4)) | - | - | - | - | - | 12,296 | 12,296 |
| Adjustment to retained earnings in respect of in-process research and development (see Note 1B(5)) | - | - | - | - | - | 407 | 407 |
| Stock-based compensation expenses | - | 24 | - | - | - | - | 24 |
| Exercise of stock options granted to employees | * - | - | - | - | - | - | * - |
| Cumulative foreign currency translation adjustments, net | - | - | - | - | 6,872 | - | 6,872 |
| Balance as at June 30, 2007 (Unaudited) | 132,858 | 604,101 | 5,111 | (1,429) | (48,165) | (92,878) | 599,598 |
| | | | | | | | |
| | Share capital | Capital reserves | Amounts received in respect of stock options | Shares held by the company and subsidiaries US\$ thousands | Foreign currency translation adjustments | Retained loss | Total Shareholders' equity |
| Balance as at April 1, 2007 (Unaudited) | 132,858 | 604,089 | 5,111 | (1,429) | (66,222) | (128,522) | 545,885 |
| Changes during the three months ended June 30, 2007 (Unaudited): | | | | | | | |
| Net earnings for the period | - | - | - | - | - | 35,644 | 35,644 |
| Stock-based compensation expenses | - | 12 | - | - | - | - | 12 |
| Exercise of stock options granted to employees | * - | - | - | - | - | - | * - |
| Cumulative foreign currency translation adjustments, net | - | - | - | - | 18,057 | - | 18,057 |
| Balance as at June 30, 2007 (Unaudited) | 132,858 | 604,101 | 5,111 | (1,429) | (48,165) | (92,878) | 599,598 |

* Represents an amount lower than NIS 1,000.

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

Condensed Consolidated Interim Statements of Cash Flows

| | Six months ended June 30 | | Three months ended June 30 | | Year ended | Convenience translation |
|--|--------------------------|------------------|----------------------------|-----------------|------------------|-------------------------|
| | 2007 | (1) 2006 | 2007 | (1) 2006 | December 31 | (Note 1A3) |
| | Unaudited | | Unaudited | | (2) 2006 | Six months ended |
| | | | | | Audited | June 30 |
| | NIS thousands | | | | | 2007 |
| | | | | | | Unaudited |
| | | | | | | US\$ thousands |
| Cash flows generated by operating activities | | | | | | |
| Net earnings (loss) for the year | 275,231 | 7,363 | 151,452 | (94,499) | (40,648) | 64,775 |
| Adjustments to reconcile net earnings (loss) to net cash flows generated by operating activities (A) | (325,553) | (16,909) | (190,259) | 92,835 | 16,273 | (76,619) |
| Net cash outflow generated by continuing operating activities | (50,322) | (9,546) | (38,807) | (1,664) | (24,375) | (11,844) |
| Net cash inflow generated by discontinued operating activities | 9,006 | 28,567 | - | 16,306 | 31,556 | 2,120 |
| Net cash flows from operating activities | (41,316) | 19,021 | (38,807) | 14,642 | 7,181 | (9,724) |
| Cash flows generated by investing activities: | | | | | | |
| Purchase of fixed assets | (811) | (499) | (353) | (251) | (3,934) | (191) |
| Amounts charged to intangible assets and deferred expenses | (12,633) | (925) | (9,269) | - | - | (2,973) |
| Proceeds from disposal of investments in investee companies and others | 253,775 | - | 67,182 | - | 182,161 | 59,726 |
| Investment in affiliate and others | (10,193) | (285,803) | (9,673) | (269,325) | (923,965) | (2,399) |
| Proceeds from sale of fixed assets and intangible assets | - | 195 | - | 144 | 910 | - |
| Investment in venture capital companies | (3,562) | (5,717) | - | (4,733) | (7,417) | (838) |
| Decrease in other investments, net | 2,521 | 4,109 | 2,521 | 18,654 | 1,649 | 593 |
| Decrease in short-term deposits and investments, net | 105,506 | 32,814 | 26,062 | 211,253 | 1,708 | 24,831 |
| Net cash inflow (outflow) generated by continuing investing activities | 334,603 | (255,826) | 76,470 | (44,258) | (748,888) | 78,749 |
| Net cash outflow generated by discontinued investing activities | (5,541) | (70,600) | (2,671) | (9,985) | (79,274) | (1,304) |
| Net cash flows from investing activities | 329,062 | (326,426) | 73,799 | (54,243) | (828,162) | 77,445 |

(1) Reclassified with respect to discontinued operations - see Note 7(2) and Note 7(3).

(2) Reclassified with respect to discontinued operations - see Note 7(3)).

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

Condensed Consolidated Interim Statements of Cash Flows (cont'd)

| | Six months ended June 30 | | Three months ended June 30 | | Year ended | Convenience translation |
|--|--------------------------|----------|----------------------------|----------|-------------|-------------------------|
| | 2007 | (1) 2006 | 2007 | (1) 2006 | December 31 | (Note 1A3) |
| | Unaudited | | Unaudited | | (2) 2006 | Six months ended |
| | | | NIS thousands | | Audited | June 30 |
| | | | | | | 2007 |
| | | | | | | Unaudited |
| | | | | | | US\$ thousands |
| Cash flows generated by financing activities | | | | | | |
| Proceeds from issuance of debentures | 640,789 | - | 640,789 | - | 593,988 | 150,809 |
| Acquisition of stock options by subsidiary | (76) | - | - | - | (1,138) | - |
| Dividend paid to minority interest in subsidiaries | - | (182) | - | - | - | (18) |
| Receipt of long-term loans and other long-term liabilities | 3,187 | 142,879 | 3,187 | 142,879 | 142,363 | 750 |
| Repayment of long-term loans, debentures and other long-term liabilities | (1,870) | (3,600) | (1,870) | (3,600) | (53,081) | (440) |
| Increase (decrease) in credit from banks and others, net | 4,963 | (2,700) | 4,963 | 4,547 | (2,835) | 1,168 |
| Net cash inflow generated by continuing financing activities | 646,993 | 136,397 | 647,069 | 143,826 | 679,297 | 152,269 |
| Net cash inflow (outflow) generated by discontinued financing activities | (5,647) | 51,897 | - | 1,906 | 47,643 | (1,329) |
| Net cash flows from financing activities | 641,346 | 188,294 | 647,069 | 145,732 | 726,940 | 150,940 |

(1) Reclassified with respect to discontinued operations - see Note 7(2) and Note 7(3).

(2) Reclassified with respect to discontinued operations - see Note 7(3).

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

Condensed Consolidated Interim Statements of Cash Flows (cont'd)

| | Six months ended June 30 | | Three months ended June 30 | | Year ended | Convenience translation |
|--|--------------------------|-----------|----------------------------|----------|-------------|-------------------------|
| | 2007 | (1) 2006 | 2007 | (1) 2006 | December 31 | (Note 1A3) |
| | Unaudited | | Unaudited | | (2) 2006 | Six months ended |
| | | | | | Audited | June 30 |
| | NIS thousands | | | | | 2007 |
| | | | | | | Unaudited |
| | | | | | | US\$ thousands |
| Translation differences in respect of cash balances of foreign subsidiaries in continuing operations | - | (1,189) | 42 | (1,525) | (657) | - |
| Translation differences in respect of cash balances of foreign subsidiaries in discontinued operations | - | 1,213 | - | - | 74 | - |
| Increase (decrease) in cash and cash equivalents | 929,092 | (119,087) | 682,103 | 104,606 | (94,624) | 218,661 |
| Increase in cash and cash equivalents from discontinued operations | 35,611 | 10,624 | 36,100 | 22,056 | 52,449 | 8,381 |
| Increase (decrease) in cash and cash equivalents from continuing operations | 964,703 | (108,463) | 718,203 | 126,662 | (42,175) | 227,042 |
| Balance of cash and cash equivalents at beginning of period | 241,586 | 283,761 | 488,086 | 48,636 | 283,761 | 56,858 |
| Balance of cash and cash equivalents at end of period | 1,206,289 | 175,298 | 1,206,289 | 175,298 | 241,586 | 283,900 |

(1) Reclassified with respect to discontinued operations - see Note 7(2) and Note 7(3).

(2) Reclassified with respect to discontinued operations - see Note 7(3).

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

Condensed Consolidated Interim Statements of Cash Flows (cont'd)

| | Six months ended June 30 | | Three months ended June 30 | | Year ended | Convenience translation | |
|--|--------------------------|-----------------|----------------------------|---------------|----------------|-------------------------|--|
| | 2007 | (1) 2006 | 2007 | (1) 2006 | December 31 | (Note 1A3) | |
| | Unaudited | | Unaudited | | (2) 2006 | Six months ended | |
| | | | NIS thousands | | Audited | June 30 | |
| | | | | | | 2007 | |
| | | | | | | Unaudited | |
| | | | | | | US\$ thousands | |
| A. Adjustments to reconcile net earnings to net cash flows generated by operating activities: | | | | | | | |
| Income and expenses not involving cash flows: | | | | | | | |
| Cumulative effect as of the beginning of the year of change in accounting method | - | (62,552) | - | - | (62,552) | - | |
| Earnings from discontinued operations | (10,355) | (3,398) | (13,678) | (11,389) | (13,918) | (2,437) | |
| Minority interest in results of subsidiaries, net | 408 | 958 | 744 | (1,011) | 2,430 | 96 | |
| Group's equity in operating results of investee companies, net | (230,466) | (3,006) | (119,282) | 40,503 | 139,450 | (54,240) | |
| Depreciation and amortization | 2,852 | 2,049 | 1,734 | (369) | 5,403 | 671 | |
| Deferred taxes, net | 1,330 | 14,305 | 660 | 15,293 | 13,869 | 313 | |
| Increase (decrease) in liabilities in respect of employee severance benefits, net | (676) | (46) | (607) | (88) | 2,097 | (159) | |
| Amortization of stock based compensation | 512 | 1,070 | 285 | 723 | 1,633 | 120 | |
| Net capital losses (gains) from realization of: | | | | | | | |
| Fixed assets and intangible assets | (34) | (17) | (36) | 6 | 339 | (8) | |
| Investments in affiliates | (25,322) | - | (1,493) | - | - | (5,960) | |
| Investments in investee companies | (24,748) | - | (14,826) | - | (79,308) | (5,824) | |
| Linkage of debentures and amortization of bond discount | 3,357 | 15,935 | 3,809 | 17,464 | 23,765 | 790 | |
| Inflationary erosion (linkage) of principal of long-term loans and other liabilities | 1,345 | 7,475 | 5,079 | 3,256 | (25,545) | 317 | |
| Inflationary erosion (linkage) of value of investments, deposits and loans receivable | (42,717) | (11,504) | (46,505) | (4,409) | (8,350) | (10,053) | |
| Impairment (reversal) in value of assets and investments (primarily venture capital investments) | (1,190) | 11,654 | (1,190) | 10,008 | (1,504) | (280) | |
| | (325,704) | (27,077) | (185,306) | 69,987 | (2,191) | (76,654) | |

(1) Reclassified with respect to discontinued operations - see Note 7(2) and Note 7(3).

(2) Reclassified with respect to discontinued operations - see Note 7(3).

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

Condensed Consolidated Interim Statements of Cash Flows (cont'd)

| | Six months ended June 30 | | Three months ended June 30 | | Year ended | Convenience translation |
|---|--------------------------|----------|----------------------------|----------|-------------|-------------------------|
| | 2007 | (1) 2006 | 2007 | (1) 2006 | December 31 | (Note 1A3) |
| | Unaudited | | Unaudited | | (2) 2006 | Six months ended |
| | | | NIS thousands | | Audited | June 30 |
| | | | | | | 2007 |
| | | | | | | Unaudited |
| | | | | | | US\$ thousands |
| Changes in operating asset and liability items: | | | | | | |
| Decrease (increase) in trade receivables and other receivables | (32,559) | (1,885) | (12,325) | 25,085 | 15,782 | (7,663) |
| Decrease (increase) in inventories (including long-term customer advances and deposits) | (11,931) | 6,046 | (6,358) | 3,100 | 18,035 | (2,808) |
| Increase (decrease) in trade payables and other payables | 44,641 | 6,007 | 13,730 | (5,337) | (15,353) | 10,506 |
| | 151 | 10,168 | (4,953) | 22,848 | 18,464 | 35 |
| | (325,553) | (16,909) | (190,259) | 92,835 | 16,273 | (76,619) |

| | Six months ended June 30 | | Three months ended June 30 | | Year ended | Convenience translation |
|---|--------------------------|----------|----------------------------|----------|-------------|-------------------------|
| | 2007 | (1) 2006 | 2007 | (1) 2006 | December 31 | (Note 1A3) |
| | Unaudited | | Unaudited | | (2) 2006 | Three months ended |
| | | | NIS thousands | | Audited | June 30 |
| | | | | | | 2007 |
| | | | | | | Unaudited |
| | | | | | | US\$ thousands |
| Sale of venture capital investments | - | - | - | - | 56,159 | - |
| Dividend in kind from affiliated company | - | - | - | - | 10,470 | - |
| Payables on account of sale of discontinued operation | 36,730 | - | 36,730 | - | - | 8,644 |
| Realization of advance payment on account of sale of discontinued operation | 26,321 | - | 26,321 | - | - | 6,289 |

B. Non-cash transactions:

| | | | | | | |
|---|--------|---|--------|---|--------|-------|
| Sale of venture capital investments | - | - | - | - | 56,159 | - |
| Dividend in kind from affiliated company | - | - | - | - | 10,470 | - |
| Payables on account of sale of discontinued operation | 36,730 | - | 36,730 | - | - | 8,644 |
| Realization of advance payment on account of sale of discontinued operation | 26,321 | - | 26,321 | - | - | 6,289 |

- (1) Reclassified with respect to discontinued operations - see Note 7(2) and Note 7(3).
(2) Reclassified with respect to discontinued operations - see Note 7(3).

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

Notes to the Interim Financial Statements as at June 30, 2007 (unaudited)

Note 1 - Significant Accounting Policies

A. General

1. These financial statements were prepared in conformity with generally accepted accounting principles applicable to the preparation of interim financial statements, in accordance with Accounting Standard No. 14 of the Israel Accounting Standards Board ("IASB") and with Article 4 of the Securities Regulation (Immediate and Periodic Reports) - 1970.
2. These financial statements were prepared as at June 30, 2007 and for the six-month period then ended. These financial statements should be read in conjunction with the Company's audited financial statements and accompanying notes as at December 31, 2006 ("the annual financial statements").
3. The adjusted interim financial statements as at June 30, 2007, and for the six months then ended have been translated into U.S. dollars using the representative exchange rate at that date (\$1=NIS 4.249). 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.
4. The significant accounting policies were applied in the interim financial statements in a manner consistent with the financial statements at December 31, 2006, except as mentioned in Note 1B below.

B. Initial application of new accounting standards

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

As from January 1, 2007 the Company implements 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 also requires entities to review the residual value, useful life and depreciation method of the asset at least at the end of each fiscal year, and if the expectations differ from the prior estimates the changes are to be treated as a change in accounting estimate.

The Company elected to measure the fixed asset items at cost less accumulated depreciation.

Application of the new Standard did not have a material impact on the Company's results of operations and its financial position.

Note 1 - Significant Accounting Policies (cont'd)

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

2. Accounting Standard No. 26, "Inventory"

As from January 1, 2007 the Company implements 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 allocation of costs to inventory.

The Standard shall be applied retroactively by restating comparative amounts in respect of prior periods.

The implementation of the Standard did not have a material impact on the Company's financial position or results of operations.

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

As from January 1, 2007 the Company implements 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.

Pursuant to the Standard's transitional provisions, the Company applies the Standard to transactions with controlling interests therein executed after January 1, 2007, as well as to loans granted or received from the controlling interest prior to the Standard's commencement date, beginning from its commencement date.

Application of the new Standard did not have a material impact on the Company's results of operations and its financial position.

