



BAZAN **בזן**
OIL REFINERIES LTD

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Consolidated Financial Statements

As of June 30, 2007

(Unaudited)

OIL REFINERIES LTD.

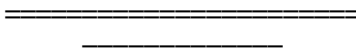
Consolidated Financial Statements

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Report of the Board of Directors on the State of the Corporation's Affairs **for the period ended June 30, 2007**

The report was prepared under the assumption that the reader has at his/her disposal the description of the business affairs of the Company and the report of the board of directors for the year ended December 31, 2006.

Until February 21, 2007, the State of Israel held 100% of the share capital of the Company. On that date, the government sold all of the shares of the Company and the Company ceased being a government company. Its shares were listed for trade on the Tel Aviv Stock Exchange.

On February 21, 2007, as part of the implementation of the privatization resolution passed by the Israeli government on December 26, 2004, all of the shares of the Company that were previously held by the Israeli government were sold, some through a private placement and some through a sales offer to the public. Within this framework, the Israel Corporation Ltd. purchased 36.8% of the shares of the Company and Petroleum Capital Holdings Ltd. purchased 9.2% of the shares of the Company. The Israel Corporation Ltd. and Petroleum Capital Holdings Ltd. notified the Company that they purchased the shares of the Company as part of a binding memorandum agreement between the two companies. Since then, the Israel Corporation Ltd. and Petroleum Capital Holdings Ltd. purchased additional shares and as of the date of the release of the financial statements, they hold 45.08% and 14.46% respectively. On March 26, 2007, the merger between the Company, the Israel Corporation and Petroleum Capital Holdings was approved as required by the Anti-Trust Law – 1988. On May 10, 2007, the Israel Corporation Ltd. notified the Company that it had issued an immediate filing to the Israel Securities Authority and to the Tel Aviv Stock Exchange regarding the cancellation of the memorandum agreement between it and Petroleum Capital Holdings Ltd. and the signing of an agreement between the Israel Corporation Ltd. and Petroleum Capital Holdings Ltd., as detailed in the filings made with the Israel Securities Authority and the Tel Aviv Stock Exchange. As of the date of the issuance of the financial statements, a ministerial permit for control in the Company was issued as required in accordance with the Government Companies Order (Declaration of Crucial State Interests in the Oil Refineries Ltd.) solely to the Israel Corporation.

On August 9, 2007, the general shareholders meeting, which convened at the request of the Israel Corporation Ltd., elected six new members to the board of directors of the Company.

Commencing on January 1, 2007, the supervision over the ex-refinery prices of most of the oil products was removed. In respect of oil products for which maximum prices were not set, the supervisory regime takes the form of reporting only. Commencing on July 1, 2007, the Company is entitled to sell fuel products also to companies which are not fuel marketing companies.

Beyond the aforementioned, no changes occurred in the areas of activity of the Company and its subsidiaries. Moreover, no significant changes occurred with regard to taxation, and dependency on customers, suppliers, and sources of raw materials.

1. Areas of activity of the Company

As of the date of this report, the Company is engaged in three areas of activity which are reported as business segments in the Company's financial statements, as follows:

Refining segment: This is the major area of Company activity, comprising 84% of the revenues of the Company during the reporting period. In conducting its activity in this area of operations, the Company purchases crude oil and interim products, refines and separates them into various distillates, some final products and some raw materials for the production of other products. This activity is conducted directly by the Company. As part of the activity in the refining segment, the Company also provides power and heating services (electricity and steam) to industrial customers in the Haifa Bay area and infrastructure services (storage, flowing, and issuance of fuel products).

Polymer segment: This area of activity (the share of the Company) comprises 6% of the revenues of the Company during the reporting period. This activity is conducted through Carmel Olefins Ltd. (hereinafter – “Carmel”), a private proportionately consolidated company which is engaged in the manufacturing of ethylene, polyethylene, and polypropylene – the major raw materials of the plastics industry.

Aromatics segment: This area of activity is carried out through Gadiv Petrochemical Industries Ltd. (hereinafter – “Gadiv”), a wholly-owned private subsidiary of the Company, which manufactures aromatic materials, mainly benzene, paraxylene, orthoxylene and toluene which are used as raw materials in the manufacture of other products. This area comprises 10% of the revenues of the Company during the reporting period.

In addition, the Company has other investee companies engaged in other activities which are immaterial to the Company.

The plants of the subsidiaries constitute downstream plants to those of the Company which receive the feedstocks they require on a regular basis entirely or for the most part from the Company through a piping system and which channel back to the Company the products they produce or the unused feedstocks. The activity of the Company in the area of refining is integrated with its activity in the areas of polymers and aromatic materials.

In the opinion of the Company, utilization of the integration and synergy between the various areas of activity, results in an increase in aggregate margins deriving to the Company in all areas of activity and a decrease in the volatility of Company profits, since the business turnover of the areas of activity of the Company and its subsidiaries do not necessary overlap. In addition, the joint management of Gadiv streamlines the activity of the companies and reduces expenses.

2. Financial position

2.1 Current assets

As of June 30, 2007, consolidated current assets amounted to approximately NIS 5,768 million, compared with NIS 5,892 million as of December 31, 2006. The major source of the decrease in current assets was the decrease in cash and customer debt in the Company, due to the cessation of commercial activity on behalf of Paz Ashdod Oil Refinery Ltd. ("ORA"), which was offset by the increases in these items in Carmel and Gadiv and by the increase in the inventories of all of the companies of the Group.

2.2 Fixed assets

As of June 30, 2007, consolidated fixed assets (property, plant and equipment) net of depreciation amounted to approximately NIS 3,728 million, compared with approximately NIS 3,702 million as of December 31, 2006. The increase of NIS 26 million derived mainly from additional investments of NIS 190 million (in Carmel an in the Metathesis facility, polypropylene – NIS 115 million, the Company – NIS 65 million in the power plant, in storage tanks in the desulfurization facility and other facilities, and in Gadiv, NIS 10 million), set off by depreciation for the period in an amount of NIS 164 million (the Company – NIS 110 million, Gadiv – NIS 23 million and Carmel – NIS 31 million).

Subsequent to the balance sheet date, the board of directors of the Company approved an investment of \$50 million to upgrade its large refining facility in order to expand the different types of crude oil that the facility can refine. Completion of the upgrade of the facility is expected during the first half of 2009. After completion of the work, the Company will be able to refine types of heavy crude oil during periods in which its refining margin is higher and focus on the refining of crude oil with a mid and low density during periods in which their refining margin is higher, allowing the Company to make the transition from one type of crude to the other without having to shut down the facility and experience a loss of operating days. Increasing this flexibility will improve the utilization rate of the facility.

In addition, the board of directors approved an investment of \$52 million, mostly in connection with environmental quality which includes infrastructure and preparation for the absorption of natural gas and a system for the reduction of emission of nitrogen oxides.

Further to the decision of the board of directors of the Company to invest in the assessment of alternatives to increase the cracking capability of the Company's facilities (an investment that will allow for full utilization of surplus HVGO and an improvement in flexibility and profitability), the Company expects to check out these alternatives and recommend investments in this area to the board of directors should it find them to be economically feasible. In the opinion of the Company, the time needed to implement the alternative to be selected is three to three and a half years.

The Minister of Environmental Quality notified the Company that the personal decree will be revised such that, among other things, the Company will be able to use only gas fuel (instead of fuel oil which is currently used and which was taken into consideration in the current decree). Further to the notification of the Minister, the Company is making preparations to implement the personal decree through the alternative of the purchase of natural gas as described above. As of the date of the report, the personal decree has not yet been revised.

2.3 Current liabilities

Consolidated current liabilities as of June 30, 2007 amounted to approximately NIS 3,591 million, constituting approximately 48% of total liabilities, compared with approximately NIS 3,919 million which constituted 50% of total liabilities as of December 31, 2006. The NIS 328 million decrease in current liabilities derived mainly from the debt to crude oil suppliers as a result of the cessation of purchasing on behalf of ORA upon the termination of the commercial agreement between the parties at the end of the previous year, and from reduction in the debt of the Company to the tax authorities. Short-term liabilities of the Company to banks increased, mainly as a result of the increase in current maturities of long-term loans, and were offset by the reduction in Carmel's short-term bank credit which was converted into the issuance of long-term debentures.

2.4 Long-term financial liabilities

Consolidated long-term financial liabilities amounted to NIS 3,095 million as of June 30, 2007 (ORL – NIS 2,110 million, Gadiv – NIS 13 million, Carmel – NIS 972 million), compared with NIS 3,061 million as of December 31, 2006 (ORL – NIS 2,537 million, Gadiv – NIS 14 million, Carmel – NIS 510 million). The NIS 134 million increase derived mainly from the issuance of debentures by Carmel, and was offset by a reduction in the amount of debentures of ORL.

2.5 Deferred taxes

Deferred taxes amounted to NIS 517 million as of June 30, 2007, compared with NIS 498 million as of December 31, 2006. The NIS 19 million increase was the result of the accelerated depreciation claimed for income tax purposes.

2.6 Shareholders' equity

Shareholders' equity amounted to approximately NIS 3,206 million, and constituted approximately 30% of the balance sheet, compared with NIS 2,715 million, which constituted approximately 26% of the balance sheet as of December 31, 2006. The NIS 491 million increase in the shareholders' equity of the Company derived from the net income of NIS 377 million during the period, and from the payment of the government in respect of the expense of privatizing the Company in an amount of NIS 118 million. These were offset by payment of the issuance costs on behalf of a controlling shareholder, in an amount of NIS 4 million. The return on capital (net income to weighted shareholders' equity), during the reporting period was 14% (on an annual basis - 28%). In 2006, it was 53% (net of the profit impact of the sale of ORA – 24%) and in the same period last year, it was 17%.

The board of directors of the Company recommended to the general shareholders meeting to distribute a dividend of NIS 280 million to the shareholders of the Company.

3. Results of operations

The consolidated results of operations during the reporting period were compared with the results of operations of the Company on the basis of the pro forma report.

As explained in Note 7 of the financial statements, the pro forma data, including the consolidated statements of income, are presented under the assumption that the sale of the shares of the Company and the State of Israel in ORA took place on January 1, 2006. Accordingly, revenues and expenses attributed to ORA were deducted from the consolidated statements of income. From a practical standpoint, the changes were solely in the refining segment of the Company.

In the share of the Company in the income of investees, there was no change when compared with the Company's statement of income prior to the sale of ORA, as detailed above.

3.1 The following table presents selected consolidated data from the Company's results for the reporting period and the same period last year:

	In millions of NIS		In millions of NIS	
	Six months ended June 30, 2007	2006	Three months ended June 30, 2007	2006
	Actual	Pro forma	Actual	Pro forma
Revenues				
Refining	9,422	10,028	5,102	5,521
Polymers	624	538	313	249
Aromatics	1,026	967	545	536
Cancellation of intercompany transactions	(631)	(280)	(315)	(84)
Total	<u>10,441</u>	<u>11,253</u>	<u>5,645</u>	<u>6,222</u>
Cost of sales, refining and services				
Refining	8,714	9,344	4,771	5,182
Polymers	536	471	271	225
Aromatics	912	893	468	500
Cancellation of intercompany transactions	(631)	(280)	(315)	(84)
Total	<u>9,531</u>	<u>10,428</u>	<u>5,195</u>	<u>5,823</u>
Gross profit				
Refining	708	684	331	339
Polymers	88	67	42	24
Aromatics	114	74	77	36
Total	<u>910</u>	<u>825</u>	<u>450</u>	<u>399</u>
Sales, general and administrative expenses				
Refining	137	103	61	53
Polymers	25	19	13	9
Aromatics	49	39	24	19
Total	<u>211</u>	<u>161</u>	<u>98</u>	<u>81</u>
Operating income				
Refining	571	581	270	286
Polymers	63	48	29	15
Aromatics	65	35	53	17
Total	<u>699</u>	<u>664</u>	<u>352</u>	<u>318</u>
Financing expenses, net	83	68	85	41
	616	596	267	277
Privatization grant (see paragraph 3.1.6 below)	119	-	-	-
Income before taxes on income	497			
Income tax	140	172	50	79
	357	424	217	198
Company's share in earnings of investee companies	20	22	11	11
Net income for the period	<u>377</u>	<u>446</u>	<u>228</u>	<u>209</u>

3.1.1 Sales turnover

The quantitative sales turnover of the refining segment (carried out through the Company) increased by 4.2% during the reporting period, compared with the same period last year. The average price per ton of the basket of principal products in the Mediterranean area similar to the basket of products produced by the Company (the Company's basket of products) amounted, in the reporting period, to approximately NIS 2,200 compared with approximately NIS 2,474 in the same period last year.

During the reporting period, there was an increase in fuel consumption in the local market of approximately 4% versus the same period last year, of which 3% was in the second quarter of this year. There was a 6% increase in the consumption of distillates in the relevant periods, distributed evenly over the quarters, offset by a decrease of 5% in fuel oil, due to the continued conversion to natural gas.

Sales turnover for the polymer segment (carried out via Carmel Olefins Ltd.) increased by 16% compared with the turnover in the same period last year. The increase in sales turnover derived mainly from the increase in the quantities of products sold and the increase in sales prices.

Sales turnover in the aromatics segment (carried out via Gadiv) increased in the reporting period by approximately 4% compared with the turnover in the same period last year. The increase derived mainly from an increase in sales prices due to the demand for downstream products in the petrochemicals industry and due to the shortage of global manufacturing capacity and from an increase in sales quantities.

Revenues from the sale of products with a volume of more than NIS 1,000 million totaled during the reporting period as follows: Gasoline – NIS 3,812 million, diesel fuel – NIS 2,521 million.

3.1.2 Gross profit

The following table presents details of the principal factors involved in the increase in gross profit in the refining segment, compared with the same period last year – pro forma (in NIS millions):

	June 30, 2007 compared with June 30, 2006
Increase in margin from refining operations	218
Increase in volume of refining and sales	18
Decrease as a result of the upward revaluation of the shekel versus the dollar	(164)
Decrease in other revenues	(28)
Increase in production expenses	(20)
	<u>24</u>

The margin from refining operations is the difference between revenues from sales of the basket of products that the Company sells, and the cost of raw materials that it purchases, ex-refinery (dollars per ton). The cost of raw materials includes also the hedging activity in respect of the inventory of crude oil and distillates, as described below in the chapter dealing with risk management:

	First quarter	Second quarter	Average	Third quarter	Fourth quarter	Annual average
2007	67.5	73.0	70.4	-	-	-
2006	53.1	61.7	57.3	52.9	30.9	51.1

The size of the refining margin is a derivative of market forces acting on two different planes – one, the supply and demand for crude oil and the other – supply and demand for end products.

For a more in-depth review, see the annual financial statements (paragraph 1.6.2 of the description of the business affairs of the company).

During the reporting period, refining margins increased to \$70.4 per ton, compared with \$57.3 per ton in the same period last year. The refining margins are higher than the average refining margins of Mediterranean Sea oil refineries having cracking capabilities in respect of Ural-type crude oil. The refining margins for the reporting period amounted to \$47.1 per ton.

During the reporting period, as in the same period last year, there were no changes in the basic economic conditions that existing in the relevant periods. Demand for oil and its distillates continued, against rigid supplies of production and refining. During the second quarter, gasoline prices which were very high (mainly in the U.S.) brought about an increase in refining margins. The increase derived from a relatively warm winter season in the previous quarter which created a situation in which gasoline consumption was high in opposition to the seasonal trend and as a result, the purchasing of gasoline in advance of the "Travel Season" was accelerated. In the second quarter, the refining margin increased from \$67.5 per ton to \$73.0 per ton, compared with a refining margin of Mediterranean Sea oil refineries having cracking capabilities in respect of Ural-type crude oil which was \$53 per ton.

From the beginning of the third quarter, refining margins decreased sharply due to the recovery in the utilization of oil refineries and the physical and speculative pressures in the crude oil market. The causes of the physical pressures are the decrease in supply from the North Sea as a result of oil field maintenance as well as the long-term impact of production cutbacks on the part of the OPEC cartel. Nevertheless, it is not possible to accurately assess the developments in the short-term. Notwithstanding the decreases in refining margins, the increase in the demand for fuel products continued (based on the estimates of the International Energy Agencies EIA and IEA), without a concurrent increase in the manufacturing capacity of the refining industry.

In the refining segment described above, there was a \$13 per ton increase in the average refining margin when compared with the same period last year. However, as a result of the continued upward revaluation of the exchange rate of the NIS against the dollar, the margin continued to erode significantly.

The decrease in other income during the reporting period when compared with the same period last year was caused mainly by the decrease in infrastructure income and due to the erosion in revenues from power and water services which are linked to the price of fuel oil and the rate of the dollar.

The increase in production expenses in the refining segment during the reporting period, in an amount of NIS 17 million, when compared with the same period last year, derived mainly from an increase in maintenance expenses, an increase in the amortization of periodic maintenance of facilities, from the volume of expenses in respect of power and water services, from increased insurance costs, from expenses relating to environmental quality, offset by a decrease in depreciation and amortization as a result of the completion of the depreciation of facilities during the reporting period.

Gross profit for the reporting period in the polymers segment amounted to approximately NIS 88 million, compared with NIS 67 million in the same period last year. The increase in profit in this segment in the reporting period when compared with the same period last year derived mainly from a decrease in the prices of inputs which was partially offset by an increase in fixed expenses due to the activation of the ethylene facility.

In the reporting period, gross profit for the aromatics segment amounted to NIS 114 million, compared with NIS 74 million in the same period last year.

The following table presents details of the principal factors involved in the increase in gross profit in the aromatics segment, compared with the same period last year (in NIS millions):

	June 30, 2007 compared with June 30, 2006
Increase in margin from the basket of products	57
Decrease in sales quantities	(5)
Decrease as a result of the upward revaluation of the shekel versus the dollar	(15)
Decrease in processing revenues	(2)
Decrease in production expenses	5
	<u>40</u>

3.1.3 Selling, general and administrative expenses

Selling, general and administrative expenses include mainly payroll, insurance, taxes and authorization fees.

In the reporting period, selling, general and administrative expenses amounted to approximately NIS 211 million, compared with approximately NIS 161 million in the same period last year. The NIS 50 million increase during the reporting period derived mainly from the provision in respect of demands for payment of various levies and municipal taxes in respect of property and from the increase in the selling expenses of Carmel as a result of the increase in export sales.

3.1.4 **Operating income and EBITDA** (earnings before interest, taxes, depreciation and amortization)

The operating income of the refining segment amounted to NIS 571 million during the reporting period, compared with NIS 581 million during the same period last year, a decrease of 2%. The NIS 10 million decrease in operating income derived from the NIS 24 million increase in gross profit as explained above, offset by the NIS 34 million increase in selling, general and administrative expenses. The EBITDA of the refining segment amounted to NIS 681 million during the reporting period, compared with NIS 701 million in the same period last year, a decrease of 3%.

The operating income of the polymer segment amounted to NIS 63 million during the reporting period, compared with NIS 48 million during the same period last year, an increase of 31%. The EBITDA of the polymer segment amounted to NIS 95 million during the reporting period, compared with NIS 68 million in the same period last year, an increase of 40%.

The operating income of the aromatics segment amounted to NIS 65 million during the reporting period, compared with NIS 35 million during the same period last year, an increase of 86%. The EBITDA of the aromatics segment amounted to NIS 89 million during the reporting period, compared with NIS 59 million in the same period last year, an increase of 51%.

Consolidated operating income during the reporting period amounted to NIS 699 million, compared with NIS 664 million in the same period last year, an increase of 5%.

Consolidated EBITDA during the reporting period amounted to NIS 865 million, compared with NIS 828 million in the same period last year, an increase of 4%.

3.1.5 **Financing expenses**

During the reporting period, Consolidated financing expenses amounted to approximately NIS 83 million, compared with an expense of approximately NIS 68 million in the same period last year.