Note 1 - Significant Accounting Policies (cont'd)

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

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

As from January 1, 2007 the Company implements 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 shall 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.

The Company elected to apply the fair value model for measuring its investment property. Therefore, in accordance with the transition requirements of the Standard, on January 1, 2007 the Company recorded an increase in the balance of its investment property in the amount of NIS 28 million. Furthermore, the Company recorded an increase in its investments in affiliates in the amount of NIS 32 million. The Company recorded an adjustment to the opening balance of retained earnings of NIS 52 million in respect of the above.

The Company recognizes a liability in respect of property sales tax upon occurrence of an event that gives rise to such a liability, therefore the financial statements do not include a liability for property sales tax in respect of its investment property. The Company estimates that in the event that it were to sell all of its investment property at prices equivalent to the fair value of the investment property as of the balance sheet date, the impact of the liability on the Company's financial statements, taking into account taxes, minority interest and the Company's equity in affiliated companies, would amount to approximately NIS 4 million.

5. Accounting Standard No. 30, "Intangible Assets"

As from January 1, 2007, the Company implements Accounting Standard No. 30, "Intangible Assets" (hereinafter – the Standard) of the IASB. The Standard prescribes the accounting treatment for intangible assets and defines how to measure the book value of these assets, and provides the disclosure requirements.

In accordance with the Standard's transition rules, the Standard shall be applied retroactively, except as set forth hereinafter. With regard to business acquisitions, the Standard shall be applied to business acquisitions that take place from January 1, 2007 and thereafter, whereas with regard to in-process research and development projects acquired within the framework of a business acquisition that occurred prior to January 1, 2007 and that meets the definition of an intangible asset on the acquisition date and that was recorded as an expense on the acquisition date, on January 1, 2007 the acquiring company shall recognize the in-process research and development project as an asset, as well as applicable deferred taxes. The in-process research and development asset shall be recorded at the amount estimated on the acquisition date, less the amortization that would have accrued from the acquisition date until December 31, 2006 according to the useful life of the asset and less impairment losses. This amount shall be recorded as an adjustment to the opening balance of retained earnings as of January 1, 2007.

Note 1 - Significant Accounting Policies (cont'd)

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

5. Accounting Standard No. 30, "Intangible Assets" (cont'd)

The Company recorded an expense of NIS 2,443 thousand in respect of in-process research and development projects acquired within the framework of a business acquisition that occurred prior to January 1, 2007. The projects meet the definition of an intangible asset on the acquisition date and therefore on January 1, 2007 the Company recognized the in-process research and development projects as assets in the amount of NIS 1,728 thousand (after recognition of applicable deferred taxes) against an adjustment to the opening balance of retained earnings as of January 1, 2007.

As from January 1, 2007 certain of the Company's investees examine the criteria for recognition of intangible assets in respect of development activities. Such investees did not recognize intangible assets in respect of past development activities as such investees did not examine the criteria or document them in prior periods.

6. 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 determines that entities that are subject to the Securities Law – 1968 and that are required to report according to the regulations of this law, shall prepare their financial statements according to IFRS for periods commencing from January 1, 2008. The Standard allows for early adoption as from financial statements published after July 31, 2006.

The initial implementation of IFRS shall be effected in accordance with the rules set forth in International Financial Reporting Standard No. 1, "Initial Adoption of IFRS".

According to IFRS 1, the Company is required to include as a note to its financial statements for December 31, 2007, the balance sheet data as at December 31, 2007 and the statement of operations data, after application of the IFRS rules for recognition, measurement and disclosure.

The Company intends to implement IFRS as of its financial statements for the period commencing January 1, 2008.

Note 2 - Rates of Change in the Consumer Price Index and Foreign Currency Exchange Rates

Below are the rates of change that occurred in the Consumer Price Index and in the exchange rates of the U.S. Dollar during the reporting periods:

| | <u>Israeli CPI Points</u> | <u>Exchange rate of one Dollar NIS</u> |
|--|-----------------------------------|--|
| At June 30, 2007 | 186.67 | 4.249 |
| At June 30, 2006 | 187.92 | 4.440 |
| At December 31, 2006 | 184.87 | 4.225 |
| | <u>Change in %</u> | <u>Change in %</u> |
| For the six months ended June 30, 2007 | 1.0 | 0.6 |
| For the three months ended June 30, 2007 | 1.2 | 2.3 |
| For the six months ended June 30, 2006 | 1.6 | (3.5) |
| For the three months ended June 30, 2006 | 1.0 | (4.8) |
| For the year ended December 31, 2006 | (0.1) | (8.2) |

Note 3 - Information Regarding Certain Investees

A. Makhteshim Agan Industries Ltd. ("M-A Industries") – an affiliate

- Under the terms of the securitization agreement of M-A Industries and its subsidiaries from September 2004, to sell customer receivables to financial institutions, the balance of trade receivables sold for cash as at the balance sheet date amounted to approximately \$275 million (June 30, 2006 – \$250 million; December 31, 2006 – \$ 175.8 million).

The maximum amount of financial resources expected to be made available to the purchasing companies to purchase the trade receivables of the subsidiaries is approximately \$275 million, on a current basis, so that the proceeds received from the customers whose receivables had been sold will be used to purchase new trade receivables.

- M-A Industries and its subsidiary in Brazil (Milenia) undertook, if certain conditions are met, to indemnify financial institutions for credit received by customers of Milenia from those financial institutions, and which was used to repay the debts of these customers to Milenia from its sales to these customers.

The indemnification amount as at the balance sheet date is \$51 million (June 30, 2006 – \$83 million, December 31, 2006 - \$65 million).

- During the first six months of 2007, approximately \$ 675 thousand par value of M-A Industries debentures issued in a private placement in March 2004 to institutional investors, were converted into approximately 149 thousand ordinary shares NIS 1 par value of M-A Industries. Furthermore, NIS 30,617 thousand par value of debentures (Series A) of M-A Industries were converted into 3,365 thousand ordinary shares, NIS 1 par value, of M-A Industries and approximately 754 thousand employee stock options were exercised for approximately 436 thousand ordinary shares NIS 1 par value of M-A Industries. As a result, during the six month period ended June 30, 2007, the Company recorded a loss of approximately NIS 20 million, which is included within the Group's equity in the operating results of investee companies, net. The Company's holding in the voting rights of M-A Industries as of June 30, 2007 is 39.1%.

Note 3 - Information Regarding Certain Investees (cont'd)

A. Makhteshim Agan Industries Ltd. ("M-A Industries") – an affiliate (cont'd)

4. Accounting treatment of options granted under the M-A Industries' 2005 option plan

On March 13, 2005, M-A Industries' Board of Directors approved an employee share option plan, an immediate report and related description in respect of which was published on March 14, 2005. Relying on the transitional rules of Accounting Standard 24, "Share-Based Payments", M-A Industries did not apply that Standard to the grants made under the option plan, and did not record an expense in respect thereof, pursuant to the Standard's transitional rules which provide that the Standard applies to grants after March 15, 2005, and which had not vested prior to January 1, 2006.

In connection with review of the draft prospectus submitted by M-A Industries for listing of bonds it issued, and following a meeting with the staff of the Israeli Securities Authority on May 8, 2007, questions arose regarding the factual circumstances leading to removal of the grants from application of the aforesaid Standard.

M-A Industries' Board of Directors decided to re-examine the facts on the basis of which the grants were treated for accounting purposes, under the supervision of M-A Industries' Audit Committee.

M-A Industries' Board of Directors has decided to re-examine the facts on the basis of which the grants were treated for accounting purposes, under the supervision of M-A Industries' Audit Committee. The outcome of the examination is that due to immateriality, among other reasons, M-A Industries is not required to restate its financial statements and is not required to record additional expenses in respect of the options granted under the 2005 plan.

5. 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.

Note 3 - Information Regarding Certain Investees (cont'd)

B. ECI Telecom Ltd. ("ECI") – an affiliate

1. During the first quarter of 2007, as ECI's affiliated company Veraz Networks Inc. ("Veraz"), made significant progress towards completion of its initial public offering, ECI's management determined that it is more likely than not that a portion of ECI's capital loss carryforwards for tax purposes will be utilized against capital gains that ECI will generate from the future sale of its shares in Veraz. As a result, ECI released part of its deferred tax asset valuation allowance and recognized an income tax benefit in the amount of \$ 12.5 million.
2. On April 4, 2007, Veraz issued its shares to the public and its shares began to trade on NASDAQ. Veraz raised gross proceeds of \$ 54 million, before underwriting discounts and expenses, from the sale of 6.75 million shares at the public offering price of \$8 per share. In addition, ECI sold in the offering 2.25 million shares of Veraz for a total gross consideration of \$18 million. Following the offering, ECI's holding in Veraz were reduced to 27.5% (on a non-diluted basis). In accordance with generally accepted accounting principles in Israel, during the second quarter of 2007 ECI recorded a gain approximately \$ 15.5 million in respect of the abovementioned sale of shares and an additional gain of \$ 12 million in respect of ECI's share in the increase in the shareholders' equity of Veraz pursuant to the offering. The Company's share in these gains is approximately NIS 31 million.
3. 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 alleged 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 alleged 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, which was denied in March 2007. The plaintiff has appealed the dismissal.

ECI's management, based on the opinion of its legal advisors, believes that the allegations made in the complaint with respect to it are without merit, therefore no provision has been recorded in the financial statements in respect thereof.

Note 3 - Information Regarding Certain Investees (cont'd)

B. ECI Telecom Ltd. ("ECI") – an affiliate (cont'd)

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

| | Six months ended June 30 | | Three months ended June 30 | | For the year ended |
|--|--------------------------|----------------|----------------------------|----------------|--------------------|
| | 2007 | 2006 | 2007 | 2006 | December 31 |
| | US\$ thousands | US\$ thousands | US\$ thousands | US\$ thousands | US\$ thousands |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| Net earnings of ECI as reported in conformity with U.S. GAAP | 43,485 | 12,699 | 24,773 | 9,637 | 22,095 |
| Adjustments: | | | | | |
| Share-based payments expenses | (2,143) | 735 | (962) | 107 | 786 |
| Financing income (expenses) from derivative financial statements | 9 | (5,015) | 529 | (633) | (5,745) |
| Realization of excess cost allocated to intangible assets | 207 | 47 | 187 | - | 55 |
| Loss (gain) on marketable securities Capitalized of R&D expenditures | 35 | (233) | (17) | (103) | 19 |
| ECI's equity in results of affiliate | 12,729 | - | 6,700 | - | - |
| Gain from issue of shares by affiliated company * | - | (1,704) | - | (1,384) | 1,704 |
| Distribution of available-for-sale securities as dividend-in-kind | 12,000 | - | 12,000 | - | - |
| Cumulative effect as of the beginning of the year of change in accounting method | - | (4,075) | - | (4,075) | (4,075) |
| | - | 1,704 | - | - | (1,704) |
| Net earnings of ECI in conformity with Israeli GAAP | 66,322 | 4,158 | 43,210 | 3,549 | 13,135 |

* According to US GAAP, the gain will be recorded during the third quarter of 2007.

5. On July 2, 2007 ECI entered into a merger agreement according to which all its shares will be sold to the Swarth Group. See Note 6.

Note 3 - Information Regarding Certain Investees (cont'd)

C. Koor Corporate Venture Capital – a consolidated partnership

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 recorded a gain of approximately NIS 23 million in the first quarter of 2007.

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

On April 26, 2007 the Company completed the sale of its entire 56.5% shareholding in Sheraton Moriah Israel Ltd. ("Sheraton") to Azorim Tourism Ltd. for total consideration of approximately \$24 million.

The first installment in the amount of \$6.3 million was received on December 21, 2006, and the second in the amount of approximately \$8.6 million was received on the date of the closing. The remaining amount of \$9.1 million, guaranteed by Azorim Investment in Development and Building Corporation Ltd., will be received no later than March 27, 2008, as follows: (a) One half of the said amount shall be paid in NIS (in accordance with the last representative dollar exchange rate known on the date of payment); and (b) The other half shall be paid in NIS (in accordance with the representative dollar exchange rate known on the date of execution of the agreement), linked to the rate of change of the Israeli Consumer Price Index (CPI) known on March 27, 2008 relative to the CPI known on the date of execution of the agreement (Basic Index), and such that the said amount shall, in no event, be lower than the amount calculated according to the Basic Index. Following the closing of the transaction the Company was released from guaranties provided to banks to secure bank debt of Sheraton Moriah in the amount of approximately \$9.2 million. The Company recorded a gain as a result of the transaction of approximately NIS 14 million in the second quarter of 2007.

Pursuant to the sale, as of the financial statements for the first quarter of 2007, Sheraton has been presented as a discontinued operation. See Note 7(3).

E. Knafaim Holdings Ltd. ("Knafaim")

Further to the agreement signed in May 2007, on June 18, the Company completed the sale of its entire holding in Knafaim (9.2%) for total consideration of approximately \$13.7 million, reflecting a price per share of \$10.47 ("purchase price").

Under the agreement, should the purchaser sell the shares purchased at the closing date, to any third party, during a period of 12 months commencing from the closing date, at a price per share higher than the purchase price, the purchaser will pay the Company additional consideration in the amount of the difference between the sale price and the purchase price, net of interest accrued, multiplied by the lower of the number of shares sold or the number of shares purchased from the Company.

The Company recorded a gain as a result of the transaction of approximately NIS 15 million in the second quarter of 2007.

Note 4 - Contingent Liabilities and Commitments

- 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, 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 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.

In the Statement of Claim, the plaintiff alleges that the defendants are responsible for false representations made by them and for which they are responsible, and upon which he acted.

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.

Note 4 - Contingent Liabilities and Commitments (cont'd)

B. (cont'd)

On June 25, 2007, responses to the request for recognition as a class action was filed with the Court on behalf of the defendants, detailing their objections to the plaintiff's request for recognition of the suit as a class action.

The responses include significant arguments against recognition of the claim as a class action. Despite the fact that the plaintiff has not yet filed his response to the defendants' response, it appears that the chances of the request for recognition of the claim as a class action are remote and therefore no provision has been made in the financial statements in respect of this matter.

Note 5 - Significant Events during the Reporting Period

1. On May 10, 2007, pursuant to completion of an offering to institutional investors in Israel the Company issued debentures with a par value of approximately NIS 595 million, for consideration of approximately NIS 640 million, implying an effective interest rate of 4.05%, linked to the Israeli CPI. The debentures will be considered part of the Series H debentures issued on August 20, 2006 by the Company to the public in Israel pursuant to the prospectus dated August 13, 2006 and the terms of the debentures are identical to the terms of the Series H debentures issued under the prospectus. 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 have been approved for trading on the Tel-Aviv Stock Exchange. The sale of the debentures by the institutional investors is subject to lock-up arrangements provided under the Israeli Securities Law, 1968 and its regulations.

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.

2. On June 18, 2007, the delisting of the Company's American Depositary Receipts (hereinafter – ADR's) from the New York Stock Exchange (hereinafter – NYSE) became effective. The delisting follows the decision of the Company's Board of Directors from May 2007 to delist the ADR's voluntarily from the NYSE and to terminate the ADR program with BONY.

Following termination of the ADR program, no additional ADR's may be issued. Holders of ADRs will, however, be entitled to return their ADRs to BONY before September 18, 2007 and receive the appropriate number of underlying ordinary shares (each ADS represents 0.20 of an ordinary share), subject to cancellation fees charged by BONY.

For ADRs not submitted to BONY for exchange by September 18, 2007, BONY will sell the underlying ordinary shares at the price that BONY can obtain on the Tel Aviv Stock Exchange. The remaining ADR holders may obtain the cash proceeds from the sale, net of any applicable charges, by returning their ADRs to BONY after September 18, 2007.

Note 5 - Significant Events during the Reporting Period (cont'd)

3. On June 11, 2007 the Company's General Shareholders Meeting approved the arrangement between the Company and Discount Investment Corporation Ltd. for participation in the compensation costs of the Chief Executive Officer of the Company. According to the arrangement, the Company will bear 80% of the compensation costs of the Chief Executive Officer of the Company. Prior to the approval of the General Shareholders' Meeting, the arrangement was approved by the Company's Audit Committee and by the Company's Board of Directors.