The following table presents an explanation of the changes in financing expenses compared with the same period last year (in NIS millions):

	1-6/2007 compared with 1-6/2006
Increase in expenses, mainly due to the effect of the devaluation of the exchange rate of the dollar during the reporting period, compared with an appreciation during the corresponding period, on long-term dollar credit	29
Increase in the cost of long-term dollar credit mainly due to the increase in volume and to the increase in interest in respect thereof	74
Increase in expenses, mainly due to the impact of the increase in the volume of long-term shekel credit	11
Increase in credit fees from customers of the Company due to the effect of the devaluation on the exchange rate of the dollar versus the appreciation in the same period last year	(28)
Decrease in the volume of short-term shekel credit	(25)
Decrease in other expenses, offset by current hedging transactions and including income on the securities portfolio	(46)
	<u>15</u>

3.1.6 **Privatization grant**

During the first quarter of 2007, the State of Israel completed the process of privatizing the Company. As part of the privatization process, the Government Companies Authority applied the entitlement to the privatization grant to employees of the Company and to employees of investee companies, proportionate to the percentage held by ORL (directly and indirectly) in each of those companies. The privatization grant, in an amount of NIS 118 million (NIS 97 million for ORL and NIS 21 million for the investee companies), was received from the State of Israel and paid to the employees of the Company and the investee companies (including payment of the privatization grant to senior officers, approved by the board of directors of the Company on August 19, 2007). The privatization grant was recorded as an expense in the first quarter. The receipt from the State was carried to a capital reserve (a net amount of NIS 106 million after the tax effect).

3.1.7 Income tax

In the reporting period, the Group recorded tax expenses of approximately NIS 140 million, compared with approximately NIS 172 million in the same period last year. The NIS 32 million decrease in tax expenses between the periods derived for the most part from the decrease in pre-tax profit, offset by the excess tax on the privatization grant.

3.1.8 Company's share in earnings of investee companies

The Company's share in the earnings of investee companies in the reporting period amounted to approximately NIS 20 million compared with approximately NIS 22 million in the same period last year.

3.2 Results of the second quarter compared with the same quarter last year

3.2.1 Sales turnover

The dollar sales turnover of the refining segment in the second quarter increased by 1.6% compared with the same quarter last year. Due to the low exchange rate, shekel sales were eroded by 7%.

The sales turnover of the polymers segment increased by 25% due to an increase in sales quantities and an increase in prices.

The sales turnover of the aromatics segment (excluding processing fees and other revenues) increased by 1.8% in the quarter when compared to the same quarter last year. The increase derived from an increase in sales prices, offset by a decrease in quantities sold.

Revenues from the sale of products with a volume of more than NIS 1,000 million totaled during the second quarter as follows: Gasoline – NIS 2,038 million, diesel fuel – NIS 1,352 million.

3.2.2 Gross profit

The gross profit of the refining segment in the second quarter amounted to NIS 331 million, compared with NIS 339 million in the same quarter last year.

The following table presents details of the principal factors involved in the decrease in gross profit in the refining segment in the second quarter, compared with the same quarter last year – (in NIS millions):

	4-6/2007 compared with 4-6/2006
Increase in margin from refining operations	88
Increase in volume of refining and sales	8
Decrease as a result of the upward revaluation of the shekel versus the dollar	(87)
Decrease in other revenues	(15)
Increase in production expenses	<u>(2)</u>
	<u>(8)</u>

The gross profit of the polymer segment in the second quarter amounted to NIS 42 million, compared with NIS 24 million in the same quarter last year.

The gross profit of the aromatics segment in the second quarter amounted to NIS 77 million, compared with NIS 36 million in the same quarter last year.

The following table presents details of the principal factors involved in the increase in gross profit in the aromatics segment in the second quarter, compared with the same quarter last year – (in NIS millions):

	4-6/2007 compared with 4-6/2006
Increase in margin of basket of products	51
Decrease in quantities sold	(4)
Decrease as a result of the upward revaluation of the shekel versus the dollar	(9)
Decrease in revenues from processing fees	(2)
Increase in processing expenses	<u>5</u>
	<u>41</u>

3.2.3 Operating income and EBITDA

The operating income of the refining segment in the second quarter amounted to NIS 270 million, compared with NIS 286 million during the same quarter last year, a decrease of 6%.

The NIS 16 million decrease in the operating income of the refining segment derived from the NIS 8 million decrease in gross profit as explained above and from the increase in selling, general, and administrative expenses in an amount of NIS 8 million. The EBITDA of the refining segment amounted to NIS 321 million during the second quarter, compared with NIS 347 million in the same quarter last year.

The operating income of the polymer segment amounted to NIS 29 million during the second quarter, compared with NIS 15 million during the same quarter last year. The EBITDA of the polymer segment amounted to NIS 46 million during the second quarter, compared with NIS 25 million in the same quarter last year.

The operating income of the aromatics segment amounted to NIS 53 million during the second quarter, compared with NIS 17 million during the same quarter last year. The EBITDA of the aromatics segment amounted to NIS 66 million during the second period, compared with NIS 29 million in the same quarter last year.

Consolidated operating income during the second quarter amounted to NIS 353 million, compared with NIS 318 million in the same quarter last year, an increase of 11%.

Consolidated EBITDA during the second quarter amounted to NIS 433 million, compared with NIS 401 million in the same quarter last year.

3.2.4 Income tax

In the second quarter of the year, tax expenses amounted to NIS 50 million, compared with approximately NIS 97 million in the same quarter last year. The decrease in tax expenses between the quarters derived for the most part from the decrease in pre-tax profit and from tax differentials.

4. Exposure to and methods of market risk management

4.1 There were no changes in the risk management policy of the companies and in the parties responsible for market risk management as reported in the report of the board of directors on the affairs of the Company for the period ended December 31, 2006 and in the notes to the financial statements for the same year.

4.2 Sensitivity testing regarding the exposure to market risks

General

Long-term dollar loans and debentures

The Company's dollar loans bear interest at variable rates, set once a quarter on the basis of the LIBOR rate for three months (as of the date of the report – 5.35%), plus a margin that reflects the Company's risk premium on the date of recruitment of the loan.

The loans of the Company are presented at fair value, reflecting the future cash flows discounted at the appropriate risk-free interest rate, plus the Company's risk premium as of the balance sheet date.

The sensitivity analysis was made for the following risk factors: changes in exchange rates, changes in the variable dollar interest rate, and changes in the Company's risk premium.

ICPI-linked debentures

ICPI-linked debentures floated by the Company, bearing fixed interest.

The debentures are presented at fair value which reflects the future cash flows discounted at a real interest rate, based on government bonds for the appropriate term, plus a margin as of the balance sheet date.

The sensitivity analysis was made for the following risk factors: changes in real interest rates, and changes in the Company's risk premium.

Interest rate SWAP transactions

The Company entered into interest rate SWAP transactions in which it undertook to pay fixed interest against a receipt of variable interest.

The swapping transactions are presented at fair value which reflects the future cash flows discounted at a risk-free interest rate, plus a margin.

The sensitivity analysis was made for the following risk factors: changes in exchange rates, changes in the risk-free dollar interest rate, and changes in the Company's risk premium.

Forward transactions

The Company executing hedging transactions, using forward transactions on the dollar-shekel exchange rate for the short term.

The forward transactions were presented at fair value as of the balance sheet date.

The sensitivity analysis was made for the following risk factors: changes in exchange rates, changes in risk-free dollar interest rates, and changes in the risk-free shekel interest rate.

Future contracts

In order to neutralize the exposure created from the date of the setting of the price of crude oil and which lasts until the date the sales prices of the distillates are set, the Company sold negotiable contracts for the future sale of crude oil at fixed prices. Concurrent with the setting of the sales price of products produced from the hedged inventory, the Company purchases contracts on the futures market, thereby fixing the price of the inventory and reducing the risk of changes in market prices. Purchases of "long" positions as part of the fixing of the value of the inventory are made in some instances to neutralize the base risk of a discrepancy between the price of the physical load and the futures contract. The results of the hedging are carried to the results of operations concurrent with the realization of the inventory.

The contracts are presented at their fair value which is based on market price quotes as of the balance sheet date.

The sensitivity analysis was made for the following risk factors: changes in exchange rates, and changes in the price of the inventory.

SWAP hedging

In order to hedge its future cash flows, the Company fixed refining margins for specific refining quantities for periods following the reporting period. The Company fixes the refining margins by use of SWAP transactions which are not traded over the counter and adapts the hedging activity to the production mix the Company intends on producing, to the extent possible. The results of the hedging are carried to the income statement concurrent with the recording of the results of the transactions they were intended to hedge.

The SWAP transactions are presented at their fair value which reflects the future cash flows discounted at a risk-free interest rate that is appropriate to the period of time.

The sensitivity analysis was made for the following risk factors: changes in exchange rates, changes in the risk-free dollar interest rate for the appropriate periods, and changes in the future prices of products included in the SWAP transactions.

Crude oil and distillates inventory

The inventory is presented at its fair value, on the basis of the balances on the balance sheet date, net of the sales in the local market, the price of which was set.

The sensitivity analysis was made for the following risk factors: changes in exchange rates, and changes in the price of the inventory.

Accounts receivable and accounts payable

The balances of accounts receivable and accounts payable include only dollar balances.

The fair value is the market value at the balance sheet date.

The sensitivity analysis was made for changes in the exchange rate.

Securities portfolio

The securities portfolio is broken up into various investment channels, on the basis of the average life span of the investment in each channel.

The fair value is the market value at the balance sheet date.

The sensitivity analysis was made for the risk factors that characterize the composition of the portfolio: changes in exchange rates, changes in the risk-free dollar interest rate, changes in the risk-free shekel interest rate, and changes in the real interest rate.

4.2.1 Table summarizing differences in fair value in view of the sensitivity testing on the dollar/shekel exchange rate:

Exchange rates	Profit (loss)		Fair value 30.6.2007 4.249	Profit (loss)	
	+10%	+5%		-5%	-10%
	4.6739	4.46145		4.03655	3.8241
In thousands of NIS					
Long-term dollar loans	(203,722)	(101,861)	(2,037,216)	101,861	203,722
Long-term dollar debentures	(2,605)	(1,303)	(26,051)	1,303	2,605
Interest SWAP transactions	770	385	7,704	(385)	(770)
Future contracts	(2,096)	(1,048)	(20,955)	1,048	2,096
SWAP hedging	4,695	2,348	46,955	(2,348)	(4,695)
Inventory	226,253	113,127	2,262,532	(113,127)	(226,253)
Trade accounts receivable	74,355	37,178	743,554	(37,178)	(74,355)
Trade accounts payable	(64,120)	(32,060)	(641,198)	23,060	64,120
Dollar-linked securities portfolio	4,326	2,163	43,256	(2,163)	(4,326)
Forward contracts	(19,016)	(9,508)	96	9,508	19,016
	<u>18,840</u>	<u>9,421</u>	<u>378,677</u>	<u>(18,421)</u>	<u>(18,840)</u>

4.2.2 Table summarizing differences in fair value in view of the sensitivity testing on the dollar interest rate:

Interest in dollar loans	Profit (loss)		Fair value 30.6.2007	Profit (loss)	
	+10%	+5%		-5%	-10%
In thousands of NIS					
Long-term dollar loans	(40)	(20)	(2,037,216)	20	40
Long-term dollar debentures	5	2	(26,051)	(2)	(5)
Interest SWAP transactions	1,735	869	7,704	(872)	(1,747)
SWAP hedging	(124)	(62)	46,955	63	126
Dollar-linked securities portfolio	(1,306)	(653)	43,256	653	1,306
Forward contracts	80	40	96	(40)	(80)
	<u>350</u>	<u>176</u>	<u>(1,965,256)</u>	<u>(178)</u>	<u>(360)</u>

4.2.3 Table summarizing differences in fair value in view of the sensitivity testing on the price of crude oil and distillates:

	Profit (loss)		Fair value 30.6.2007	Profit (loss)	
	+10%	+5%		-5%	-10%
In thousands of NIS					
Future contracts	(74,291)	(37,146)	(20,955)	37,146	74,291
SWAP hedging	(26,453)	(13,226)	46,955	13,226	26,453
Inventory	226,253	113,127	2,262,532	(113,127)	(226,253)
	<u>125,509</u>	<u>62,755</u>	<u>2,288,532</u>	<u>(62,755)</u>	<u>(125,509)</u>

4.2.4 Table summarizing differences in fair value in view of the sensitivity testing on shekel interest in real terms:

	Profit (loss)		Fair value 30.6.2007	Profit (loss)	
	+10%	+5%		-5%	-10%
In thousands of NIS					
ICPI-linked securities portfolio	(2,893)	(1,447)	238,687	1,447	2,893
ICPI-linked long-term shekel debentures	5,732	2,875	(922,638)	(2,892)	(5,802)
	<u>2,839</u>	<u>1,428</u>	<u>(683,951)</u>	<u>(1,445)</u>	<u>(2,909)</u>

4.2.5 Table summarizing differences in fair value in view of the sensitivity testing on risk-free shekel interest:

	Profit (loss)		Fair value 30.6.2007	Profit (loss)	
	+10%	+5%		-5%	-10%
	In thousands of NIS				
Shekel securities portfolio	(1,405)	(703)	150,499	703	1,405
Forward contracts	(59)	(29)	96	30	59
	<u>(1,464)</u>	<u>(732)</u>	<u>150,595</u>	<u>733</u>	<u>1,464</u>

4.2.6 Table summarizing differences in fair value in view of the sensitivity testing on the risk premium:

	Profit (loss)		Fair value 30.6.2007	Profit (loss)	
	+10%	+5%		-5%	-10%
	In thousands of NIS				
Long-term dollar loans	5,545	2,775	(2,037,216)	(2,781)	(5,568)
Long-term dollar debentures	85	43	(26,051)	(43)	(85)
Long-term shekel debentures	3,124	1,565	(922,638)	(1,570)	(3,144)
Interest SWAP transactions	(6)	(3)	7,704	3	6
	<u>8,748</u>	<u>4,380</u>	<u>(2,978,201)</u>	<u>(4,391)</u>	<u>(8,791)</u>

- The Company's risk premium which is inherent in the calculations is fixed for all periods of time due to immateriality.
- The sensitivity tests described above tested the items and derivatives included in the Company's balance sheet as of June 30, 2007 that are exposed to changes in fair value as a result of changes in market risks.
- The sensitivity tests do not take into consideration the coefficients between the various risk factors.

The following tables present the sensitivity analysis from the report on market risks of Carmel Olefins:

1. Table summarizing differences in fair value in view of the sensitivity testing on the exchange rates:

Change in exchange rate	Profit (loss)		Profit (loss)	
	+10%	+5%	-5%	-10%
	In thousands of NIS			
Trade accounts receivable – dollar	42,039	21,020	(21,020)	(42,039)
Trade accounts receivable – euro	9,602	4,801	(4,801)	(9,602)
Trade accounts receivable – sterling	3,104	1,552	(1,552)	(3,104)
Trade accounts payable – dollar	(24,463)	(12,232)	12,232	24,463
Trade accounts payable – euro	(1,249)	(625)	625	1,249
Long-term loans – dollar	(94,050)	(47,025)	47,025	94,050
Long-term loans – euro	(28,378)	(14,189)	14,189	28,378
Hedging transactions – dollar	93,115	46,558	(46,558)	(93,115)
Hedging transactions – euro	6,905	3,452	(3,452)	(6,905)
Hedging transactions – sterling	6,009	3,004	(3,004)	(6,009)

2. Table summarizing differences in fair value in view of the sensitivity testing on interest rates:

Change in interest rate	Profit (loss)		Fair value 30.6.2007	Profit (loss)	
	+10%	+5%		-5%	-10%
	In thousands of NIS				
Long-term dollar loans	6,254	3,137	939,685	(3,157)	(6,335)
Long-term euro loans	2,952	1,484	281,863	(1,500)	(3,015)

3. Table summarizing differences in fair value in view of the sensitivity testing on shekel interest in real terms:

Change in interest	Profit (loss)		Fair value 30.6.2007	Profit (loss)	
	+10%	+5%		-5%	-10%
	In thousands of NIS				
ICPI-linked long-term shekel debentures	30,113	15,236	849,310	(15,604)	(31,586)

4.3 Maximum holding of derivatives, consolidated

Maximum holding of derivatives for crude oil and distillates inventory in the reporting period of sale position amounted to NIS 1.5 billion.

The maximum holding of derivatives for currency in the reporting period, of the total purchase positions was NIS 811 million and of the total sale positions was NIS 788 million.

4.4 Consolidated Linkage Bases

As of June 30, 2007 (in thousands of reported NIS)

	Index-linked	Foreign currency- linked (*)	Unlinked	Non- monetary	Total
<u>Assets</u>					
Cash	-	29,152	19,419	-	48,571
Trade and other accounts receivable and debit balances	-	1,223,233	1,012,892	89,211	2,325,336
Futures purchases	-	-	191,081	-	191,081
Inventory of fuel products	-	2,427,304	810,119	133,157	3,370,580
Affiliated companies	-	-	-	190,848	190,848
Deposits and loans(**)	-	-	19,151	-	19,151
Loan to Haifa Early Pensions Ltd.	299,592	-	-	-	299,592
Severance pay fund, net	-	-	-	50,906	50,906
Fixed assets	-	-	-	3,902,629	3,902,629
Quoted securities	238,687	43,256	150,499	-	432,442
Other assets	-	-	-	49,630	49,630
Total assets	<u>538,279</u>	<u>3,722,945</u>	<u>2,203,161</u>	<u>4,416,381</u>	<u>10,880,766</u>
<u>Liabilities</u>					
Short-term credit and loans	-	(214,356)	(112,203)	-	(326,559)
Trade and other accounts payable and credit balances	(69,336)	(883,536)	(1,425,614)	-	(2,378,486)
Futures sales	-	(191,205)	-	-	(191,205)
Deferred taxes	-	-	-	(496,485)	(496,485)
Authorization fees	(29,217)	-	-	-	(29,217)
Liability for employee severance pay	-	-	-	(278,213)	(278,213)
Long-term loans (**)	(1,300,680)	(2,688,331)	-	14,846	(3,974,165)
Total liabilities	<u>(1,399,233)</u>	<u>(3,977,428)</u>	<u>(1,537,817)</u>	<u>(759,852)</u>	<u>(7,674,330)</u>
Net balance	<u>(860,954)</u>	<u>(254,483)</u>	<u>665,344</u>	<u>3,656,529</u>	<u>3,206,436</u>

(*) Mainly linked to the dollar

(**) Including current maturities

Company management views the product inventory, consisting of commodities with a turnover of a month, as a financial item. Accordingly, it is included in the table above.

5. Liquidity

Working capital as of June 30, 2007 amounted to approximately NIS 2,177 million compared with NIS 2,025 million as of December 31, 2006. The current ratio as of June 30, 2007 was approximately 1.6 compared with approximately 1.5 as of December 31, 2006.

Cash flows provided by current operations in the reporting period amounted to approximately NIS 558 million. The investment of the Company in working capital during the reporting period amounted to NIS 920 million, of which an amount of NIS 631 million includes a payment to the tax authorities, and NIS 579 million in respect of an investment in inventory (half due to an increase in prices). The investment in working capital was partially funded by collections from customers in an amount of NIS 290 million.

Cash flows used in investment activity amounted to NIS 528 million, more than half of which was a loan to Haifa Early Pensions Ltd. (see Note 3) and the balance in investments in facilities, mainly at the Company and Carmel.

Cash flows provided by financing activity during the reporting period amounted to NIS 414 million. The source of the increase in cash from financing activity is the issuance of debentures by Carmel Olefins and the raising of short-term credit by the Company, in excess of the repayment of short-term credit by Carmel Olefins. The cash flows from current operations, invested in working capital and in investment activity, plus the cash flows from financing activities, as described above, resulted in a decrease of cash during the reporting period in an amount of NIS 475 million.