Note 6 - Events Subsequent to the Balance Sheet Date

1. On July 2, 2007 ECI, in which the Company has a holding of approximately 28%, reported the signing of a merger agreement, whereby ECI will be sold in its entirety to Swarth Investments and certain investment funds (hereinafter – the Buyers). According to the agreement, the shareholders of ECI will receive \$ 10 per share in cash upon consummation of the transaction, amounting to approximately \$1.2 billion (hereinafter – the merger transaction). ECI's Board of Directors approved the transaction and recommended that ECI's shareholders vote in favor of it.

The Company, Clal Industries and Investments Ltd., a company controlled by the Company's controlling shareholder, and a group led by Carmel Ventures, which together hold approximately 44% of the outstanding share capital of ECI, have undertaken towards the buyers to exercise the voting power of their shares in ECI to approve the merger transaction. These undertakings will expire if the Board of Directors of ECI changes its recommendation to approve the acquisition of ECI by the current buyers.

Under the terms of the merger, until July 31, 2007, ECI was entitled to solicit alternative transactions from other entities. ECI may also, at any time and subject to the provisions of the merger agreement, consider offers it receives without its solicitation. If ECI chooses to accept a preferable alternative offer, ECI will pay the Buyers an agreed compensation amount for termination of the agreement with them. ECI estimates that the transaction will take place during the fall of 2007. In the event of the closing of the abovementioned transaction, ECI's shares will cease to trade on NASDAQ. The closing of the transaction is subject to the approval of the general meeting of the shareholders of ECI, to certain regulatory approvals and to other standard closing terms. At this stage, there is no certainty that the transaction will be completed.

In the event of the closing of the abovementioned transaction, the Company expects to receive in consideration of its holdings in ECI's shares, an amount of approximately USD 330.5 million, and to record upon closing a gain which is estimated by the Company at this stage of NIS 569 million, based on the exchange rate of the dollar as of August 13, 2007 and on the financial statements of ECI for the second quarter of 2007.

2. On August 15, 2007 the Company's Board of Directors resolved to distribute an interim dividend of NIS 150 million to be paid on September 6, 2007 to the shareholders of record on August 22, 2007.

Note 7 - Discontinued Operations

1. Koor Trade Ltd.

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 three-year period, at a price that exceeds the sale price (or the price fixed in the agreement for the value of the aforesaid affiliated company), the sale price will be increased by an incremental amount as set forth in the agreement.

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 results of operations of the discontinued operations, as included in the financial statements, for the:

| | <u>Six months ended June 30</u> | <u>Three months ended June 30</u> | <u>Year ended December 31</u> |
|---|-------------------------------------|---------------------------------------|-----------------------------------|
| | <u>2006</u> | <u>2006</u> | <u>2006</u> |
| | <u>Unaudited</u> | <u>Unaudited</u> | <u>Audited</u> |
| | <u>NIS thousands</u> | <u>NIS thousands</u> | <u>NIS thousands</u> |
| Revenues and earnings | | | |
| Revenue from sales and services | 41,203 | - | 41,203 |
| Other income | 4,599 | 3,961 | 4,599 |
| | <u>45,802</u> | <u>3,961</u> | <u>45,802</u> |
| Costs and losses | | | |
| Cost of sales and services | 27,309 | - | 27,309 |
| Selling and marketing expenses | 7,431 | - | 7,431 |
| General and administrative expenses | 4,495 | - | 4,495 |
| Other expenses | 2,840 | - | 2,840 |
| Finance (income), net | (318) | - | (318) |
| | <u>41,757</u> | <u>-</u> | <u>41,757</u> |
| Earnings before income tax | | | |
| Income tax | 4,045 | 3,961 | 4,045 |
| | <u>(1,459)</u> | <u>-</u> | <u>(1,459)</u> |
| | 2,586 | 3,961 | 2,586 |
| Minority interest in subsidiaries' results, net | <u>(253)</u> | <u>-</u> | <u>(253)</u> |
| Net earnings for the period | <u>2,333</u> | <u>3,961</u> | <u>2,333</u> |

Note 7 - Discontinued Operations (cont'd)

2. 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:

| | <u>June 31</u> <u>2006</u> <u>Unaudited</u> <u>NIS thousands</u> |
|--|---|
| Assets related to discontinued operation: | |
| Cash and cash equivalents | 19,887 |
| Short-term deposits and investment | 15,664 |
| Trade receivables | 17,986 |
| Other long-term investments and receivables | 1,172 |
| Fixed assets, net | 1,363 |
| Intangible assets, deferred tax assets and deferred expenses, net | <u>3,516</u> |
| | <u>59,588</u> |
| Liabilities related to discontinued operation: | |
| Trade payables | 19,589 |
| Customer advances | 29,735 |
| Other payables | 10,673 |
| Liability for employee severance benefits, net | 280 |
| Minority interest | <u>(351)</u> |
| | <u>59,926</u> |

Note 7 - Discontinued Operations (cont'd)

2. 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:

| | Six months ended June 30 | Three months ended June 30 | Year ended December 31 |
|---|-----------------------------|-------------------------------|---------------------------|
| | 2006 | 2006 | 2006 |
| | Unaudited | Unaudited | Audited |
| | NIS thousands | NIS thousands | NIS thousands |
| Revenues and earnings | | | |
| Revenue from sales and services | 134,312 | 89,615 | 253,473 |
| Other income | - | - | 8,001 |
| | <u>134,312</u> | <u>89,615</u> | <u>261,474</u> |
| Costs and losses | | | |
| Cost of sales and services | 116,142 | 77,937 | 219,573 |
| Selling and marketing expenses | 2,555 | 1,425 | 5,143 |
| General and administrative expenses | 12,279 | 5,943 | 23,413 |
| Finance income, net | (260) | (185) | (262) |
| | <u>130,716</u> | <u>85,120</u> | <u>247,867</u> |
| Earnings before income tax | | | |
| Income tax | 3,596 | 4,495 | 13,607 |
| | <u>(826)</u> | <u>(663)</u> | <u>(5,240)</u> |
| | 2,770 | 3,832 | 8,367 |
| Minority interest in subsidiaries' results, net | <u>(952)</u> | <u>(1,144)</u> | <u>(226)</u> |
| Net earnings for the period | <u><u>1,818</u></u> | <u><u>2,688</u></u> | <u><u>8,141</u></u> |

Note 7 - Discontinued Operations (cont'd)

3. Sheraton Moriah (Israel) Ltd. ("Sheraton")

On April 26, 2007 the Company completed the sale of its entire 56.5% shareholding in Sheraton to Azorim Tourism Ltd. See Note 3D. Pursuant to the sale, Sheraton has been presented as a discontinued operation as of the financial statements of the Company for March 31, 2007.

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

| | June 30 | Year ended |
|---|----------------------|----------------------|
| | 2006 | December 31 |
| | Unaudited | Audited |
| | NIS thousands | NIS thousands |
| Assets related to discontinued operation: | | |
| Cash and cash equivalents | 31,082 | 35,611 |
| Trade receivables | 46,535 | 49,031 |
| Other accounts receivable | 28,131 | 17,935 |
| Inventories | 4,607 | 3,409 |
| Investments in affiliates | 3,510 | 2,043 |
| Other long-term investments and receivables | 24,598 | 23,184 |
| Fixed assets, net | 680,084 | 665,870 |
| Intangible assets, deferred tax assets and deferred expenses, net | 17,530 | 17,562 |
| | <u>836,077</u> | <u>814,645</u> |
| Liabilities related to discontinued operation: | | |
| Credit from banks and others | 22,032 | 20,167 |
| Trade payables | 33,140 | 27,372 |
| Other payables | 28,442 | 29,907 |
| Customer advances | 5,922 | 3,262 |
| Long-term bank loans | 590,541 | 569,759 |
| Liability for employee severance benefits, net | 3,955 | 4,102 |
| Deferred tax liabilities | 10,460 | 10,977 |
| Minority interest | 69,308 | 72,175 |
| | <u>763,800</u> | <u>737,721</u> |

Note 7 - Discontinued Operations (cont'd)

3. Sheraton Moriah (Israel) Ltd. ("Sheraton") (cont'd)

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

| | Six months ended June 30 | | Three years ended June 30 | | Year ended |
|--|--------------------------|----------------|---------------------------|---------------|----------------|
| | 2007 | 2006 | 2007 | 2006 | December 31 |
| | Unaudited | Unaudited | Unaudited | Unaudited | Audited |
| | NIS thousands | NIS thousands | NIS thousands | NIS thousands | NIS thousands |
| Revenues and earnings | | | | | |
| Revenue from sales and services | 69,690 | 158,738 | - | 93,066 | 312,801 |
| Company's equity in the operating results of investee companies, net | 360 | (9) | - | 244 | 1,006 |
| Other income | 13,678 | (584) | 13,678 | (792) | 4,714 |
| | <u>83,728</u> | <u>158,145</u> | <u>13,678</u> | <u>92,518</u> | <u>318,521</u> |
| Costs and losses | | | | | |
| Cost of sales and services | 56,373 | 112,288 | - | 61,621 | 227,622 |
| Selling and marketing expenses | 3,553 | 8,643 | - | 4,948 | 16,231 |
| General and administrative expenses | 10,112 | 22,495 | - | 11,968 | 47,087 |
| Other expenses | 102 | - | - | - | - |
| Finance expenses, net | 5,188 | 13,562 | - | 3,854 | 16,455 |
| | <u>75,328</u> | <u>156,988</u> | <u>-</u> | <u>82,391</u> | <u>307,395</u> |
| Earnings before income tax | 8,400 | 1,157 | 13,678 | 10,127 | 11,126 |
| Income tax | (568) | (2,442) | - | (1,358) | (4,698) |
| | <u>7,832</u> | <u>(1,285)</u> | <u>13,678</u> | <u>8,769</u> | <u>6,428</u> |
| Minority interest in subsidiaries' results, net | 2,523 | 532 | - | (4,029) | (2,984) |
| Net (loss) earnings for the period | <u>10,355</u> | <u>(753)</u> | <u>13,678</u> | <u>4,740</u> | <u>3,444</u> |

Note 8 - Business Segments

Information regarding business segments of the Koor Group:

| | Six months ended June 30 | | Three months ended June 30 | | For the year ended |
|---|------------------------------|------------------------------|------------------------------|------------------------------|--|
| | 2007 | (1) 2006 | 2007 | (1) 2006 | December 31 |
| | NIS thousands (Unaudited) | NIS thousands (Unaudited) | NIS thousands (Unaudited) | NIS thousands (Unaudited) | (2) 2006 NIS thousands (Audited) |
| Revenues from sales and services | | | | | |
| Telecommunications | 114,474 | 136,650 | 63,135 | 61,972 | 260,384 |
| Others | 3,739 | 5,006 | 1,460 | 2,585 | 10,068 |
| | 118,213 | 141,656 | 64,595 | 64,557 | 270,452 |
| Group's equity in the results of investee companies, net | | | | | |
| Telecommunications | 73,804 | (76,904) | 47,934 | (56,065) | (106,781) |
| Agro-chemicals | 155,589 | 138,859 | 71,459 | 53,160 | 65,925 |
| Venture capital investments | - | (2,221) | - | (1,677) | (4,739) |
| Others | 4,596 | 810 | 1,716 | 815 | 8,040 |
| | 233,989 | 60,544 | 121,109 | (3,767) | (37,555) |
| Earnings (losses) before income tax | | | | | |
| Telecommunications | 70,600 | (78,583) | 50,354 | (60,593) | (121,613) |
| Agro-chemicals | 155,589 | 138,859 | 71,459 | 53,160 | 65,925 |
| Venture capital investments | 24,320 | (14,033) | 919 | (11,826) | 39,585 |
| Others | 4,805 | 1,188 | 2,381 | 757 | 11,816 |
| Total | 255,314 | 47,431 | 125,113 | (18,502) | (4,287) |
| Joint general income (expenses) | 15,580 | (30,643) | 11,364 | (27,850) | (8,250) |
| Financing expenses, net | (6,527) | (57,684) | 1,609 | (43,774) | (97,480) |
| Earnings (losses) before income tax | 264,367 | (40,896) | 138,086 | (90,126) | (110,017) |

(1) Reclassified with respect to discontinued operations - see Note 7(2) and Note 7(3).

(2) Reclassified with respect to discontinued operations - see Note 7(3).

Makhteshim–Agan Industries Ltd.

**Condensed Consolidated
Financial Statements**

(Unaudited)

As at June 30, 2007

(In U.S. Dollars)

Condensed Financial Statements as at June 30, 2007 (Unaudited)

Contents

Page

| | |
|---|----|
| Auditors' Review Report | 2 |
| Unaudited Financial Statements: | |
| Condensed Consolidated Balance Sheets | 3 |
| Condensed Consolidated Statements of Income | 4 |
| Condensed Statements of Changes in Shareholders' Equity | 5 |
| Condensed Consolidated Statements of Cash Flows | 8 |
| Notes to the Financial Statements | 12 |



Somekh Chaikin
KPMG Millennium Tower
17 Ha'arba'a Street, PO Box 609
Tel Aviv 61006 Israel

Telephone 972 3 684 8000
Fax 972 3 684 8444
Internet www.kpmg.co.il

The Board of Directors
Makhteshim–Agan Industries Ltd.

Dear Sirs,

Review of the unaudited interim condensed consolidated financial statements as at June 30, 2007

At your request, we have reviewed the interim condensed consolidated balance sheet of Makhteshim–Agan Industries Ltd. and its subsidiaries as at June 30, 2007, and the related condensed consolidated statements of income, condensed changes in shareholders' equity and condensed cash flows for the six-month and three-month periods then ended.

Our review was conducted in accordance with procedures prescribed by the Institute of Certified Public Accountants in Israel and included, inter alia, reading the said financial statements, reading the minutes of shareholders' meetings and of meetings of the Board of Directors and its committees, as well as making inquiries of persons responsible for financial and accounting matters.

We received review reports of other auditors, regarding the interim financial statements of certain subsidiaries, whose assets constitute 5.6% of the total consolidated assets as at June 30, 2007 and whose revenues constitute 7.9% and 7.2% of the total consolidated revenues for the six-month and three-month periods then ended.

Since the review performed is limited in scope and does not constitute an audit in accordance with generally accepted auditing standards, we do not express an opinion on the said interim consolidated financial statements.

In the course of our review, which included reading the review reports of other auditors as stated above, nothing came to our attention which would indicate the necessity of making material modifications to the interim consolidated financial statements referred to above, in order for them to be in conformity with generally accepted accounting principles and in accordance with Section D of the Securities Regulations (Periodic and Immediate Reports) – 1970.

Somekh Chaikin
Certified Public Accountants (Isr.)