6. Sources of financing

The following is the composition of the corporation's sources of financing:

	Six month period ended June 30, 2007 (unaudited)	Year ended December 31, 2006 (audited)
	NIS Millions	
Sources		
Proceeds from sale of Ashdod - Oil Refineries Ltd.	-	3,251
Cash from current operations (prior to changes in working capital)	538	552
Dividend from investee companies	20	-
Long-term loans and debentures	590	2,141
Receipt of short-term credit and deposits from customers	59	6
Privatization grant	119	-
	<u>1,326</u>	<u>5,950</u>
Uses		
Investments in fixed and other assets	228	1,001
Loan to Haifa Early Pensions Ltd.	300	-
Repayment of long term loans and debentures	328	266
Payment of dividend	20	3,382
Repayment of short term credit and deposits from customers	4	924
Increase in working capital	446	377
	<u>1,326</u>	<u>5,950</u>

Long term loans and debentures

The long term loans and debentures (after deduction of current maturities) amounted to approximately NIS 3,095 million, and constitute approximately 29% of the balance sheet compared with approximately NIS 3,061 million which constituted approximately 29% as of December 31, 2006. The proceeds of the loans are used to finance investments in fixed assets and to finance working capital. Financial leverage (long term loans and debentures to shareholders' equity plus long term loans and debentures) is approximately 49% and was approximately 53% in the balance sheet of December 31, 2006.

Total financial liabilities

Financial liabilities – current financial liabilities plus long term loans and debentures amounted to approximately NIS 4,301 million and constitute approximately 40% of the balance sheet compared with approximately NIS 3,960 million which constituted approximately 38% as of December 31, 2006. Financial leverage of total financial liabilities to banks and other credit providers is approximately 57% compared with approximately 59% as of December 31, 2006.

Long-term financial debt, net (long-term loans and debentures – including current maturities, less the fund for investment in fixed assets) amounted to NIS 3.6 billion during the reporting period (in the Company NIS 2.5 billion, Carmel – NIS 1 billion, and Gadiv – NIS 28 million).

Average volume of sources of finance in the reporting period (NIS millions).

Long term loans (including current maturities) – 3,300, short term credit - 700, suppliers – 2,000, customers - 2,000.

7. Additional information contained in the auditors' report to shareholders

Without qualifying their opinion, the auditors of the Company drew attention to:

1. the contents of Note 16B(1) to the financial statements as of December 31, 2006 regarding the civil suit filed by the Movement for Quality Government against the State of Israel, the Company, and the Israel Corporation Ltd. requesting declaratory relief, whereby on October 18, 2003, the Company was required to transfer ownership to the State of Israel, without consideration, all of the assets the Company owned at that time. This suit is a recycling of an appeal submitted to the High Court of Justice against a compromise arrangement reached between the State of Israel, the Company and the Israel Corporation, which appeal was rejected by the High Court of Justice. The State of Israel, the Company, and the Israel Corporation petitioned to have the claim summarily dismissed and the Company filed a defense brief. In the opinion of the Company, based on its legal counsel, it is unreasonable that the court will intervene in the compromise reached by the parties to a dispute to which the Movement for Quality Government is not party and which was approved by the High Court of Justice.
2. the contents of Note 16B(2) to the financial statements as of December 31, 2006 regarding the suits filed against the Company and certain investee companies, claiming that the bodily injury and property damage caused to the plaintiffs were the result of the pollution of the Kishon River in which the plaintiffs allege the Company and the stipulated investees have a share, and regarding the demand of the Ministry for Environmental Protection that the Company bear the costs of removing polluted sludge from the Kishon River. Based on the opinion of the legal counsels of the Company and its investee companies, Company Management is unable to assess the amount of the exposure, if any exists, and therefore, no provision regarding this matter was included in their financial statements.
3. the contents of Note 16B(3) of the financial statements as of December 31, 2006 regarding a petition that was filed with the district court to have a suit against the Company and against an investee of the Company recognized as a class action. The plaintiffs claimed that events involving emission of smoke from the Company's plants, which occurred on two different dates, provided the plaintiffs with the basis for the claim under the Torts Ordinance, especially the claim of negligence. Subsequent to the balance sheet date, the class action against the investee company was erased by mutual consent. The Company notes that the suit is covered by an insurance policy and the Company has been acting in coordination with its insurers.
4. to the contents of Note 20D to the financial statements as of December 31, 2006 regarding the dependency of the Company on receipt of services from infrastructure companies.

8. Adoption of International Financial Reporting Standards (IFRS)

In July 2006, the Israel Accounting Standards Board issued Accounting Standard No. 29 – "Adoption of International Financial Reporting Standards (IFRS)" (hereinafter – the "Standard"). See Note 2H of the financial statements.

The Company has no intention of implementing early adoption of the Standard.

A qualitative and quantitative description of the expected impact on the financial statements of the transition to IFRS:

We present below a breakdown of the major issues which the Company believes, at present, may have a material impact on its financial statements as a result of the transition to reporting in accordance with IFRS (hereinafter – the "Transition Date"). Please be informed that there may be changes in these estimates when full financial statements are prepared in accordance with IFRS.

Please note that in view of the fact that the functional currency of the Company and its subsidiaries (hereinafter – the "Group") is the dollar (see Note A below), the financial statements presented in shekels are a translation from the dollar currency to shekels – with the resultant translation differences in most of the items presented in the financial statements.

Difference in the major items of the consolidated financial statements:

8.1 Balance sheet items:

	Note	Israeli Standards	Impact of transition to IFRS* January 1, 2007	IFRS	Israeli Standards	Impact of transition to IFRS* June 30, 2007	IFRS
N I S M i l l i o n s							
Inventory	A+G	2,791	(2)	2,789	3,370	97	3,467
Investee companies	A+G	191	32	223	190	37	227
Plant, equipment, net	A+G	3,702	202	3,904	3,728	228	3,956
Spare parts	A+G	148	(12)	136	175	(20)	155
Deferred taxes	F	(477)	(19)	(496)	(496)	(57)	(553)
Liability for employee termination benefits, net	C	(313)	(54)	(367)	(306)	(61)	(367)
Other liabilities, net, in items in respect of which differences were immaterial		(3,328)	(5)	(3,333)	(3,455)	-	(3,455)
Shareholders' equity	A+G+H	(2,714)	(142)	(2,856)	(3,206)	(224)	(3,430)

(*) Based on the end of period rate.

8.2 Income statement items:

	Note	Israeli Standards	Differences	IFRS NIS*
N I S M i l l i o n s				
Revenues	A	10,441	7	10,448
Cost of sales, refining and services	A+G	<u>9,531</u>	<u>116</u>	<u>9,415</u>
Gross profit		910	123	1,033
Selling, general and administrative expenses		<u>210</u>	<u>9</u>	<u>219</u>
Operating income	A	700	114	814
Financing expenses, net		<u>84</u>	<u>38</u>	<u>122</u>
		616	76	692
Other expenses		<u>118</u>	<u>-</u>	<u>118</u>
		498	76	574
Taxes on income	F	<u>140</u>	<u>25</u>	<u>165</u>
		358	51	409
Share of company in income of investee companies		<u>19</u>	<u>3</u>	<u>22</u>
		<u>377</u>	<u>103</u>	<u>431</u>

(*) Based on the average rate for the period.

A. The functional currency of the Company and its investee companies

Under IFRS, the effects of changes in the exchange rate of foreign currency are accounted for in accordance with IAS 21, whereby the Company is required to assess the functional currency of each component of the Company (on the basis of the Company and each of its components separately – subsidiary, branch, or other activity that constitutes part of any unit of the consolidated entity). The Company shall measure its results of operations and financial position or the results of its components on the basis of this currency.

The functional currency is the currency of the economic environment in which the Company or its component operates (the major economic environment impacting on the Company) and which constitutes the major currency in which the Company (or its component) generates and expends a cash flow.

After assessing the criteria, it was decided that the functional currency of the Group is the dollar.

The data set out in the note are shekel data, in accordance with the guidelines for the translation of the functional currency to the presentation currency set out in IAS 21.

B. Contingent liabilities and provisions

Under IFRS, provisions, contingent liabilities and contingent assets are accounted for in accordance with the provisions of IAS 37, whereby a provision should be recognized if it is more likely than not that economic resources will have to be used. The estimate of the provision is the present value of the estimated amount that the company is ready to pay to settle the liability or transfer it to a third party. According to the provisions of IAS 37, only in the rarest of cases is it not possible to estimate a liability in a reliable manner. According to accounting principles generally accepted in Israel, a liability is to be recognized in an amount equal to the estimated amount required to pay the other party in respect of the contingent loss if it is probable that the value of the asset was impaired or that a liability was created on the balance sheet date and the amount of the loss is measured reliably.

In the opinion of Company Management, based on its legal and professional counsels, no additional provision was recorded against the surplus in respect of the Company's contingent liabilities as of January 1, 2007.

C. Employee benefits

Under IFRS, employee benefits following retirement are accounted for in accordance with the provisions of IAS 19 whereby the liability in respect of employee termination benefits should be classified in accordance with one of the following two alternatives:

- **Defined benefit plans:** Plans in respect of which the actuarial and economic risks rest with the Company. In a defined benefits plan, the liability has to be estimated using actuarial methods that take into consideration the expected duration of the employees' tenure at the company, the value of the time, the expected salary increases until retirement, and the possibility that employees will leave the company under terms that do not grant them the benefit. In such a plan, actuarial gains or losses deriving from changes in assumptions are recognized in the current period if certain conditions are fulfilled and through a mechanism that regulates the amounts to be recognized over the remainder of the average employment period of the employees in the plan. Or,
- **Defined deposit plans:** Plans in respect of which the actuarial and economic risks do not rest with the Company. In such plans and during the employment period, the Company pays fixed amounts to a separate entity (fund) without it having a legal or implied obligation to make additional payments if the amounts accumulated in the fund prove to be insufficient. Deposits to defined deposit plans should be included as expenses upon the making of the deposit to the plan, concurrently with the receipt of the service from the employee (e.g., deposits under article 14 of the Severance Pay Law).

According to accounting principles generally accepted in Israel, the liability for employee termination benefits is computed on the basis of the product of employees' seniority at work and their latest monthly salary, assuming that all employees are terminated as of the balance sheet date under conditions that entitle them to full severance pay, ignoring discount rates, rates of future salary increases and future terminations. In addition, the liability in respect of unutilized vacation and sick pay are computed on the basis of estimates of utilization and redemption, respectively.

As of the Transition Date, the net liabilities in respect of post-retirement employee benefits and in respect of other long-term benefit plans are measured in accordance with the provisions of IAS 19. The discrepancy between the measurement principles set out above is estimated at NIS 54 million. As of the Transition Date (January 1, 2007), an amount of NIS 41 million will be charged to retained earnings (net of the tax consequence in an amount of NIS 13 million).

The Group intends on adopting the leniency of IFRS-1 whereby accrued actuarial gains and losses as of the Transition Date are to be carried to retained earnings.

In addition, the Company elected to carry the actuarial gains or losses to shareholders' equity.

D. Investments in investee companies

The Group intends on adopting the leniency of IFRS-1 whereby it will implement the provisions of IFRS 3 only in respect of business combinations that occurred after January 1, 2007 (the Transition Date).

E. Transactions under joint control

According to IFRS, transactions under joint control are accounted for under the provisions of IAS 31 which require an agreement for joint control in order to implement the proportionate consolidation method. In order to meet the criteria for a joint venture, the venture has to have its own economic activity. A company may elect to present the investment either on the proportionate consolidation basis or the equity basis. The Company intends on electing presentation under the proportionate consolidation method.

According to accounting principles generally accepted in Israel, transactions under joint control are to be presented in accordance with the proportionate consolidation method.

F. Deferred taxes

Deferred taxes are computed on the basis of the difference between the value of assets and liabilities for tax purposes (in which no change occurs) and the value of the assets and liabilities on the books of the Company. Since the value of assets under Israeli standards is not equal to their identity under IFRS, there is an impact on deferred taxes.

The increase in deferred taxes derives mainly from the one-time revaluation of the cost of assets of a subsidiary in accordance with deemed cost, in respect of which a reserve for taxes was set up.

G. Non-monetary items

Expendable material inventory, plant, equipment and spare parts in respect thereof, are non-monetary items which under IFRS are presented at their dollar cost while under Israeli standards were maintained in shekels which until December 31, 2003 were adjusted for changes in the Index. The transition to historical dollar cost increases the value of these assets.

The increase in plant and equipment, net, derives mainly from the fact that fixed assets of a subsidiary are presented on the basis of deemed cost.

H. Shareholders' equity

Share capital – Share capital constitutes the translation of the investment of shekels to dollars based on the original investment dates.

Retained earnings – The impact on retained earnings is the result of the changes described in items A – G above.

We would like to emphasize that the information presented below is based on the existing estimates and assessments as of the date of the report. Such information may change as a result of the continuing process of data collection and the adaptation of such information to the principles of IFRS and to changes that may derive as a result of changes in interpretation of IFRS. Since the approval of the first financial statements to be based on IFRS will be in the future, it is possible that the board of directors will see fit to change the accounting policies on which this information is based. We would also like to emphasize the fact that the information presented above has neither been audited nor reviewed.

9. Disclosure regarding the process of approving the Company's financial statements

On June 26, 2007, the Israel Corporation notified the Company that it had received ministerial approval under the Government Companies Order (Declaration of Crucial State Interests in the Oil Refineries Ltd.) – 2007 to hold the means of control in the Company (the "Control Permit"). On June 28, 2007, the Israel Corporation asked the Company to convene a general shareholders meeting for purposes of appointing directors to the Company's board of directors. The same day, the board of directors of the Company resolved to convene a general shareholders meeting which convened on August 9, 2007 and appointed six new directors to the Company's board. On August 15, 2007, the board of directors appointed a new audit committee and empowered it, among other duties, to deliberate and make recommendations to the board in connection with the approval of the financial statements. Among the audit committee's members are Mr. Avisar Paz and Ms. Daphne Schwartz, who have accounting and financial expertise, and other directors.

Taking into consideration the timetable set out above and on a one-time basis, the board of directors of the Company deliberated on the financial statements without having a preliminary deliberation and recommendation of the audit committee. The independent auditors of the Company are invited to attend and attend the meeting of the board of directors at which the financial statements are deliberated and approved. The auditors present the major findings, if any, which arose during the course of the audit or review. In addition, the meeting is attended by the CEO and the VP – Finance of the Company.

The board of directors assesses, through a detailed presentation of the senior officers of the Company and others, including the CEO and the VP – Finance of the Company, the significant issues regarding financial reporting, including any material transactions not in the normal course of business, the significant assessments and critical estimates applied in the financial statements, the accounting policies applied and any changes thereto, and the implementation of the fair disclosure principle in the financial statements and related data. The board of directors assesses various aspects of risk management and control, both those reflected in the financial statements (such as the report on financial risks) and those affecting the reliability of the financial statements. When necessary, the board of directors demands that certain issues be reviewed at its meetings.

The financial statements are submitted to the members of the board for approval a few days prior to the date of the deliberations on the financial statements.

As part of the deliberations at the meeting of the board, questions are raised by board members regarding various issues including those that arose during the course of the audit, with a goal of ensuring that the financial statements faithfully present the financial position of the Company. The questions and issues are addressed when necessary both by Company Management through the CEO or the VP – Finance of the Company and by the independent auditors of the Company. Following the deliberations, the chairman of the board calls for a vote to approve the financial statements after ensuring that the members of the board have no further questions or issues that were not addressed.

10. Corporate governance

As part of the changes in the institutions of the Company, further to the completion of the privatization of the Company, the board of directors assesses the recommendations of the Committee for the Assessment of Corporate Governance in Israel (the “Goshen Committee”), with a goal of adopting a corporate governance code at the Company, based on the recommendations of the Goshen Committee.

11. Meetings of the board of directors

During the reporting period, 12 meetings of the board of directors were held, and 8 meetings were held of committees of the board of directors.

Yossi Rosen
Chairman of the Board

Yashar Ben Mordechai
General Manager

August 19, 2007

Certified Public Accountants (Isr)
Member firm of Grant Thornton

The Board of Directors
Oil Refineries Ltd.
HAIFA

Dear Sirs:

**Re: Review of the Unaudited Condensed Interim Consolidated Financial
Statements for the Six and Three-month Periods ended June 30, 2007**

At your request, we have reviewed the condensed consolidated interim balance sheet of "Oil Refineries Limited" (hereinafter - the "Company") and subsidiaries as of June 30, 2007, and the related condensed consolidated statement of income, condensed statement of changes in shareholders' equity and condensed consolidated statement cash flows for the six 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 condensed financial statements, reading the minutes of the shareholders' meetings and of the meetings 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 reports of other auditors regarding the review of the condensed interim financial statements of a subsidiary whose assets included in the condensed consolidated balance sheet as of June 30, 2007 constitute approximately 10% of total consolidated assets and whose revenues included in the condensed consolidated statement of income for the six and three month periods ended June 30, 2007 constitute approximately 10% of total consolidated revenues. In addition, the data presented in the consolidated financial statements, which relate to the equity of affiliated companies and to the share of the Company in the results of operations of those companies are based on financial statements that were reviewed by other auditors.

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 condensed financial statements.

During the performance of our review, including reading review reports of other auditors as stated above, nothing came to our attention that would necessitate any material modifications to the condensed 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.

Moreover, at your request, we reviewed the pro forma condensed consolidated statement of income for the six and three-month periods ended June 30, 2006. We were furnished with the reports of other auditors regarding the review of the condensed interim financial statements of a subsidiary whose revenues included in the pro forma condensed consolidated statement of income for the six and three month periods ended June 30, 2006 constitute approximately 10% of total pro forma consolidated revenues. In addition, the data presented in the consolidated financial statements, which relate to the share of the Company in the results of operations of those companies are based on financial statements that were reviewed by other auditors.

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 pro forma condensed consolidated financial statements.

During the performance of our review, including reading review reports of other auditors as stated above, nothing came to our attention that would necessitate any material modifications to the pro forma condensed financial statements referred to above in order for them to be in conformity with generally accepted accounting principles, on the basis of the assumptions set out in Note 7.

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Israel

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We draw attention to:

1. the contents of Note 16B(1) to the financial statements as of December 31, 2006 regarding the civil suit filed by the Movement for Quality Government against the State of Israel, the Company, and the Israel Corporation Ltd. requesting declaratory relief, whereby on October 18, 2003, the Company was required to transfer ownership to the State of Israel, without consideration, all of the assets the Company owned at that time. This suit is a recycling of an appeal submitted to the High Court of Justice against a compromise arrangement reached between the State of Israel, the Company and the Israel Corporation, which appeal was rejected by the High Court of Justice. The State of Israel, the Company, and the Israel Corporation petitioned to have the claim summarily dismissed and the Company filed a defense brief. In the opinion of the Company, based on its legal counsel, it is unreasonable that the court will intervene in the compromise reached by the parties to a dispute to which the Movement for Quality Government is not party and which was approved by the High Court of Justice.
2. the contents of Note 16B(2) to the financial statements as of December 31, 2006 regarding the suits filed against the Company and certain investee companies, claiming that the bodily injury and property damage caused to the plaintiffs were the result of the pollution of the Kishon River in which the plaintiffs allege the Company and the stipulated investees have a share, and regarding the demand of the Ministry for Environmental Protection that the Company bear the costs of removing polluted sludge from the Kishon River. Based on the opinion of the legal counsels of the Company and its investee companies, Company Management is unable to assess the amount of the exposure, if any exists, and therefore, no provision regarding this matter was included in their financial statements.
3. the contents of Note 16B(3) of the financial statements as of December 31, 2006 regarding a petition that was filed with the district court to have a suit against the Company and against an investee of the Company recognized as a class action. The plaintiffs claimed that events involving emission of smoke from the Company's plants, which occurred on two different dates, provided the plaintiffs with the basis for the claim under the Torts Ordinance, especially the claim of negligence. Subsequent to the balance sheet date, the class action against the investee company was erased by mutual consent. The Company notes that the suit is covered by an insurance policy and the Company has been acting in coordination with its insurers.
4. to the contents of Note 20D to the financial statements as of December 31, 2006 regarding the dependency of the Company on receipt of services from infrastructure companies.

Fahn Kanne & Co.
Certified Public Accountants (Isr.)