August 13, 2007

Condensed Consolidated Balance Sheets

| | As at June 30 2007 <u>(Unaudited)</u> <u>US \$ thousands</u> | As at June 30 2006 <u>(Unaudited)</u> <u>US \$ thousands</u> | As at December 31 2006 <u>(Audited)</u> <u>US \$ thousands</u> |
|---|--|--|--|
| Current assets | | | |
| Cash and cash equivalents | 426,590 | 135,942 | 324,362 |
| Short-term investments | 46,004 | 2,148 | 1,706 |
| Trade receivables | 547,177 | 417,566 | 486,368 |
| Other receivables | 99,050 | *119,090 | 106,372 |
| Inventories | 598,313 | 569,054 | 607,328 |
| | <u>1,717,134</u> | <u>1,243,800</u> | <u>1,526,136</u> |
| Long-term investments, loans and receivables | | | |
| Affiliated companies | - | 2,419 | 2,496 |
| Investment and other debts | 75,826 | *37,192 | 46,125 |
| | <u>75,826</u> | <u>39,611</u> | <u>48,621</u> |
| Fixed assets | | | |
| Cost | 975,195 | 916,288 | 952,652 |
| Less – accumulated depreciation | 464,773 | 431,148 | 446,534 |
| | <u>510,422</u> | <u>** 485,140</u> | <u>** 506,118</u> |
| Other assets and deferred expenses | | | |
| Cost | 922,232 | 850,264 | 885,453 |
| Less – accumulated amortization | 374,680 | 300,998 | 347,406 |
| | <u>547,552</u> | <u>** 549,266</u> | <u>** 538,047</u> |
| | <u>2,850,934</u> | <u>2,317,817</u> | <u>2,618,922</u> |

| | As at June 30 2007 <u>(Unaudited)</u> <u>US \$ thousands</u> | As at June 30 2006 <u>(Unaudited)</u> <u>US \$ thousands</u> | As at December 31 2006 <u>(Audited)</u> <u>US \$ thousands</u> |
|----------------------------------|--|--|--|
| Current liabilities | | | |
| Credit from banks and others | 114,296 | 308,720 | 99,850 |
| Trade payables | 402,918 | 357,076 | 369,574 |
| Other payables | 309,809 | * 283,143 | 271,413 |
| Proposed dividend payable | - | 28,508 | - |
| Convertible debentures | 4,930 | - | 12,055 |
| Debentures | 1,333 | - | - |
| | <u>833,286</u> | <u>977,447</u> | <u>752,892</u> |
| Long-term liabilities | | | |
| Loans from banks | 37,828 | 48,449 | 45,012 |
| Convertible debentures | - | 25,473 | 675 |
| Debentures | 553,538 | - | 554,728 |
| Other long-term liabilities | 7,982 | 6,090 | 3,407 |
| Deferred taxes, net | 75,699 | * 73,298 | 62,147 |
| Employee severance benefits, net | 41,027 | 30,426 | 38,131 |
| | <u>716,074</u> | <u>183,736</u> | <u>704,100</u> |
| Minority interest | <u>35,958</u> | <u>30,083</u> | <u>30,212</u> |
| Shareholders' equity | <u>1,265,616</u> | <u>1,126,551</u> | <u>1,131,718</u> |
| | <u>2,850,934</u> | <u>2,317,817</u> | <u>2,618,922</u> |

Avraham Bigger
Chief Executive Officer
Chairman of the Board of Directors

Raanan Cohen
Director

Ran Maidan
Chief Financial Officer

Date of approval of the financial statements: August 13, 2007

* Reclassified

** Reclassified - see Note 1B(4).

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

Condensed Consolidated Statements of Income

| | For the six months ended | | For the three months ended | | For the |
|--|--------------------------|-----------------|----------------------------|-----------------|-------------|
| | June 30 | June 30 | June 30 | June 30 | year ended |
| | 2007 | 2006 | 2007 | 2006 | December 31 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| US \$ thousands | US \$ thousands | US \$ thousands | US \$ thousands | US \$ thousands | |
| Revenues | 1,109,225 | * 952,131 | 549,886 | * 458,265 | 1,778,756 |
| Cost of sales | 722,298 | 614,282 | 361,204 | 298,572 | 1,172,017 |
| Gross profit | 386,927 | 337,849 | 188,682 | 159,693 | 606,739 |
| Expenses | | | | | |
| Research and development, net | 9,767 | 9,703 | 4,734 | 5,047 | 19,001 |
| Selling and marketing | 153,885 | 147,874 | 78,141 | 72,891 | 303,177 |
| General and administrative | 34,838 | 30,499 | 17,403 | 15,552 | 80,767 |
| | 198,490 | 188,076 | 100,278 | 93,490 | 402,945 |
| Operating income | 188,437 | 149,773 | 88,404 | 66,203 | 203,794 |
| Financing expenses, net | 23,425 | * 25,684 | 11,988 | * 13,954 | 44,244 |
| Income before other expenses, net | 165,012 | 124,089 | 76,416 | 52,249 | 159,550 |
| Other expenses, net | 11,550 | 11,768 | 7,178 | 4,664 | 74,641 |
| Income before taxes on income | 153,462 | 112,321 | 69,238 | 47,585 | 84,909 |
| Taxes on income | 29,754 | 11,627 | 13,871 | 4,987 | (1,438) |
| Income after taxes on income | 123,708 | 100,694 | 55,367 | 42,598 | 86,347 |
| Company equity in earnings of affiliated companies | - | 186 | - | 186 | 254 |
| Minority interest in earnings of subsidiaries, net | (4,866) | (2,937) | (3,117) | (2,552) | (2,682) |
| Net income | 118,842 | 97,943 | 52,250 | 40,232 | 83,919 |
| | US\$ | US\$ | US\$ | US\$ | US\$ |
| Earnings per share | | | | | |
| Basic earnings per share | 0.27 | 0.23 | 0.12 | 0.09 | 0.19 |
| Fully diluted earnings per share | 0.27 | 0.22 | 0.12 | 0.09 | 0.19 |

* Reclassified

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

Condensed Statements of Changes in Shareholders' Equity

| | Share capital | Premium on shares | Capital reserves | Dividend proposed subsequent to balance sheet date | Retained earnings | Company shares held by the Company and by a subsidiary | Total |
|---|----------------|-------------------|------------------|--|-------------------|--|------------------|
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) |
| | US\$ thousands | US\$ thousands | US\$ thousands | US\$ thousands | US\$ thousands | US\$ thousands | US\$ thousands |
| Six-month period ended June 30, 2007 | | | | | | | |
| Balance as at December 31, 2006 | 123,232 | 614,052 | 2,719 | - | 535,911 | (144,196) | 1,131,718 |
| Employee options exercised | 434 | (434) | - | - | - | - | - |
| Conversion of convertible debentures | 838 | 7,013 | - | - | - | - | 7,851 |
| Adjustments deriving from translation of financial statements of investee companies | - | - | 3,367 | - | - | - | 3,367 |
| Capital reserve in respect of taxes relating to employee options | - | - | 1,311 | - | - | - | 1,311 |
| Capital reserve in respect of expenses relating to employee options | - | - | 2,527 | - | - | - | 2,527 |
| Net income | - | - | - | - | 118,842 | - | 118,842 |
| Balance as at June 30, 2007 | <u>124,504</u> | <u>620,631</u> | <u>9,924</u> | <u>-</u> | <u>654,753</u> | <u>(144,196)</u> | <u>1,265,616</u> |
| Six-month period ended June 30, 2006 | | | | | | | |
| Balance as at December 31, 2005 | 120,391 | 589,261 | (3,715) | 23,500 | 480,119 | (75,369) | 1,134,187 |
| Employee options exercised | 350 | (350) | - | - | - | - | - |
| Conversion of convertible debentures | 756 | 13,905 | - | - | - | - | 14,661 |
| Adjustments deriving from translation of financial statements of investee companies | - | - | (1,298) | - | - | - | (1,298) |
| Dividend proposed | - | - | - | (23,500) | (28,127) | - | (51,627) |
| Capital reserve in respect of taxes relating to employee options | - | - | 752 | - | - | - | 752 |
| Capital reserve in respect of expenses relating to employee options | - | - | 760 | - | - | - | 760 |
| Self purchase of Company shares | - | - | - | - | - | (68,827) | (68,827) |
| Net income | - | - | - | - | 97,943 | - | 97,943 |
| Balance as at June 30, 2006 | <u>121,497</u> | <u>602,816</u> | <u>(3,501)</u> | <u>-</u> | <u>549,935</u> | <u>(144,196)</u> | <u>1,126,551</u> |

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

Condensed Statements of Shareholders' Equity (cont'd)

| | Share capital (Unaudited) US\$ thousands | Premium on shares (Unaudited) US\$ thousands | Capital reserves (Unaudited) US\$ thousands | Dividend proposed subsequent to balance sheet date (Unaudited) US\$ thousands | Retained earnings (Unaudited) US\$ thousands | Company shares held by the Company and by a subsidiary (Unaudited) US\$ thousands | Total (Unaudited) US\$ thousands |
|--|--|---|--|---|---|---|--|
| Three-month period ended June 30, 2007 | | | | | | | |
| Balance as at March 31, 2007 | 124,067 | 617,659 | 5,320 | - | 602,503 | (144,196) | 1,205,353 |
| Employee options exercised | 102 | (102) | - | - | - | - | - |
| Conversion of convertible debentures | 335 | 3,074 | - | - | - | - | 3,409 |
| Adjustments deriving from translation of financial statements of investee companies | - | - | 2,539 | - | - | - | 2,539 |
| Capital reserve in respect of taxes relating to employee options | - | - | 932 | - | - | - | 932 |
| Capital reserve in respect of expenses relating to employee options | - | - | 1,133 | - | - | - | 1,133 |
| Net income | - | - | - | - | 52,250 | - | 52,250 |
| Balance as at June 30, 2007 | <u>124,504</u> | <u>620,631</u> | <u>9,924</u> | <u>-</u> | <u>654,753</u> | <u>(144,196)</u> | <u>1,265,616</u> |
| Three-month period ended June 30, 2006 | | | | | | | |
| Balance as at March 31, 2006 | 121,315 | 601,701 | (3,589) | 28,508 | 509,447 | (116,885) | 1,140,497 |
| Employee options exercised | 84 | (84) | - | - | - | - | - |
| Conversion of convertible debentures | 98 | 1,199 | - | - | - | - | 1,297 |
| Adjustments deriving from translation of financial statements of investee companies | - | - | (862) | - | - | - | (862) |
| Dividend proposed | - | - | - | (28,508) | 256 | - | (28,252) |
| Capital reserve in respect of taxes relating to employee options | - | - | 331 | - | - | - | 331 |
| Capital reserve in respect of expenses relating to employee options | - | - | 619 | - | - | - | 619 |
| Self purchase of Company shares | - | - | - | - | - | (27,311) | (27,311) |
| Net income | - | - | - | - | 40,232 | - | 40,232 |
| Balance as at June 30, 2006 | <u>121,497</u> | <u>602,816</u> | <u>(3,501)</u> | <u>-</u> | <u>549,935</u> | <u>(144,196)</u> | <u>1,126,551</u> |

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

Condensed Statements of Shareholders' Equity (cont'd)

| | Share capital | Premium on shares | Capital reserves | Dividend proposed subsequent to the balance sheet date | Retained earnings | Company shares held by the Company and by a subsidiary | Total |
|--|------------------|----------------------|---------------------|--|----------------------|---|------------------|
| | (Audited) | (Audited) | (Audited) | (Audited) | (Audited) | (Audited) | (Audited) |
| | US\$ thousands | US\$ thousands | US\$ thousands | US\$ thousands | US\$ thousands | US\$ thousands | US\$ thousands |
| Balance as at December 31, 2005 | 120,391 | 589,261 | (3,715) | 23,500 | 480,119 | (75,369) | 1,134,187 |
| Exercise of employee options | 651 | (651) | - | - | - | - | - |
| Conversion of convertible debentures into shares | 2,190 | 25,442 | - | - | - | - | 27,632 |
| Self purchase of Company shares | - | - | - | - | - | (68,827) | (68,827) |
| Tax benefit in respect of employee options | - | - | 1,146 | - | - | - | 1,146 |
| Expenses in respect of options to employees | - | - | 2,412 | - | - | - | 2,412 |
| Dividend | - | - | - | (23,500) | (28,127) | - | (51,627) |
| Net income for 2006 | - | - | - | - | 83,919 | - | 83,919 |
| Adjustments deriving from translation of financial statements of investee companies | - | - | 2,876 | - | - | - | 2,876 |
| Balance as at December 31, 2006 | <u>123,232</u> | <u>614,052</u> | <u>2,719</u> | <u>-</u> | <u>535,911</u> | <u>(144,196)</u> | <u>1,131,718</u> |

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

Condensed Consolidated Statements of Cash Flows

| | For the six months ended | | For the three months ended | | For the |
|--|--------------------------|-----------------|----------------------------|-----------------|------------------|
| | June 30 | June 30 | June 30 | June 30 | year ended |
| | 2007 | 2006 | 2007 | 2006 | December 31 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | 2006 |
| | US \$ thousands | US \$ thousands | US \$ thousands | US \$ thousands | (Audited) |
| | | | | | US \$ thousands |
| Cash flows generated by operating activities: | | | | | |
| Net income | 118,842 | 97,943 | 52,250 | 40,232 | 83,919 |
| Adjustments to reconcile net income to net cash flows generated by operating activities (see A. below) | 98,086 | * 97,542 | 172,714 | * 159,460 | 43,958 |
| Net cash inflow generated by operating activities | 216,928 | 195,485 | 224,964 | 199,692 | 127,877 |
| Cash flows generated by investing activities: | | | | | |
| Acquisition of fixed assets | (31,228) | (39,587) | (9,668) | (22,722) | (70,552) |
| Investment grant received | 3,922 | - | 1,607 | - | 466 |
| Investment in affiliated companies | - | (2,243) | - | (143) | (2,033) |
| Additions to other assets and deferred expenses, net | (33,424) | (26,004) | (12,080) | (15,904) | (42,884) |
| Short-term investments, net | (44,262) | (834) | (44,262) | (834) | - |
| Proceeds from disposal of fixed and other assets | 49 | 148 | 15 | 59 | 690 |
| Proceeds from sale of investments in former subsidiaries (see C. below) | - | 6,047 | - | 6,047 | 6,047 |
| Other long-term investments | - | * 87 | - | *87 | - |
| Investments in newly consolidated companies and operations (see B. below) | (7,878) | (25,453) | - | (25,453) | (28,689) |
| Repayment of liabilities in respect of subsidiaries | (1,000) | - | - | - | - |
| Dividend from affiliated | 530 | - | 530 | - | - |
| Acquisition of minority interest in subsidiaries | (1,105) | (2,406) | - | (2,406) | (2,406) |
| Net cash outflow generated by investing activities | (114,396) | (90,245) | (63,858) | (61,269) | (139,361) |
| Cash flows generated by financing activities: | | | | | |
| Receipt of long-term loans from banks | 3,444 | 15,000 | 1,061 | 15,000 | 43,001 |
| Repayment of long-term loans from banks and others | (3,940) | (19,780) | (1,452) | (15,262) | (41,042) |
| Self purchase of Company shares | - | (68,827) | - | (27,311) | (68,827) |
| Issuance of debentures less issuance expenses | - | - | - | - | 554,466 |
| Increase (decrease) in short-term credit from banks, net | 642 | 70,964 | (6,861) | (24,312) | (154,393) |
| Dividend to shareholders | - | (37,176) | - | (23,003) | (65,685) |
| Dividend to minority shareholders in subsidiaries | (450) | (772) | (93) | (420) | (2,967) |
| Net cash outflow generated by financing activities | (304) | (40,591) | (7,345) | (75,308) | 264,553 |
| Increase in cash and cash equivalents | 102,228 | 64,649 | 153,761 | 63,115 | 253,069 |
| Cash and cash equivalents at beginning of period | 324,362 | 71,293 | 272,829 | 72,827 | 71,293 |
| Cash and cash equivalents at end of the period | 426,590 | 135,942 | 426,590 | 135,942 | 324,362 |