Tel Aviv, August 19, 2007

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OIL REFINERIES LTD.
CONSOLIDATED BALANCE SHEETS
In thousands of reported NIS

	June 30,	2006^(**)	December 31,
	2007		2006
	Unaudited		Audited
Current assets			
Cash and cash equivalents	48,571	23,897	523,570
Trade accounts receivable	1,855,135	2,137,030	2,175,459
Receivables and debit balances	493,159	548,644	454,701
Inventory	<u>3,370,580</u>	<u>4,477,254^(*)</u>	<u>2,791,167^(*)</u>
	<u>5,767,445</u>	<u>7,186,825</u>	<u>5,944,897</u>
Long-term investments and loans			
Investee companies	190,848	181,619	191,002
Loan to Haifa Early Pensions Ltd.	299,592	-	-
Long-term loans and debit balances	16,641	15,212	7,409
Excess of funded amounts over the liability for severance pay, net	<u>50,906</u>	<u>44,216</u>	<u>45,458</u>
	<u>557,987</u>	<u>241,047</u>	<u>243,869</u>
Fixed assets			
Property, plant and equipment	3,728,025	4,283,380 ^(*)	3,701,744 ^(*)
Materials and spare parts	174,604	172,702 ^(*)	147,526 ^(*)
Fund for investment in fixed assets	<u>432,442</u>	<u>403,612</u>	<u>414,749</u>
	<u>4,335,071</u>	<u>4,859,694</u>	<u>4,264,019</u>
Other assets and deferred expenses			
	<u>49,630</u>	<u>51,557^(*)</u>	<u>48,100</u>
	<u>10,710,133</u>	<u>12,339,123</u>	<u>10,500,885</u>

(*) Reclassified.

(**) Restated – see Note 2B.

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

OIL REFINERIES LTD.
CONSOLIDATED BALANCE SHEETS
In thousands of reported NIS

	June 30, 2007	June 30, 2006 ^(**) Unaudited	December 31, 2006 Audited
Current liabilities			
Credit from banking institutions and other credit providers	1,205,988	1,982,743	899,142
Suppliers and service providers	1,828,342	2,430,461	2,214,883
Payables and credit balances	556,340	728,800	785,309
Declared dividend	-	16,535	20,000
	<u>3,590,670</u>	<u>5,158,539</u>	<u>3,919,334</u>
Long-term liabilities			
Debentures	974,717	1,319,296	854,799
Loans and liabilities	2,120,019	873,789	2,205,647
Deferred taxes	517,057	642,981	498,352
Liability in respect of financing lease	29,217	39,247	29,275
Liability for severance pay, net	272,017	230,379	278,801
	<u>3,913,027</u>	<u>3,105,692</u>	<u>3,866,874</u>
Total liabilities	<u>7,503,697</u>	<u>8,264,231</u>	<u>7,786,208</u>
Shareholders' equity	<u>3,206,436</u>	<u>4,074,892</u>	<u>2,714,677</u>
	<u>10,710,133</u>	<u>12,339,123</u>	<u>10,500,885</u>

(**) Restated – see Note 2B.

Yossi Rosen
Chairman of the Board

Y. Ben-Mordechai
General Manager

J. Hirsh
Deputy General Manager
– Finance

Date of approval: August 19, 2007

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

OIL REFINERIES LTD.
CONSOLIDATED STATEMENTS OF INCOME
In thousands of reported NIS

	Six month period ended June 30,		Three month period ended June 30,		Year ended December 31,
	2007	2006^(**)	2007	2006^(**)	2006
	Unaudited		Unaudited		Audited
Revenues	10,440,995	15,584,647	5,644,961	8,453,235	28,497,803
Cost of sales, refining and services	<u>9,531,371</u>	<u>14,389,288</u>	<u>5,195,551</u>	<u>7,873,582</u>	<u>26,764,492</u>
Gross profit	909,624	1,195,359	449,410	579,653	1,733,311
Selling expenses	59,945	46,034	29,366	21,703	94,702
General and administrative expenses	<u>150,332</u>	<u>131,953</u>	<u>67,431</u>	<u>64,446</u>	<u>247,345</u>
Operating income	699,347	1,017,372	352,613	493,504	1,391,264
Financing expenses, net	<u>83,573</u>	<u>110,538</u>	<u>85,781</u>	<u>64,807</u>	<u>166,843</u>
	615,774	906,834	266,832	428,697	1,224,421
Gain on sale of Ashdod Oil Refinery Ltd. (*)	-	-	-	-	1,655,593
Privatization grant (see Note 4B)	(118,529)	-	-	-	-
Expenses in respect of early retirement	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(81,000)</u>
Income before taxes on income	497,245	906,834	266,832	428,697	2,799,014
Taxes on income	<u>139,982</u>	<u>251,578</u>	<u>49,938</u>	<u>110,286</u>	<u>828,551</u>
Income after taxes on income	357,263	655,256	216,894	318,411	1,970,463
Company's share in income of investee companies	<u>20,163</u>	<u>21,630</u>	<u>11,007</u>	<u>11,032</u>	<u>32,570</u>
Net income for the period	<u><u>377,426</u></u>	<u><u>676,886</u></u>	<u><u>227,901</u></u>	<u><u>329,443</u></u>	<u><u>2,003,033</u></u>
Earnings per 1 ordinary share (in NIS)	<u>0.189</u>	<u>0.334</u>	<u>0.114</u>	<u>0.165</u>	<u>1.001</u>

(*) See Statements of Cash Flows.

(**) Restated – see Note 2B.

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

OIL REFINERIES LTD.

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
In thousands of reported NIS

Six month period ended June 30, 2007
Unaudited

	Share capital	Adjustments deriving from the translation of financial statements of autonomous unit	Capital reserve	Retained earnings	Dividend declared after balance sheet date	Total
Balance as of January 1, 2007	919,650	(435)	-	1,795,462	-	2,714,677
Net income for the period	-	-	-	377,426	-	377,426
Share of Company in capital reserve of affiliated company	-	(317)	-	-	-	(317)
Payment of issuance costs on behalf of controlling shareholder	-	-	-	(3,879)	-	(3,879)
Increase of share capital (see Note 18A)	1,080,350	-	-	(1,080,350)	-	-
Privatization grant paid by the State of Israel to employees of the Company	-	-	97,179	-	-	97,179
Privatization grant paid by the State of Israel to investee companies	-	-	21,350	-	-	21,350
Dividends declared subsequent to the financial statements	-	-	-	(280,000)	280,000	-
Balance as of June 30, 2007	<u>2,000,000</u>	<u>(752)</u>	<u>118,529</u>	<u>808,659</u>	<u>280,000</u>	<u>3,206,436</u>

Six month period ended June 30, 2006
Unaudited

	Share capital	Adjustments deriving from the translation of financial statements of autonomous unit	Capital reserve	Retained earnings	Dividend declared after balance sheet date	Total
Balance as of January 1, 2006	919,650	-	-	2,489,690 ^(*)	702,442	4,111,782
Net income for the period	-	-	-	676,886 ^(*)	-	676,886
Share of Company in capital reserve from a transaction between the Company and the controlling shareholder of an investee company	-	-	(11,366)	-	-	(11,366)
Transfer of capital reserve to retained earnings	-	-	11,366	(11,366)	-	-
Share of Company in capital reserve of affiliated company	-	-	32	-	-	32
Dividend	-	-	-	-	(702,442)	(702,442)
Balance as of June 30, 2006	<u>919,650</u>	<u>-</u>	<u>32</u>	<u>3,155,210</u>	<u>-</u>	<u>4,074,892</u>

(*) Restated – see Note 2B.

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

OIL REFINERIES LTD.

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (cont.)
In thousands of reported NIS

Three month period ended June 30, 2007
Unaudited

	Share capital	Adjustments deriving from the translation of financial statements of autonomous unit	Capital reserve	Retained earnings	Dividend declared after balance sheet date	Total
Balance as of April 1, 2007	2,000,000	(752)	118,529	861,139	-	2,978,916
Net income for the period	-	-	-	227,901	-	227,901
Payment of issuance costs on behalf of controlling shareholder	-	-	-	(381)	-	(381)
Dividends declared subsequent to the financial statements	-	-	-	(280,000)	280,000	-
Balance as of June 30, 2007	<u>2,000,000</u>	<u>(752)</u>	<u>118,529</u>	<u>808,659</u>	<u>280,000</u>	<u>3,206,436</u>

Three month period ended June 30, 2006
Unaudited

	Share capital	Adjustments deriving from the translation of financial statements of autonomous unit	Capital reserve	Retained earnings^(*)	Dividend declared after balance sheet date	Total
Balance as of April 1, 2006	919,650	340	-	2,825,427 ^(*)	-	3,745,417
Net income for the period	-	-	-	329,443 ^(*)	-	329,443
Transfer of capital reserve to retained earnings	-	(340)	-	340	-	-
Share of Company in capital reserve of affiliated company	-	-	32	-	-	32
Balance as of June 30, 2006	<u>919,650</u>	<u>-</u>	<u>32</u>	<u>3,155,210</u>	<u>-</u>	<u>4,074,892</u>

(*) Restated – see Note 2B.

OIL REFINERIES LTD.

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (cont.)
In thousands of reported NIS

Year ended December 31, 2006
Audited

	Share capital	Adjustments deriving from the translation of financial statements of autonomous unit	Retained earnings (*)	Dividend declared after balance sheet date	Total
Balance as of January 1, 2006	919,650	-	2,489,690	702,442	4,111,782
Net income for the year	-	-	2,003,033	-	2,003,033
Share of Company in capital reserve of investee company	-	(435)	(11,293)	-	(11,728)
Payment of issuance costs on behalf of controlling shareholder	-	-	(2,503)	-	(2,503)
Dividend declared and paid	-	-	(2,680,000)	(702,442)	(3,382,442)
Cancellation of dividend declared and not paid	-	-	16,535	-	16,535
Dividend declared and not yet paid	-	-	(20,000)	-	(20,000)
Balance as of December 31, 2006	<u>919,650</u>	<u>(435)</u>	<u>1,795,462</u>	<u>-</u>	<u>2,714,677</u>

(*) Restated – see Note 2B.