* Reclassified

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

Condensed Consolidated Statements of Cash Flows (cont'd)

| | For the six months ended | | For the three months ended | | For the |
|---|--------------------------|-----------------|----------------------------|-----------------|-----------------|
| | June 30 | June 30 | June 30 | June 30 | year ended |
| | 2007 | 2006 | 2007 | 2006 | December 31 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | 2006 |
| | US \$ thousands | US \$ thousands | US \$ thousands | US \$ thousands | (Audited) |
| | | | | | US \$ thousands |
| A. Adjustments to reconcile net income to net cash flows generated by operating activities | | | | | |
| Revenues and expenses not affecting cash flows: | | | | | |
| Depreciation and amortization | 47,804 | 40,277 | 22,449 | 20,097 | 103,090 |
| Adjustment of long-term liabilities to banks and others | (1,904) | 611 | (8,127) | 2 | 841 |
| Minority interest in earnings of subsidiaries, net | 4,866 | 2,937 | 3,117 | 2,552 | 2,682 |
| Increase (decrease) in employee severance benefits, net | 6,727 | 1,636 | (1,354) | 1,863 | 6,771 |
| Deferred taxes, net | 11,805 | (2,271) | 6,188 | (347) | (20,478) |
| Capital loss on realization of fixed and other assets, net | 425 | 983 | 164 | 573 | 299 |
| Amortization of discount on convertible debentures | 90 | 172 | 64 | 87 | 296 |
| Expenses in respect of employee options | 2,801 | 760 | 1,158 | 619 | 3,238 |
| Capital gain on sale of investment subsidiary | - | (216) | - | (216) | (216) |
| Company equity in earnings of affiliated companies | - | (186) | - | (186) | (254) |
| Changes in operating assets and liabilities: | | | | | |
| Decrease (increase) in trade and other receivables | (59,431) | *(40,385) | 143,475 | * 106,206 | (114,523) |
| Decrease (increase) in inventories | 19,152 | 2,679 | (588) | 8,345 | (28,672) |
| Increase (decrease) in trade and other payables | 65,751 | *90,545 | 6,168 | *19,865 | 90,884 |
| | 98,086 | 97,542 | 172,714 | 159,460 | 43,958 |

* Reclassified

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

Condensed Consolidated Statements of Cash Flows (cont'd)

| | For the six months ended | | For the three months ended | | For the |
|--|--------------------------|-----------------|----------------------------|-----------------|-----------------|
| | June 30 | June 30 | June 30 | June 30 | year ended |
| | 2007 | 2006 | 2007 | 2006 | December 31 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | US \$ thousands | US \$ thousands | US \$ thousands | US \$ thousands | US \$ thousands |
| B. Investments in newly consolidated companies and operations | | | | | |
| Working capital (excluding cash and cash equivalents) | (4,593) | (8,035) | - | (8,035) | (8,998) |
| Fixed assets | (1,857) | (13,795) | - | (13,795) | (16,045) |
| Other assets | (4,559) | (7,940) | - | (7,940) | (10,633) |
| Long-term liabilities | 3,000 | 7,750 | - | 7,750 | 9,726 |
| Goodwill created on acquisition | (2,032) | (7,777) | - | (7,777) | (8,012) |
| Realization of Company shares held by a subsidiary | 2,163 | - | - | - | - |
| Payables in respect of acquisition of activities | - | 1,000 | - | 1,000 | 1,792 |
| Minority interest | - | 3,344 | - | 3,344 | 3,481 |
| | (7,878) | (25,453) | - | (25,453) | (28,689) |
| C. Proceeds from sale of investment in former subsidiaries | | | | | |
| Working capital (excluding cash and cash equivalents) | - | 3,679 | - | 3,679 | 3,679 |
| Fixed assets, net | - | 607 | - | 607 | 607 |
| Other assets, net | - | 2,629 | - | 2,629 | 2,629 |
| Long-term liabilities | - | (1,084) | - | (1,084) | (1,084) |
| Capital gain | - | 216 | - | 216 | 216 |
| | - | 6,047 | - | 6,047 | 6,047 |
| D. Non-cash activities | | | | | |
| Acquisition of other assets | - | - | - | - | 17,901 |
| Acquisition of fixed assets | - | - | - | - | 4,767 |

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

Notes to the Financial Statements as at June 30, 2007 (Unaudited)

Note 1 - Financial Reporting Principles and Accounting Policies

A. General

1. These interim financial statements have been prepared in accordance with generally accepted accounting principles applicable to the preparation of interim-period financial statements in accordance with Standard No. 14 of the Israel Accounting Standards Board and with Section D of the Securities Regulations (Immediate and Periodic Reports), 1970.
2. The accounting policies applied in the preparation of these financial statements are consistent with those applied in the audited financial statements as at December 31, 2006, except for that stated in Section B., below.
3. These financial statements have been prepared in an abridged form as at June 30, 2007 and for the six and three-month periods then ended. It should be read in conjunction with the annual financial statements as at December 31, 2006 and for the year then ended, and the accompanying notes thereto.

B. First-time application of new accounting standards

- (1) Commencing from January 1, 2007, the Company applies Accounting Standard No. 26, regarding "Inventory" (hereinafter – "the Standard"), of the Israeli Accounting Standards Board.

Pursuant to the Standard's provisions, the Company measures the inventory at the lower of cost or net realizable value. The Standard also provides guidelines regarding allocation of conversion costs to inventory.

According to its transitional rules, the Standard is to be applied retroactively to the comparative data relating to prior periods

Application of the new Standard does not have a material impact on the Company's results of operations and its financial position.

- (2) Commencing from January 1, 2007, the Company applies Accounting Standard No. 27, regarding "Fixed Assets" (hereinafter – "the Standard"), of the Israeli Accounting Standards Board. The Standard provides principles for the recognition, measurement and elimination of fixed-asset items and the disclosure required in respect thereof.

The main changes provided by the Standard compared with the principles previously applied are: inclusion as part of the cost of a fixed-asset item an estimate of the costs to be incurred in respect of an obligation to dismantle and transfer the item and to restore the site on which it is located, already at the time of the initial recognition of thereof; provision of an alternative to measurement of groups of similar fixed-asset items at a revalued amount less accumulated depreciation where an increase in the value of the asset as a result of the revaluation beyond its original cost is to be recorded directly in the shareholders' equity section in the category "reserve for revaluation"; separate depreciation of every component of a fixed-asset item having a significant cost in relation to the item, including costs of significant periodic examinations; determination that a fixed-asset

Note 1 - Financial Reporting Principles and Accounting Policies (cont'd)

B. First-time application of new accounting standards (cont'd)

item acquired in exchange for a non-monetary asset in a transaction that is commercial in nature, is to be measured at fair value; a requirement to review the residual value, useful life and depreciation method of the asset at least at the end of each fiscal year, and if the expectations are different than the prior estimates the changes are to be treated as a change in accounting estimate.

The Company elected to measure the fixed-asset items at cost less accumulated depreciation.

Application of the new Standard does not have a material impact on the Company's results of operations and its financial position.

- (3) Commencing from January 1, 2007, the Company applies Accounting Standard No. 23, regarding "The Accounting Treatment of Transactions between an Entity and the Controlling Interest Therein" (hereinafter – "the Standard"), of the Israeli Accounting Standards Board. The Standard essentially supersedes the main provisions set forth in the Securities Regulations (Presentation of Transactions between a Company and a Controlling Interest Therein in the Financial Statements). The Standard provides that assets (except for an intangible asset not having an active market) and liabilities with respect to which a transaction was executed between the entity and the controlling interest therein are to be measured on the transaction date based on fair value and the difference between the fair value and consideration recorded on the transaction is to be recorded in the shareholders' equity. A debit balance difference constitutes essentially a dividend and, therefore, it reduces the balance of the retained earnings. A credit balance difference constitutes essentially a shareholder's investment and, therefore, it is presented in a separate category in the shareholders' equity section called "capital reserve from a transaction between an entity and the controlling interest therein".

The Standard addresses three issues relating to transactions between an entity and the controlling interest therein:

- 1) Transfer of an asset to the entity from the controlling interest therein or, alternatively, transfer of an asset from the entity to the controlling interest therein;
- 2) Assumption of a liability of the entity to a third party, in whole or in part, by the controlling interest therein, indemnification of the entity by the controlling interest therein in respect of an expense, and waiver by the controlling interest to the entity of a debt due to the controlling interest, in whole or in part;
- 3) Loans made to the controlling interest or loans received by the controlling interest.

In addition, the Standard provides the disclosure to be provided in the financial statements in connection with transactions between the entity and the controlling interest therein during the period.

Pursuant to the Standard's transitional provisions, the Company applies the Standard to transactions with controlling interests therein executed after January 1, 2007, as well as to loans made or received from the controlling interest prior to the Standard's commencement date, beginning from its commencement date.

Application of the new Standard does not have a material impact on the Company's results of operations and its financial position.

Note 1 - Financial Reporting Principles and Accounting Policies (cont'd)

B. First-time application of new accounting standards (cont'd)

- (4) Commencing from January 1, 2007, the Company applies Accounting Standard No. 30, regarding "Intangible Assets" (hereinafter – "the Standard"), of the Israeli Accounting Standards Board. The Standard explains the accounting treatment of intangible assets and defines how to measure the book value of these assets, while providing detail in respect of the required disclosures. The Standard will be initially applied retroactively, except with respect to a research and development project in process acquired in the framework of a business combination that took place prior to January 1, 2007 and that fulfills the definition of an intangible asset on the acquisition date and that was recorded as an expense on the acquisition date. As of January 1, 2007, the entity will recognize the research and development project as an asset while making a tax allocation.

Commencing from the first quarter of 2007, the Company is examining the need to capitalize costs in respect of product development where the conditions required by the Standard exist, among other things, where the technical possibility exists to complete the asset, the asset is expected to produce future economic benefits and the required expenses that can be allocated to the asset during its development period are capable of reasonable estimation.

Furthermore, according to accounting standard No. 30, computer software which is integral to related item of hardware, previously shown as fixed assets, is included as other assets.

Due to application of the new standard, the Company reclassified computer software which is not integral to a related item as other assets (previously shown as fixed assets) in the amount of US \$ 5.3 million and US \$ 5.2 million as of June 30, 2006 and December 31, 2006 respectively.

- (5) In July 2006, the Israeli Accounting Standards Board 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 impact of the application of the Standard on its financial statements. The Company does not intend to make an early adoption of the IFRS Standards.

Note 1 - Financial Reporting Principles and Accounting Policies (cont'd)

C. Financial statements in US dollars

The Company and its Israeli subsidiaries maintain their current accounting records in nominal shekels and dollars using a multi-currency system. Since most of the Group's revenues are received in dollars and the principal raw materials and fixed assets are purchased in dollars, the dollar is the principal currency of the economic environment in which the Group operates ("the functional currency"). Accordingly, the dollar is the measurement and reporting currency in these financial statements. It should not be construed that the translated amounts actually represent or can be converted into dollars, unless otherwise indicated in these statements.

Changes in the representative exchange rates of the U.S. dollar and the Consumer Price Index (CPI) are as follows:

| | Exchange rate of the U.S.\$ to the NIS | Exchange rate of the U.S.\$ to the Euro | Exchange rate of the U.S.\$ to the Brazilian Real |
|-------------------------------------|---|--|--|
| CPI | % | % | % |
| % | % | % | % |
| During the six-month period ended: | | | |
| June 30, 2007 | 0.97 | 0.57 | (2.05) |
| June 30, 2006 | 1.55 | (3.54) | (6.91) |
| During the three-month period ended | | | |
| June 30, 2007 | 1.21 | 2.26 | (0.94) |
| June 30, 2006 | 0.97 | (4.82) | (4.51) |
| During the year ended | | | |
| December 31, 2006 | (0.1) | (8.21) | (10.17) |

Note 2 - Segment Information

A. Products and services:

Commencing from 2006, the Company presents its segments' information according to a primary format, which is based on a breakdown by business segments, and a secondary format, which is based on a breakdown by geographical segments.

The Company's reporting format reflects the main and significant source of the risks and rewards to which it is exposed. In formulation of the segments' report, the Company examined the risks and rewards deriving from the various segments, along with the nature of the products, production processes, product consumers and methods used for product distribution.

The comparative amounts appearing in the note to the six-month and three-month periods ended June 30, 2006 were restated in order to reflect the segments' report in the above-mentioned format.

Note 2 - Segment Information (cont'd)

A. Products and services: (cont'd)

The Company operates in the following areas:

Agro products – This is the main area of operation of the Company and involves the manufacture and marketing of convention agro products.

Non-agro products – This area of activity includes a large number of sub-areas, including, Lykohan (oxidizing retardant), aromatic products, and other chemicals, and combines all the Company's activities not included in the agro-products segment.

| | <u>Agro</u> <u>US\$ thousands</u> | <u>Non-Agro</u> <u>US\$ thousands</u> | <u>Adjustments</u> <u>US\$ thousands</u> | <u>Consolidated</u> <u>US\$ thousands</u> |
|-----------------------------------|--------------------------------------|--|---|--|
| For the six months ended | | | | |
| June 30, 2007 | | | | |
| Segment income | 1,009,769 | 100,969 | (1,513) | 1,109,225 |
| Segment results | 177,806 | 10,631 | - | 188,437 |
| For the six months ended | | | | |
| June 30, 2006 * | | | | |
| Segment income | 842,553 | 110,629 | (1,051) | 952,131 |
| Segment results | 136,388 | 13,385 | - | 149,773 |
| For the three months ended | | | | |
| June 30, 2007 | | | | |
| Segment income | 498,600 | 51,953 | (667) | 549,886 |
| Segment results | 83,888 | 4,516 | - | 88,404 |
| For the three months ended | | | | |
| June 30, 2006 * | | | | |
| Segment income | 402,238 | 56,542 | (515) | 458,265 |
| Segment results | 59,673 | 6,530 | - | 66,203 |
| For the year ended | | | | |
| December 31, 2006 | | | | |
| Segment income | 1,581,328 | 199,770 | (2,342) | 1,778,756 |
| Segment results | 192,900 | 10,894 | - | 203,794 |

* Restated

Note 2 - Segment Information (cont'd)

B. Sales by geographic area

| | For the six months ended | | For the three months ended | | For the |
|---------------|--------------------------|-------------------|----------------------------|-------------------|------------------|
| | June 30 | June 30 | June 30 | June 30 | year ended |
| | 2007 | 2006 | 2007 | 2006 | December 31 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | 2006 |
| | US\$ thousands | US\$ thousands | US\$ thousands | US\$ thousands | (Audited) |
| | US\$ thousands | US\$ thousands | US\$ thousands | US\$ thousands | US\$ thousands |
| Israel | 55,922 | 63,561 | 30,535 | 34,430 | 111,565 |
| Latin America | 205,511 | ** 162,834 | 100,380 | ** 79,693 | 430,042 |
| Europe | 490,604 | 410,283 | 222,090 | 180,405 | 689,965 |
| North America | 233,658 | 205,985 | 131,375 | 105,839 | 349,404 |
| Other | 123,530 | 109,468 | 65,506 | 57,898 | 197,780 |
| | 1,109,225 | ** 952,131 | 549,886 | ** 458,265 | 1,778,756 |

** Reclassified

Note 3 - Additional Information

- (1) As part of the commitments of the Company and of its subsidiaries under agreements signed in September 2004, regarding a securitization transaction whereby trade receivables were sold to companies in the RaboBank International Group, the balance of the trade receivables sold for cash amounted, as at the balance sheet date, to \$275 million (June 30, 2006 – \$250 million, December 31, 2006 – \$175.8 million).

The maximum expected volume of the financial means available to the acquiring companies for the purpose of purchasing the trade receivables of the consolidated subsidiaries, is an amount ranging between \$250 million and \$275 million, on a current basis, such that the amounts to be collected from customers whose debts were sold, will serve to purchase new trade receivables.

- (2) The Company and Milenia committed to indemnify financial institutions, upon the existence of certain conditions, in respect of credit received by Milenia's customers from those financial institutions and which was used for repayment of the debts of those customers to Milenia for sales made to them.

As at the balance sheet date, the amount of the liability to indemnify is \$50.6 million (June 30, 2006 – \$82.7 million).

- (3) During the period of the report, NIS 30,617 thousand par value debentures (Series A) were converted into 3,365 thousand of the Company's ordinary shares of NIS 1 par value. Furthermore in the current period \$675 thousand par value of the debentures that were allotted in March 2004 in placement to institutional investors were converted into 149 thousand of the Company's ordinary shares of NIS 1 par value. As a result of the conversion, as stated, the Company's shareholders' equity increased by about \$7.8 million.

Note 3 - Additional Information (cont'd)

- (4) Accounting treatment of options granted under the Company's 2005 option plan

On March 13, 2005, the Company's Board of Directors approved an employee share option plan, an immediate report and related description in respect of which was published on March 14, 2005. Relying on the transitional rules of Accounting Standard 24, "Share-Based Payments", the Company did not apply that Standard to the grants made under the option plan, and did not record an expense in respect thereof, pursuant to the Standard's transitional rules which provide that the Standard applies to grants after March 15, 2005, and which had not vested prior to January 1, 2006.

In connection with review of the draft prospectus submitted by the Company for listing of bonds it issued, and following a meeting with the staff of the Israeli Securities Authority on May 8, 2007, questions arose regarding the factual circumstances leading to removal of the grants from application of the aforesaid Standard.

The Company Board of Directors has decided to re-examine the facts on the basis of which the grants were treated for accounting purposes, under the supervision of the Company's Audit Committee. After reviewing the issue, no requirement has arisen to amend its financial statements nor will it be required to record any additional expense on account of the options issued under 2005 plan, also due to such change not being material.

Note 4 - Seasonality

Sales of crop protection products are directly related to the agricultural seasons and the cyclical pattern of the growing seasons and, therefore, the Company's revenues are not spread evenly throughout the year. Countries located in the northern hemisphere are all characterized by the same timing of the agricultural seasons and, as a result, sales made by these countries are usually highest in February through April. On the other hand, in the southern hemisphere the seasonal trends are exactly the opposite and most of the local sales are concentrated in the months August through November, except for Australia where most of the sales are made in the months April through July.

The Company's worldwide operations act to balance out the above-mentioned seasonal impacts, notwithstanding the fact that most of the Company's sales are made in the northern hemisphere.

ECI Telecom Ltd.
Interim Consolidated
Financial Statements
(Unaudited)
As of June 30, 2007

Interim Unaudited Consolidated Financial Statements as of June 30, 2007

Contents

| | Page |
|--|-------------|
| Review Letter of the Unaudited Interim Consolidated Financial Statements | 1 |
| Interim Unaudited Consolidated Balance Sheets | 3 |
| Interim Unaudited Consolidated Statements of Operations | 4 |
| Interim Unaudited Consolidated Statements of Comprehensive Income | 5 |
| Interim Unaudited Consolidated Statements of Changes in Shareholders' Equity | 6 |
| Interim Unaudited Consolidated Statements of Cash Flows | 9 |
| Notes to the Interim Consolidated Financial Statements | 12 |



Somekh Chaikin
KPMG Millennium Tower
17 Ha'arba'a Street, PO Box 609
Tel Aviv 61006 Israel

Telephone 972 3 684 8000
Fax 972 3 684 8444
Internet www.kpmg.co.il

The Board of Directors of ECI Telecom Ltd.

Review of the unaudited interim consolidated financial statements for the six-month and three-month periods ended June 30, 2007

At your request, we have reviewed the interim consolidated balance sheet of ECI Telecom Ltd. and its subsidiaries as of June 30, 2007, and the related interim consolidated statements of operations, the interim statements of comprehensive income, the interim statements of changes in shareholders' equity and the interim consolidated statements of cash flows for the six-month and three-month periods then ended.

Our review was carried out in accordance with procedures prescribed by the Institute of Certified Public Accountants in Israel and included, inter alia, reading the said financial statements, reading the minutes of Shareholders' Meetings and of the Board of Directors and its committees, as well as making inquiries of those responsible for financial and accounting matters.

We received review reports of other auditors, regarding the interim financial statements of certain consolidated subsidiary whose assets constitute approximately 1.67% of the total consolidated assets as of June 30, 2007 and whose revenues constitute approximately 4.47% and 4.15% of the consolidated revenues for the six and three month periods then ended, respectively.

Since such a review is limited in scope and does not constitute an audit in accordance with generally accepted auditing standards, we do not express an opinion on the said interim consolidated financial statements.

In the course of our review, including the review of reports of other auditors, nothing came to our attention which would indicate the necessity of making material changes in the said financial statements in order for them to be in conformity with generally accepted accounting principles (GAAP) in the United States.

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

August 2, 2007 - Tel Aviv, Israel

Interim Unaudited Consolidated Balance Sheets as of

| | June 30 2007 | June 30 2006 | December 31 2006 |
|--|---------------------------------------|---------------------------------------|-------------------------------------|
| | <u>\$ in thousands</u> (Unaudited) | <u>\$ in thousands</u> (Unaudited) | <u>\$ in thousands</u> (Audited) |
| Assets | | | |
| Current assets | | | |
| Cash and cash equivalents | 149,325 | 84,925 | 92,732 |
| Short-term investments | 90,743 | 70,756 | 80,708 |
| Receivables: | | | |
| Trade, net | 167,522 | 163,446 | 187,410 |
| Other | 29,553 | 31,070 | 27,110 |
| Prepaid expenses | 5,138 | 4,967 | 4,819 |
| Work in progress | 20,767 | 3,457 | 13,062 |
| Inventories | 140,142 | 148,705 | 159,355 |
| Total current assets | 603,190 | 507,326 | 565,196 |
| Long-term receivables, net | 10,528 | 8,519 | 6,314 |
| Long-term deposit and marketable securities | 42,772 | 102,980 | 72,767 |
| Assets held for severance benefits | 20,831 | 24,942 | 20,549 |
| Investments | 13,736 | 16,336 | 11,988 |
| Property, plant and equipment | | | |
| Cost | 302,776 | 278,121 | 293,254 |
| Less – Accumulated depreciation | 179,666 | 156,979 | 169,362 |
| | 123,110 | 121,142 | 123,892 |
| Software development costs, net | 13,835 | 11,327 | 12,852 |
| Goodwill | 39,329 | 39,329 | 39,329 |
| Other assets, net | 53,348 | 45,224 | 42,993 |
| Total assets | 920,679 | 877,125 | 895,880 |

President, Chief Executive Officer

Rafi Maor

Executive Vice President,
Chief Financial Officer

Itzik Zion

August 2, 2007

| | June 30 2007 | June 30 2006 | December 31 2006 |
|--|--|--|--------------------------------------|
| | \$ in thousands (Unaudited) | \$ in thousands (Unaudited) | \$ in thousands (Audited) |
| Liabilities and shareholders' equity | | | |
| Current liabilities | | | |
| Trade payables | 65,647 | 77,095 | 82,954 |
| Other payables and accrued liabilities | 117,654 | 122,244 | 120,422 |
| Total current liabilities | 183,301 | 199,339 | 203,376 |
| Long-term liabilities | | | |
| Other liabilities | 1,000 | 1,000 | 985 |
| Liability for employee severance benefits | 42,359 | 46,249 | 43,664 |
| Total long-term liabilities | 43,359 | 47,249 | 44,649 |
| Total liabilities | 226,660 | 246,588 | 248,025 |
| Minority Interest | - | 4,120 | 4,144 |
| Shareholders' equity | | | |
| Ordinary shares NIS 0.12 par value per share, Authorized 200,000,000 shares; Issued and outstanding 120,268,980 shares as at June 30, 2007, 117,072,532 as at June 30, 2006 and 119,324,849 shares as at December 31, 2006 | 6,425 | 6,387 | 6,396 |
| Capital surplus | 667,803 | 652,695 | 661,053 |
| Accumulated other comprehensive loss | (1,638) | (1,213) | (1,682) |
| Retain earnings (deficit) | 21,429 | (31,452) | (22,056) |
| Total shareholders' equity | 694,019 | 626,417 | 643,711 |
| Total liabilities and shareholders' equity | 920,679 | 877,125 | 895,880 |

The accompanying notes are an integral part of these interim financial statements.

Interim Unaudited Consolidated Statements of Operations

| | Six months ended | | Three months ended | | Year ended |
|---|--------------------------------|--------------------------------|--------------------------------|--------------------------------|------------------------------|
| | June 30 2007 | June 30 2006 | June 30 2007 | June 30 2006 | December 31 2006 |
| | \$ in thousands (Unaudited) | \$ in thousands (Unaudited) | \$ in thousands (Unaudited) | \$ in thousands (Unaudited) | \$ in thousands (Audited) |
| Revenues | 319,258 | 332,283 | 164,139 | 170,273 | 656,342 |
| Cost of revenues | 180,899 | 200,350 | 93,135 | 103,331 | 388,023 |
| Gross profit | 138,359 | 131,933 | 71,004 | 66,942 | 268,319 |
| Research and development costs, net | 51,722 | 50,416 | 26,545 | 25,362 | 99,525 |
| Selling and marketing expenses | 50,486 | 46,139 | 25,402 | 24,211 | 96,971 |
| General and administrative expenses | 22,906 | 24,134 | 11,926 | 11,498 | 47,560 |
| Recovery of doubtful debt | (3,160) | - | (3,160) | - | - |
| Amortization of acquisition – related intangible assets | 2,352 | 2,491 | 1,091 | 1,273 | 5,019 |
| Operating income | 14,053 | 8,753 | 9,200 | 4,598 | 19,244 |
| Financial expenses | (1,916) | (1,187) | (1,121) | (554) | (3,091) |
| Financial income | 6,127 | 5,757 | 3,434 | 2,932 | 12,867 |
| Other income, net | 15,842 | 4,487 | 15,618 | 4,500 | 4,315 |
| Income from continuing operations before taxes on income | 34,106 | 17,810 | 27,131 | 11,476 | 33,335 |
| Taxes on income (tax benefit) | (9,578) | 2,226 | 1,988 | 1,180 | 3,924 |
| Income from continuing operations after taxes on income | 43,684 | 15,584 | 25,143 | 10,296 | 29,411 |
| Company's equity in results of investee company | (423) | (2,885) | (370) | (659) | (7,292) |
| Minority interest | 224 | - | - | - | (24) |
| Net Income | 43,485 | 12,699 | 24,773 | 9,637 | 22,095 |
| Earnings per ordinary share | | | | | |
| Basic earnings per share: | | | | | |
| Net earnings per ordinary share (\$) | 0.37 | 0.11 | 0.21 | 0.08 | 0.19 |
| Weighted average number of shares outstanding used to compute basic earnings per share - in thousands | 118,025 | 114,712 | 118,211 | 116,102 | 115,803 |
| Diluted earnings per share: | | | | | |
| Net earnings per ordinary share (\$) | 0.36 | 0.11 | 0.20 | 0.08 | 0.18 |
| Weighted average number of shares outstanding used to compute diluted earnings per share – in thousands | 121,343 | 119,719 | 121,411 | 120,532 | 120,456 |

The accompanying notes are an integral part of these interim financial statements.

Interim Unaudited Consolidated Statements of Comprehensive Income

| | Six months ended | | Three months ended | | Year ended |
|---|------------------|-----------------|--------------------|-----------------|-----------------|
| | June 30 | June 30 | June 30 | June 30 | December 31 |
| | 2007 | 2006 | 2007 | 2006 | 2006 |
| | \$ in thousands | \$ in thousands | \$ in thousands | \$ in thousands | \$ in thousands |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| Net income | 43,485 | 12,699 | 24,773 | 9,637 | 22,095 |
| Other comprehensive income (loss): | | | | | |
| Changes in the fair value of financial instruments, net of taxes (nil) | 9 | (5,015) | 529 | (633) | (5,745) |
| Realization of gain on available for sale securities | - | (4,075) | - | (4,075) | (4,066) |
| Unrealized holding gain (loss) on available for sale securities arising during the period, net of taxes (nil) | 35 | (609) | (17) | (2,531) | (357) |
| Total other comprehensive income (loss) | 44 | (9,699) | 512 | (7,239) | (10,168) |
| Comprehensive income | 43,529 | 3,000 | 25,285 | 2,398 | 11,927 |

The accompanying notes are an integral part of these interim financial statements.

Interim Unaudited Consolidated Statements of Changes in Shareholders' Equity

| | Number of shares ⁽¹⁾ | Share capital | Capital surplus | Accumulated other comprehensive income (loss) | Accumulated earnings (deficit) | Total shareholders' equity |
|---|--------------------------------------|------------------|--------------------|--|--------------------------------------|----------------------------------|
| | \$ in thousands except share amounts | | | | | |
| Balance at January 1, 2007 | 119,324,849 | 6,396 | 661,053 | (1,682) | (22,056) | 643,711 |
| Net income for the six months ended June 30, 2007 | - | - | - | - | 43,485 | 43,485 |
| Employee stock options exercised and paid | 640,002 | 18 | 1,979 | - | - | 1,997 |
| Share-based payments expenses | - | - | 4,782 | - | - | 4,782 |
| Restricted shares issuance | 372,381 | 11 | (11) | - | - | - |
| Restricted shares forfeited | (68,252) | - | - | - | - | - |
| Net unrealized gain on available for sale securities | - | - | - | 35 | - | 35 |
| Changes in the fair value of financial instruments | - | - | - | 9 | - | 9 |
| Balance at June 30, 2007 (Unaudited) | 120,268,980 | 6,425 | 667,803 | (1,638) | 21,429 | 694,019 |
| Balance at January 1, 2006 | 111,827,822 | 6,262 | 648,532 | 8,486 | (44,151) | 619,129 |
| Net income for the six months ended June 30, 2006 | - | - | - | - | 12,699 | 12,699 |
| Employee stock options exercised and paid | 4,989,169 | 125 | 9,910 | - | - | 10,035 |
| Share-based payments expenses | - | - | 6,681 | - | - | 6,681 |
| Restricted shares issuance | 276,607 | - | - | - | - | - |
| Restricted shares forfeited | (21,066) | - | - | - | - | - |
| Net unrealized gain on available for sale securities | - | - | - | (609) | - | (609) |
| Realization of gain on available for sale securities | - | - | - | (4,075) | - | (4,075) |
| Changes in the fair value of financial instruments | - | - | - | (5,015) | - | (5,015) |
| Distribution of available for sale securities as dividend in kind | - | - | (12,428) | - | - | (12,428) |
| Balance at June 30, 2006 (Unaudited) | 117,072,532 | 6,387 | 652,695 | (1,213) | (31,452) | 626,417 |

(1) Issued and outstanding

The accompanying notes are an integral part of these interim financial statements.

Interim Unaudited Consolidated Statements of Changes in Shareholders' Equity (cont'd)

| | Number of shares ⁽¹⁾ | Share capital | Capital surplus | Accumulated other comprehensive income (loss) | Accumulated earnings (deficit) | Total shareholders' equity |
|---|---------------------------------------|------------------|--------------------|--|--------------------------------------|----------------------------------|
| | \$ in thousands, except share amounts | | | | | |
| Balance at April 1, 2007 (Unaudited) | 119,624,724 | 6,405 | 664,325 | (2,150) | (3,344) | 665,236 |
| Net income for the three months ended June 30, 2007 | - | - | - | - | 24,773 | 24,773 |
| Employee stock options exercised and paid | 337,993 | 9 | 941 | - | - | 950 |
| Share-based payments expenses | - | - | 2,548 | - | - | 2,548 |
| Restricted shares issuance | 333,527 | 11 | (11) | - | - | - |
| Restricted shares forfeited | (27,264) | - | - | - | - | - |
| Net unrealized gain on available for sale securities | - | - | - | (17) | - | (17) |
| Changes in the fair value of financial instruments | - | - | - | 529 | - | 529 |
| Balance at June 30, 2007 (Unaudited) | 120,268,980 | 6,425 | 667,803 | (1,638) | 21,429 | 694,019 |
| Balance at April 1, 2006 (Unaudited) | 116,392,303 | 6,375 | 659,710 | 6,026 | (41,089) | 631,022 |
| Net income for the three months ended June 30, 2006 | - | - | - | - | 9,637 | 9,637 |
| Employee stock options exercised and paid | 435,869 | 12 | 1,563 | - | - | 1,575 |
| Share-based payments expenses | - | - | 3,850 | - | - | 3,850 |
| Restricted shares issuance | 259,470 | - | - | - | - | - |
| Restricted shares forfeited | (15,110) | - | - | - | - | - |
| Net unrealized gain on available for sale securities | - | - | - | (2,531) | - | (2,531) |
| Realization of gain on available for sale securities | - | - | - | (4,075) | - | (4,075) |
| Changes in the fair value of financial instruments | - | - | - | (633) | - | (633) |
| Distribution of available for sale securities as dividend in kind | - | - | (12,428) | - | - | (12,428) |
| Balance at June 30, 2006 (Unaudited) | 117,072,532 | 6,387 | 652,695 | (1,213) | (31,452) | 626,417 |

⁽¹⁾ Issued and outstanding

The accompanying notes are an integral part of these interim financial statements.

Interim Unaudited Consolidated Statements of Changes in Shareholders' Equity (cont'd)

| | Number of shares ⁽¹⁾ | Share capital | Capital surplus | Accumulated other comprehensive income (loss) | Accumulated earnings (deficit) | Total shareholders' equity |
|---|---------------------------------------|------------------|--------------------|--|--------------------------------------|----------------------------------|
| | \$ in thousands except share amounts | | | | | |
| Balance at January 1, 2006 | 111,827,822 | 6,262 | 648,532 | 8,486 | (44,151) | 619,129 |
| Net income for the year ended December 31, 2006 | - | - | - | - | 22,095 | 22,095 |
| Employee stock options exercised and paid | 5,963,555 | 134 | 12,489 | - | - | 12,623 |
| Restricted shares issuance | 1,574,767 | - | - | - | - | - |
| Restricted shares forfeited | (41,295) | - | - | - | - | - |
| Realization of gain on available for sale securities | - | - | - | (4,066) | - | (4,066) |
| Share based compensation expense | - | - | 12,460 | - | - | 12,460 |
| Net unrealized loss on available for sale securities | - | - | - | (357) | - | (357) |
| Changes in fair value of financial instruments | - | - | - | (5,745) | - | (5,745) |
| Distribution of available for sale securities as dividend in kind | - | - | (12,428) | - | - | (12,428) |
| Balance at December 31, 2006 (audited) | 119,324,849 | 6,396 | 661,053 | (1,682) | (22,056) | 643,711 |

⁽¹⁾ Issued and outstanding

The accompanying notes are an integral part of these interim financial statements.

Interim Unaudited Consolidated Statement of Cash Flows

| | Six months ended | | Three months ended | | Year ended |
|--|------------------|-----------------|--------------------|-----------------|-----------------|
| | June 30 | June 30 | June 30 | June 30 | December 31 |
| | 2007 | 2006 | 2007 | 2006 | 2006 |
| | \$ in thousands | \$ in thousands | \$ in thousands | \$ in thousands | \$ in thousands |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| Cash flows for operating activities | | | | | |
| Income for the period | 43,485 | 12,699 | 24,773 | 9,637 | 22,095 |
| Adjustments to reconcile income to cash provided by operating activities: | | | | | |
| Depreciation and amortization | 20,712 | 18,774 | 10,807 | 9,170 | 39,771 |
| Share-based payments expenses | 4,782 | 6,681 | 2,548 | 3,850 | 12,460 |
| Accrued severance pay, net | (1,588) | 463 | (1,193) | 1,374 | 1,137 |
| Gain on sale of property and equipment | 12 | (345) | (1) | (151) | (447) |
| Capital gains, net | (15,665) | (3,701) | (15,480) | (4,030) | (3,639) |
| Other - net | (54) | (2,422) | 237 | (2,770) | (1,532) |
| Company's equity in results of investee company | 423 | 2,885 | 370 | 659 | 7,292 |
| Minority interest | (224) | - | - | - | 24 |
| Loss (gain) from marketable securities | (33) | 208 | (20) | (105) | 9 |
| Deferred taxes | (12,706) | - | 342 | - | - |
| Decrease (increase) in trade receivables (including non-current maturities of trade receivables) | 15,674 | (10,887) | (12,129) | 3,875 | (32,647) |
| Decrease (increase) in other receivables | (3,387) | (14,697) | 3,796 | (8,725) | (10,339) |
| Decrease (increase) in prepaid expenses | (319) | (1,350) | (233) | 705 | (1,202) |
| Increase in work in progress | (7,704) | (520) | (2,936) | (273) | (10,125) |
| Decrease (increase) in inventories | 19,212 | (1,742) | 12,259 | 2,163 | (12,392) |
| Increase (decrease) in trade payables | (17,307) | 20,644 | 1,295 | 6,063 | 26,503 |
| Increase (decrease) in other payable and accrued liabilities | (2,768) | 5,302 | (8,043) | (10,154) | 2,997 |
| Increase (decrease) in other long-term liabilities | 15 | 843 | (1) | 780 | 828 |
| Net cash provided by operating activities | 42,560 | 32,835 | 16,391 | 12,068 | 40,793 |

The accompanying notes are an integral part of these interim financial statements.

Interim Unaudited Consolidated Statement of Cash Flows (cont'd)

| | Six months ended | | Three months ended | | Year ended |
|---|------------------|-----------------|--------------------|-----------------|-----------------|
| | June 30 | June 30 | June 30 | June 30 | December 31 |
| | 2007 | 2006 | 2007 | 2006 | 2006 |
| | \$ in thousands | \$ in thousands | \$ in thousands | \$ in thousands | \$ in thousands |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| Cash flows provided by (used in) investing activities | | | | | |
| Investments in deposits, net | (27,565) | 396 | (31,164) | 50 | (5,160) |
| Software development costs capitalized | (6,468) | (3,488) | (3,323) | (1,678) | (9,472) |
| Investment in property, plant and equipment | (12,263) | (13,640) | (5,779) | (7,189) | (30,755) |
| Proceeds from sale of property, plant and equipment | 158 | 534 | 44 | 221 | 992 |
| Payments for acquisition of additional shares in consolidated company | (2,820) | - | - | - | (1,100) |
| Investment in investee companies | (3,333) | (250) | - | - | (608) |
| Proceeds from selling shares of investee companies | 16,740 | - | 16,740 | - | - |
| Repayment of long-term loans granted | - | 217 | - | 60 | 506 |
| Investment in marketable securities | (59,919) | (25,091) | (2,341) | (4,317) | (29,248) |
| Proceeds from realization of marketable securities | 107,327 | 19,318 | 42,695 | 11,573 | 49,940 |
| Net cash provided by (used in) investing activities | 11,857 | (22,004) | 16,872 | (1,280) | (24,905) |
| Cash flows provided by financing activities | | | | | |
| Exercise of stock options | 1,997 | 10,035 | 950 | 1,575 | 12,623 |
| Net cash provided by financing activities | 1,997 | 10,035 | 950 | 1,575 | 12,623 |
| Effect of change in exchange rate on cash | 179 | 231 | (4) | 423 | 393 |
| Net increase in cash and cash equivalents | 56,593 | 21,097 | 34,209 | 12,786 | 28,904 |
| Cash and cash equivalents at beginning of period | 92,732 | 63,828 | 115,116 | 72,139 | 63,828 |
| Cash and cash equivalents at end of period | 149,325 | 84,925 | 149,325 | 84,925 | 92,732 |
| Non-cash activities | | | | | |
| Fixed assets received as loan consideration | - | 224 | - | - | 221 |
| Distribution of available for sale securities as dividend in kind | - | 12,428 | - | 12,428 | 12,428 |

The accompanying notes are an integral part of these interim financial statements.

Notes to the Interim Unaudited Consolidated Financial Statements

Note 1 - General

The interim consolidated financial statements are unaudited and prepared in a condensed format. The interim consolidated financial statements should be read in conjunction with Company's annual consolidated financial statements as of December 31, 2006 and the accompanying notes thereto. Information presented with respect to December 31, 2006 and the year then ended is derived from our audited consolidated financial statements as of and for the year then ended. Information with respect to June 30, 2007 and June 30, 2006 and the respective six-month and three-month periods then ended is unaudited but, in the opinion of management, include all adjustments (all of which are of a normal recurring nature) necessary for a fair presentation of the interim financial information.

Note 2 - Significant Accounting Policies

- A. The accounting policies applied in the preparation of these interim consolidated financial statements are identical with those applied in the preparation of the latest annual consolidated financial statements.
- B. The interim consolidated financial statements are prepared in accordance with accounting principles for preparation of financial statements for interim periods.
- C. The interim consolidated financial statements have been prepared in accordance with US GAAP and are reported in U.S. dollars.
- D. In June 2006, the FASB issued Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109*" ("*FIN 48*"). *FIN 48* clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with *SFAS No. 109, "Accounting for Income Taxes"*. *FIN 48* prescribes a recognition threshold and measurement attribute for the financial statements recognition and measurement of a tax position taken or expected to be taken in a tax return. *FIN 48* is effective for fiscal years beginning after December 15, 2006. Effective January 1, 2007, the Company adopted the provisions of *FIN 48*. The implementation of *FIN 48* did not have a significant impact on the Company's financial position or results of operations. The total amount of unrecognized tax benefits as of the adoption date at January 1, 2007 is approximately \$13 million. The Company does not anticipate any significant increase or decrease to the unrecognized tax benefits within the next twelve months. The Company recognizes interest and penalties accrued related to unrecognized tax benefits in income tax expenses. The Company had approximately \$1.5 million and \$1.4 million accrued for the payment of interest and penalties as of June 30, 2007 and January 1, 2007, respectively. The Company and its subsidiaries are subject to periodic and routine audits in all major tax jurisdictions in which they operate. It is reasonably possible that the amounts of unrecognized tax benefits could change as a result of an audit. Based on the current audits in process, the payment of taxes as a result of audit settlements are not expected

to have an adverse significant impact on the Company's financial position or results of operations. The Company is generally no longer subject to tax examinations by tax authorities for years before 2001.

Note 3 - Inventory

Inventory is comprised of the following:

| | <u>June 30</u> <u>2007</u> | <u>June 30</u> <u>2006</u> | <u>December 31</u> <u>2006</u> |
|------------------------------|-------------------------------|-------------------------------|-----------------------------------|
| | <u>\$ in thousands</u> | <u>\$ in thousands</u> | <u>\$ in thousands</u> |
| | <u>(Unaudited)</u> | <u>(Unaudited)</u> | <u>(Audited)</u> |
| Raw materials and components | 46,962 | 56,312 | 57,806 |
| Work in process | 20,972 | 21,730 | 23,499 |
| Finished products | 72,208 | 70,663 | 78,050 |
| | <u>140,142</u> | <u>148,705</u> | <u>159,355</u> |

Note 4 - Shareholders' Equity

A. Authorized, issued and outstanding shares

| | <u>Authorized</u> | |
|---------------------------------------|-------------------------------|-----------------------------------|
| | <u>June 30</u> <u>2007</u> | <u>December 31</u> <u>2006</u> |
| | <u>Number of shares</u> | |
| NIS 0.12 par value per ordinary share | <u>200,000,000</u> | <u>200,000,000</u> |

1. The Company's shares (NIS 0.12 par value each) are traded in the United States on the over the counter market and are listed on the Nasdaq Stock Market.
2. For details of the issued share capital see consolidated Statements of Changes in Shareholders' Equity.

B. Dividends

According to the Israeli corporate laws, dividends may be paid by the Company only out of accumulated earnings, or out of net income, in two consecutive years.

C. Share incentive (stock options and restricted shares plans)

1. The Company's current stock option plans are the ECI Telecom Ltd. Key Employee Share Incentive Plan 1991 (the "1991 Plan") and the ECI Telecom Ltd. Employee Share Incentive Plan 2002 (the "2002 Plan", together the "ECI Plans"), which were adopted by the shareholders at the Annual General Meetings held respectively on August 29, 1991 and November 19, 2002. The ECI Plans will expire on December 31, 2012.

The ECI Plans provide that options may be granted to any employee, director, consultant or contractor of the Company pursuant to (a) one or more sub-plans designed to benefit from the provisions of Section 102 of the Israeli Income Tax Ordinance (New Version) 1961 and (b) any other share incentive plan approved by the Board of Directors of the Company.

Note 4 - Shareholders' Equity (cont'd)

C. Share incentive (stock options and restricted shares plans) (cont'd)

In January 2006, the Board of Directors approved an amendment to the 2002 Plan, which provided that, unless otherwise specified at the time of the award, options granted under subsequent option awards are exercisable on a "net exercise" basis: instead of issuing to the grantee the number of shares specified in the option award, the grantee will receive the number of shares having a market value equal to the difference between the exercise price and closing market price of our shares immediately prior to the date of exercise, multiplied by the number of options being exercised. The only amount payable by the grantee for the issue to him or her of the shares is the aggregate par value of such shares, which amount may be waived.

Under the terms of the ECI Plans, as of June 30, 2007, the Company is authorized to grant options for a total of 32,760,700 shares, subject to anti-dilution adjustment. The option awards are personal and non-assignable and terminate automatically upon termination of employment (except for approved retirement or termination caused by death or disability or as otherwise approved by the Board of Directors or its Remuneration Committee).

Stock options granted during the reporting period

The only stock option award made by the Company during the six months ended June 30, 2007 was as stated below. These stock options vest as follows: 12.5% after six months and 6.25% on the last day of each following quarter over a period of 14 quarters. The stated stock option award is exercisable on a "net exercise" basis.

On May 2, 2007, the Company granted an employee options for 250,000 shares at an exercise price of \$ 8.28 per share, being the closing market price on the date of the grant.

2. At the Annual General Meeting held on July 28, 2005, the Company's shareholders adopted the ECI Telecom Ltd. Employee Restricted Share Incentive Plan (the "ECI Restricted Share Plan"). The ECI Restricted Share Plan will expire on June 4, 2015. Restricted shares issued under the ECI Restricted Share Plan are issued from the same pool of shares available for the issue of stock options under the ECI Plans.

The ECI Restricted Share Plan provides that restricted shares may be granted to any employee, director, consultant or contractor of the Company (the "Participant"). The restricted shares are held in trust on behalf of a Participant until the Participant's interest in such restricted shares vests and they become freely transferable.

Should a Participant cease to remain in the employ or service of the Company, for any reason, while holding unvested restricted shares (except for termination caused by death or as otherwise approved by the Board of Directors or its Remuneration Committee), then those restricted shares shall either (i) be surrendered to the Company for cancellation, or (ii) be sold by the Participant to the Company (for consideration equal to the issue price of such shares), or (iii) shall be treated in any other manner that will assure that the Participants rights in such shares shall cease to exist; and the Participant shall have no further shareholder rights with respect to those restricted shares.

The fair value of the restricted shares as of the date of the issue is amortized over the vesting period.

Unearned compensation on the grant of the options in the six month period ended on June 30, 2007, as measured at the original grant date, totaling \$0.8 million was calculated based on the market value of the shares on the date of grants and is being amortized over the vesting period.

Note 4 - Shareholders' Equity (cont'd)

C. Share incentive (stock options and restricted shares plans) (cont'd)

2. (Cont'd)

Restricted shares issued during the reporting period

The restricted shares issued by the Company to its employees and directors, during the six months ended June 30, 2007 were as stated below: Unless otherwise stated, these restricted shares vest according to the following schedule: 12.5% will vest following the lapse of six months from the date of issuance and a further 6.25% will vest on the last day of each quarter, during 14 consecutive quarters thereafter. The shares were issued for no cash consideration.

On January 29, 2007, the Company issued an aggregate of 26,700 restricted shares to its employees.

On February 1, 2007, the Company issued an aggregate of 5,800 restricted shares to two directors. The shares vest and become transferable as follows: as regards 2,900 of the shares – one third on February 1, 2008, a further one third on February 1, 2009 and the remaining third on February 1, 2010; as regards the other 2,900 shares – one half on February 1, 2008 and the remaining half on February 1, 2009.

On March 1, 2007, the Company issued an aggregate of 6,354 restricted shares to two directors. The shares vest and become transferable as follows: one half on March 1, 2008 and the remaining half on March 1, 2009.

On May 1, 2007, the Company issued 3,027 restricted shares to a director. The shares vest and become transferable as follows: one half on May 1, 2008 and the remaining half on May 1, 2009.

On May 2, 2007, the Company issued an aggregate of 330,500 restricted shares to its employees.

Unearned compensation on the grant of the restricted shares in the six month period ended on June 30, 2007, as measured at the original grant date, totaling \$2.8 million was calculated based on the market value of the shares on the date of grants and is being amortized over the vesting period.

Compensation expense of \$ 2.2 millions was recognized for the restricted shares during the six months ended June 30, 2007.

During the six month period ended June 30, 2007, the Board of Directors approved modifications to the vesting and termination periods of outstanding options and restricted shares granted to certain senior employees. Accordingly, compensation expenses of \$ 0.3 million were recognized for the period ended June 30, 2007.

Note 4 - Shareholders' Equity (cont'd)

D. Share incentive and stock option plans

1. Stock options under the ECI Plans are as follows:

| | Six months ended June 30 2007 | Year ended December 31 2006 |
|---|--|--------------------------------------|
| | <u>Number of shares</u> (Unaudited) | <u>Number of shares</u> (Audited) |
| Total number authorized at beginning of period | 32,760,700 | 32,760,700 |
| Options unexercised and unvested restricted shares at beginning of period | (15,150,669) | (21,732,191) |
| Options exercised and restricted shares vested prior to beginning of period | (11,774,204) | (5,296,665) |
| Options granted during the period | (250,000) | (1,114,157) |
| Options cancelled during the period | 1,164,448 | 2,751,612 |
| Restricted shares granted during the period | (372,381) | (1,574,767) |
| Restricted shares forfeited during the period | 68,252 | 41,295 |
| | <u>6,446,146</u> | <u>5,835,827</u> |
| Available for future grants at the end of the period | | |
| Options exercised during the period* | <u>640,002</u> | <u>5,963,555</u> |
| | | |
| * Average price of options exercised during the period (in \$) | <u>3.12</u> | <u>2.12</u> |
| | | |
| Restricted shares vested during the period | <u>393,680</u> | <u>513,984</u> |
| | | |
| Options unexercised and unvested restricted shares at the end of period | <u>13,506,668</u> | <u>15,150,669</u> |
| | | |
| Options unexercised and unvested restricted shares vest as follows: | | |
| First year or thereafter | 11,363,049 | 11,983,992 |
| Second year or thereafter | 1,294,131 | 1,994,713 |
| Third year or thereafter | 849,488 | 1,171,964 |
| | <u>13,506,668</u> | <u>15,150,669</u> |

Note 4 - Shareholders' Equity (cont'd)

- D. Share incentive and stock option plans (cont'd)
2. To be paid in NIS based on the rate of exchange of the dollar on the date of payment as follows:

| Dollars per Share (*) | June 30 2007 | December 31 2006 |
|-----------------------|-------------------|---------------------|
| | Number of shares | Number of shares |
| | (Unaudited) | (Audited) |
| Restricted shares | 1,547,923 | 1,637,474 |
| Zero | 331,619 | 438,083 |
| \$ 1.16 - \$ 2.94 | 1,044,800 | 1,169,486 |
| \$ 3.01 | 846,022 | 975,814 |
| \$ 3.02 - \$ 6.97 | 2,154,245 | 2,538,046 |
| \$ 7.03 - \$ 8.61 | 1,656,324 | 1,596,953 |
| \$ 8.75 | 1,192,421 | 1,261,071 |
| \$ 8.91 - \$ 9.22 | 629,001 | 873,251 |
| \$ 9.77 - \$ 20.66 | 277,000 | 583,175 |
| \$ 23.66 - \$ 26.04 | 25,500 | 25,500 |
| \$ 26.32 | 2,501,456 | 2,591,756 |
| \$ 27.17 - \$ 29.19 | 975,807 | 1,135,510 |
| \$ 29.66 - \$ 39.66 | 324,550 | 324,550 |
| | 13,506,668 | 15,150,669 |

(*) As of June 30, 2007, the weighted average exercise price of options was \$ 13.14 and the weighted average remaining contractual life of outstanding options was 6 years.

E. Fair value method

As required by SFAS 123, the Company has determined the weighted average fair value per option of stock-based arrangements grants during the six months ended June 30, 2007, the six months ended June 30, 2006, the year ended 2006, the three months ended June 30, 2007 and the three months ended June 30, 2006 to be \$3.1, \$3.3, \$2.8, \$3.1 and \$3.4, respectively. The fair values of stock based compensation awards granted were estimated using the "Black - Scholes" option pricing model with the following assumptions.

| <u>Period of grant</u> | <u>Option term</u> | <u>Expected volatility</u> | <u>Risk free interest rate</u> |
|----------------------------------|--------------------|----------------------------|--------------------------------|
| | <u>Term</u> | <u>Volatility</u> | <u>Interest rate</u> |
| Six months ended June 30, 2007 | 3.0 | 44 | 5.4% |
| Six months ended June 30, 2006 | 3.0 | 60 | 5.0% |
| Three months ended June 30, 2007 | 3.0 | 44 | 5.4% |
| Three months ended June 30, 2006 | 3.0 | 61 | 5.1% |
| Year ended December 31, 2006 | 3.0 | 57 | 4.8% |

Note 5 - Material Events in the Current Period

- A. In January 2007, the Company merged the Data Networking Division and the Optical Networks Division into a new Transport Networking Division. The focus of this new division will be to deliver next generation transport products that enable migration from voice oriented technologies (SDH/SONET) to IP and data technologies, addressing carriers' needs to evolve their networks to a single converged IP network.
- B. In January 2007, the Company invested \$3.3 million in Veraz, as part of a private placement of shares by Veraz.
- C. In February 2007, the Company completed the purchase of the remaining 27.6% minority interest in its Chinese subsidiary, HETC, for \$3.8 million, increasing its interest from 72.4% to 100%.
- D. During the first quarter of 2007, as Veraz made significant progress towards completion of its initial public offering (see Note 9), Management determined that it is more likely than not that a portion of the Company's capital loss carryforwards for tax purposes will be utilized against capital gains that the Company will generate from the future sale of its shares in Veraz. As a result, the Company released part of its deferred tax asset valuation allowance and recognized an income tax benefit in the amount of \$ 12.5 million.

On April 4, 2007, an S-I Registration Statement filed with the SEC by Veraz in connection with an initial public offering was declared effective and Veraz raised gross proceeds of \$ 54 million, before underwriting discounts and expenses, from the sale of 6.75 million shares at the public offering price of \$8 per share. In addition, the Company sold in the offering 2.25 million shares of Veraz for a total gross consideration of \$18 million resulting in the recognition of a gain of \$15.5 million. Following the offering, the company's holding in Veraz were reduced to 27.5% (on a non-diluted basis).

- E. In April 2005, the Company sold to ABN Amro Bank certain notes that had been issued to it by GVT, a Brazilian customer. The consideration for the transaction was the sum of \$ 96 million paid to the Company in cash, plus a further potential gross amount of approximately \$ 3 million, based upon the occurrence of certain contingencies. In June 2007, the aforesaid contingencies have been fulfilled resulting in the recognition of net gain from recovery of doubtful debts of \$ 3.2 million.

Note 6 - Segment Reports

1. Segment activities disclosure:

Segment information is presented in accordance with SFAS No. 131, "*Disclosures about Segments of an Enterprise and Related Information*". This standard is based on a management approach, which requires segmentation based upon the Company's internal organization and internal financial reports used by management to run the business.

Note 6 - Segment Reports (cont'd)

2. Operational segment disclosure:

| | Six months ended June 30, 2007 | | | |
|-----------------------------------|---------------------------------|-----------------------------|------------------------|------------------------|
| | **Transport Networks | Broadband Access | Other | Consolidated |
| | \$ in thousands | \$ in thousands | \$ in thousands | \$ in thousands |
| | (Unaudited) | | | |
| Revenues | <u>213,659</u> | <u>95,207</u> | <u>10,392</u> | <u>319,258</u> |
| Operating expenses ^(*) | <u>201,311</u> | <u>84,516</u> | <u>19,378</u> | <u>305,205</u> |
| Operating income (loss) | <u>12,348</u> | <u>10,691</u> | <u>(8,986)</u> | <u>14,053</u> |

| | Six months ended June 30, 2006 | | | |
|-----------------------------------|---------------------------------|-----------------------------|------------------------|------------------------|
| | **Transport Networks | Broadband Access | Other | Consolidated |
| | \$ in thousands | \$ in thousands | \$ in thousands | \$ in thousands |
| | (Unaudited) | | | |
| Revenues | <u>186,000</u> | <u>128,247</u> | <u>18,036</u> | <u>332,283</u> |
| Operating expenses ^(*) | <u>179,023</u> | <u>118,409</u> | <u>26,098</u> | <u>323,530</u> |
| Operating income (loss) | <u>6,977</u> | <u>9,838</u> | <u>(8,062)</u> | <u>8,753</u> |

| | Three months ended June 30, 2007 | | | |
|-----------------------------------|----------------------------------|-----------------------------|------------------------|------------------------|
| | **Transport Networks | Broadband Access | Other | Consolidated |
| | \$ in thousands | \$ in thousands | \$ in thousands | \$ in thousands |
| | (Unaudited) | | | |
| Revenues | <u>108,915</u> | <u>50,452</u> | <u>4,772</u> | <u>164,139</u> |
| Operating expenses ^(*) | <u>103,384</u> | <u>43,533</u> | <u>8,022</u> | <u>154,939</u> |
| Operating income (loss) | <u>5,531</u> | <u>6,919</u> | <u>(3,250)</u> | <u>9,200</u> |

(*) Includes cost of sales, research and development costs, selling and marketing expenses, general and administrative expenses.

(**) Reclassified – see Note 5A.

Note 6 - Segment Reports (cont'd)

2. Operational segment disclosure: (cont'd)

| | Three months ended June 30, 2006 | | | |
|-------------------------|----------------------------------|-----------------------------|------------------------|------------------------|
| | **Transport Networks | Broadband Access | Other | Consolidated |
| | \$ in thousands | \$ in thousands | \$ in thousands | \$ in thousands |
| | | | | (Unaudited) |
| Revenues | 94,535 | 66,436 | 9,302 | 170,273 |
| Operating expenses (*) | 90,693 | 62,503 | 12,479 | 165,675 |
| Operating income (loss) | 3,842 | 3,933 | (3,177) | 4,598 |

| | Year ended December 31, 2006 | | | |
|-------------------------|-----------------------------------|-----------------------------|------------------------|------------------------|
| | **Transport Networking | Broadband Access | Other | Consolidated |
| | \$ in thousands | \$ in thousands | \$ in thousands | \$ in thousands |
| | | | | (Audited) |
| Revenues | 396,822 | 225,081 | 34,439 | 656,342 |
| Operating expenses (*) | 376,865 | 209,640 | 50,593 | 637,098 |
| Operating income (loss) | 19,957 | 15,441 | (16,154) | 19,244 |

(*) Includes cost of sales, research and development costs, selling and marketing expenses, general and administrative expenses.

(**) Reclassified – see Note 5A.

Note 7 - Contingencies

- Following the reduction in workforce in accordance with the reorganization plan of the Company that was implemented in 2002, claims and demands for higher amounts of severance pay were submitted by certain former employees. Management of the Company believes, based on the opinion of its legal advisors that the effect, if any, of the results of such claims and demands on the financial position of the Company and the results of its operations, will be immaterial and the provisions which are included in the financial statements in respect thereof are appropriate and sufficient.
- The Company conducts negotiations from time to time with international technology companies (“technology companies”) regarding allegations that it is using certain patents owned by the technology companies in its products. Although the Company cannot assess each negotiation for its merit, it estimates that any settlement, if needed, will not have a material adverse effect on the Company's financial position or results of operations.

Note 7 - Contingencies (cont'd)

3. Several claims have been submitted against the Company and against consolidated subsidiaries, in respect of activities by the Company, in the ordinary course of business, alleging that the Company, inter alia, used patents owned by others. The Company's Management based mainly on opinions of its legal advisors, believes that the effect, if any, of the results of such claims on the financial position of the Company and the results of its operations will be immaterial and the provisions which are included in the financial statements in respect thereof are appropriate and sufficient.

4. In 1997, an investigation was commenced by the Israeli Comptroller of Restrictive Trade Practices ("comptroller") regarding alleged price fixing and non-competitive practices among Tadiran Telecommunications Ltd. ("TTL"), Tadiran Ltd ("Tadiran" - the parent company of TTL) and Telrad Telecommunications and Electronics Industries Ltd., a subsidiary of Koor Industries Ltd. (a significant shareholder of the Company and Tadiran Ltd.).
ECI merged with TTL in 1999.

In 2004, the Company was informed that the comptroller has ceased the investigation without taking any action against the Company.

In September 2004, following the completion of the investigation by the comptroller mentioned above, a claim was filed against Bezeq (Israel's national telecommunications provider), Koor, TTL, Tadiran and Telrad in the District Court of Tel Aviv-Jaffa. Attached to the claim was a request for certification thereof as a class action, brought in the name of all Bezeq customers against the aforesaid companies, including the Company, in an amount of \$ 400 million.

In March 2005 the Company and the other respondents filed their respective answers to the request to certify the claim as a class action. The applicant filed its reply to the respondents' answers in December 2005.

Management of the Company believes, in light of the advice of its legal counsel, that the allegations against the Company are without merit and therefore no provision has been recorded in respect thereto in the financial statements.

5. In January 2005, the Company was named as a defendant in a purported class action complaint filed in the United States against ECtel, certain officers and directors of ECtel, and ECI. The complaint alleged 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 alleged 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, which was denied in March 2007. The plaintiff has appealed the dismissal.

ECI, based on the opinion of its legal advisors believes that the allegations made in the complaint with respect to it are without merit, and accordingly no provision in respect thereof has been included in the consolidated financial statements.

Note 8 - Relevant Recently Enacted Accounting Standards

1. In September 2006, the FASB issued *SFAS No. 157, Fair Value Measurements*, (“*SFAS No. 157*”). *SFAS No. 157* establishes a framework for measuring fair value and expands disclosures about fair value measurements. The changes to current practice resulting from the application of this Statement relate to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements. The Statement is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company does not believe that the adoption of the provisions of *SFAS No. 157* will materially impact its financial position and results of operations.
2. In February 2007, the FASB issued *SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115 (“SFAS 159”)*, which permits entities to choose to measure many financial instruments at fair value. The statement allows entities to achieve an offset accounting effect for certain changes in fair value of certain related assets and liabilities without having to apply complex hedge accounting provisions, and is expected to expand the use of fair value measurement consistent with the Board's long-term objectives for financial instruments. This Statement is effective for fiscal years beginning after November 15, 2007. The Company is currently reviewing this new standard to determine its effects, if any, on its results of operations or financial position.

Note 9 - Subsequent Events

On July 2, 2007 the Company announced that it has entered into a definitive merger agreement for the Company to be acquired by affiliates of the Swarth Group, and certain funds that have appointed Ashmore Investment Management Limited as their investment manager. Under the terms of the agreement, ECI shareholders will receive \$10 per share in cash (“the Merger Consideration”) at closing in a transaction valued at approximately \$ 1.2 billion.

The Board of Directors of ECI approved the agreement and recommended that ECI shareholders vote in favor of the transaction. The closing of the transaction is subject to shareholder approval, certain regulatory approvals and other customary closing conditions. It is currently anticipated that the transaction will be consummated in the fall of 2007. Upon the closing of the transaction, ECI ordinary shares would no longer be traded on NASDAQ.

Upon the closing of the transaction each outstanding stock option (whether or not then vested), will be cashed out at a price equal to the excess, if any, of the Merger Consideration over the per share exercise price payable. The vesting of all outstanding unvested restricted shares will be accelerated and the holders thereof will be entitled to receive the Merger Consideration. Subsequently, all stock options and all restricted shares shall no longer be outstanding and shall automatically cease to exist.