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

OIL REFINERIES LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
In thousands of reported NIS

	Six month period ended June 30,		Three month period ended June 30,		Year ended December 31,
	2007	2006 ^(**)	2007	2006 ^(**)	2006
	Unaudited		Unaudited		Audited
Cash flows from operating activities					
Net income for the period	377,426	676,886	227,901	329,443	2,003,033
Income and expense items not constituting a flow of funds (Appendix A)	<u>181,061</u>	<u>130,429</u>	<u>123,901</u>	<u>37,137</u>	<u>(1,450,645)</u>
	558,487	807,315	351,802	366,580	552,388
Changes in the current assets and liabilities (Appendix B)	<u>(919,749)</u>	<u>22,805</u>	<u>(170,853)</u>	<u>280,608</u>	<u>119,014</u>
Cash provided by (used in) operating activities	<u>(361,262)</u>	<u>830,120</u>	<u>180,949</u>	<u>647,188</u>	<u>671,402</u>
Cash flows from investment activities					
Net proceeds from sale of Ashdod Oil Refineries Ltd. (Appendix D)	-	-	-	-	3,251,409
Repayment of long-term loans to others, net	292	238	93	201	1,235
Loan to Haifa Early Pensions Ltd.	(299,592)	-	-	-	-
Purchase of fixed assets	(224,740)	(633,859) ^(*)	(109,990)	(313,755) ^(*)	(995,620)
Proceeds from realization of fixed assets	-	36	-	36	36
Investments in other assets and deferred expenses	<u>(3,777)</u>	<u>(8,861)^(*)</u>	<u>(3,777)</u>	<u>(8,100)^(*)</u>	<u>(6,112)</u>
Cash provided by (used in) investment activities	<u>(527,817)</u>	<u>(642,446)</u>	<u>(113,674)</u>	<u>(321,618)</u>	<u>2,250,948</u>
Cash flows from financing activities					
Receipt (repayment) of short-term credit	57,009	450,255	(156,910)	(313,205)	(923,911)
Receipt of deposits from customers	2,008	6,173	(4,219)	73	6,097
Dividend paid	(20,000)	(702,442)	-	-	(3,382,442)
Issuance expenses paid on behalf of a controlling shareholder	(3,879)	-	(2,108)	-	(1,126)
Issuance of debentures	425,000	-	-	-	-
Redemption of debentures	(37,084)	-	(20,044)	-	(34,442)
Receipt of long-term loans	163,973	214,295	2,777	69,328	2,140,733
Redemption of long-term loans	(291,476)	(160,695)	(154,122)	(78,602)	(232,326)
Receipt of privatization grant	<u>118,529</u>	<u>-</u>	<u>118,529</u>	<u>-</u>	<u>-</u>
Cash provided by (used in) financing activities	<u>414,080</u>	<u>(192,414)</u>	<u>(216,097)</u>	<u>(322,406)</u>	<u>(2,427,417)</u>
Total increase (decrease) in cash and cash equivalents	(474,999)	(4,740)	(148,822)	3,164	494,933
Balance of cash and cash equivalents at beginning of the period	<u>523,570</u>	<u>28,637</u>	<u>197,393</u>	<u>20,733</u>	<u>28,637</u>
Balance of cash and cash equivalents at end of the period	<u>48,571</u>	<u>23,897</u>	<u>48,571</u>	<u>23,897</u>	<u>523,570</u>

(*) Reclassified.

(**) Restated – see Note 2B.

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

OIL REFINERIES LTD.

APPENDICES TO THE CONSOLIDATED STATEMENTS OF CASH FLOWS
In thousands of reported NIS

Appendix A – Adjustments to reconcile net income to net cash from operating activities:

	Six month period ended June 30,		Three month period ended June 30,		Year ended December 31,
	2007	2006^(**)	2007	2006^(**)	2006
	Unaudited		Unaudited		Audited
Income and expense items not constituting a flow of funds					
Gain on sale of Ashdod Oil Refineries Ltd.	-	-	-	-	(1,655,593)
Depreciation and amortization	168,588	204,629	81,755	102,709	407,771
Gain (loss) on realization of fixed assets	-	(35)	-	(35)	336
Increase in the value of marketable securities	(17,693)	(7,107)	(10,533)	(2,650)	(18,242)
Company's share in profit of investee companies	(20,163)	(21,630)	(11,007)	(11,032)	(32,570)
Dividend received from investee companies	20,000	4,630	-	-	5,793
Increase (decrease) in liability for severance pay, net	(13,566)	(1,544)	(8,671)	(1,971)	74,180
Increase (decrease) in deferred taxes, net	22,061	(29,444)	6,274	(22,951)	(164,412)
Inflationary erosion and exchange rate variances of liabilities	21,834	(19,070)	66,083	(26,933)	(67,908)
	<u>181,061</u>	<u>130,429</u>	<u>123,901</u>	<u>37,137</u>	<u>(1,450,645)</u>

Appendix B – Changes in current assets and current liabilities

Decrease (increase) in trade and other receivables and debit balances	290,275	(343,922)	(121,674)	(28,395)	(434,059)
Increase (decrease) in trade and other payables and credit balances	(630,611)	720,293	498,129	76,992	504,761
Increase (decrease) in inventory	<u>(579,413)</u>	<u>(353,566)</u>	<u>(547,308)</u>	<u>232,011</u>	<u>48,312</u>
	<u>(919,749)</u>	<u>22,805</u>	<u>(170,853)</u>	<u>280,608</u>	<u>119,014</u>

Appendix C – Material non-cash activities

Purchase of fixed assets on supplier credit	<u>8,862</u>	<u>4,373</u>	<u>(5,091)</u>	<u>(21,658)</u>	<u>14,198</u>
Credit costs capitalized to fixed assets	<u>(170)</u>	<u>(16,984)</u>	<u>(8,063)</u>	<u>(22,989)</u>	<u>(40,968)</u>
Expenses in respect of sale of Ashdod Oil Refineries Ltd.	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>118,126</u>
Payment of issuance costs on behalf of controlling shareholder	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,377</u>

(**) Restated – see Note 2B.

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

OIL REFINERIES LTD.

APPENDICES TO THE CONSOLIDATED STATEMENTS OF CASH FLOWS (cont.)
In thousands of reported NIS

Appendix D – Proceeds from sale of Ashdod Oil Refineries Ltd. (“ORA”)

	Six month period ended June 30,		Three month period ended June 30,		Year ended December 31,
	2007	2006^(**)	2007	2006^(**)	2006
	Unaudited		Unaudited		Audited
Assets and liabilities of ORA as of the date of sale (net of selling costs):					
Fixed assets	-	-	-	-	689,400
Other assets	-	-	-	-	19,693
Spare parts inventory	-	-	-	-	34,303
Crude oil and distillates inventory	-	-	-	-	1,286,231
Loan to Ashdod Early Pensions Ltd.	-	-	-	-	100,000
Long-term loans	-	-	-	-	(169,395)
Long-term debentures	-	-	-	-	(433,345)
Deferred taxes in respect of real estate	-	-	-	-	(5,348)
Other financial liabilities, net	-	-	-	-	(43,849)
Expenses in respect of sale of Ashdod Oil Refineries Ltd.	-	-	-	-	118,126
Total net assets	-	-	-	-	1,595,816
Gain on sale of Ashdod Oil Refineries Ltd.	-	-	-	-	1,655,593
Total proceeds from sale	-	-	-	-	3,251,409

(**) Restated – see Note 2B.

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

OIL REFINERIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – GENERAL

- A. Oil Refineries Ltd. (hereinafter – the "Company" or "ORL") and its subsidiaries are industrial companies which operate in Israel and are engaged primarily in the production of oil products, feedstocks for the petrochemical industry and aromatic materials for the chemical and plastics industry. The facilities of the subsidiaries are integrated with those of the Company. Until September 28, 2006 (date of sale of the Ashdod oil refinery (see Note 7, below)), the Company had two operational sites, one in the Haifa Bay area and the other in Ashdod. In addition, the Company provides water treatment and power generation services (primarily electricity and steam) to a number of industries adjacent to the Haifa refinery.
- B. On February 21, 2007, as part of the implementation of the privatization resolution passed by the Israeli government on December 26, 2004, all of the shares of the Company that were previously held by the Israeli government were sold, some through a private placement and some through a sales offer to the public. Within this framework, the Israel Corporation Ltd. purchased 36.8% of the shares of the Company and Petroleum Capital Holdings Ltd. purchased 9.2% of the shares of the Company. The Israel Corporation Ltd. and Petroleum Capital Holdings Ltd. notified the Company that they purchased the shares of the Company as part of a binding memorandum agreement between the two companies. Since then, the Israel Corporation Ltd. and Petroleum Capital Holdings Ltd. purchased additional shares and as of the date of the release of the financial statements, they hold 45.08% and 14.46% respectively. On March 26, 2007, the merger between the Company, the Israel Corporation and Petroleum Capital Holdings was approved as required by the Anti-Trust Law – 1988. On May 10, 2007, the Israel Corporation Ltd. notified the Company that it had issued an immediate filing to the Israel Securities Authority and to the Tel Aviv Stock Exchange regarding the cancellation of the memorandum agreement between it and Petroleum Capital Holdings Ltd. and the signing of an agreement between the Israel Corporation Ltd. and Petroleum Capital Holdings Ltd., as detailed in the filings made with the Israel Securities Authority and the Tel Aviv Stock Exchange. As of the date of the issuance of the financial statements, a ministerial permit for control in the Company was issued as required in accordance with the Government Companies Order (Declaration of Crucial State Interests in the Oil Refineries Ltd.) solely to the Israel Corporation.

On August 9, 2007, the general shareholders meeting, which convened at the request of the Israel Corporation Ltd., elected six new members to the board of directors of the Company.

C. The Company's concession and the agreement following the termination of the concession period

1. General

The Company operated under a concession it received to build, operate, and maintain facilities and ancillary plants for the purpose of refining mineral oils. The concession attained the force of law, pursuant to the 1938 Anglo-Iranian Oil Convention Ordinance. The original concession period expired in October 2003.

2. Agreement covering the period after the termination of the concession period

On December 2, 2002, an arrangement was signed by the Company, the Israeli Government and the Israel Corporation, concerning the period following the termination of the concession (the "Original Arrangement"), regulating the relationship among the parties for the period set out therein (the 25-year period commencing on October 18, 2003 and an option granted to the Company extending the period for another 25 years).

On January 24, 2007, the State of Israel and the Company entered into a new asset agreement which resolves the dispute between the parties regarding the rights to the assets of the Company. According to the agreement, the company undertook to pay the State annual payments.

OIL REFINERIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 2 – GENERAL REPORTING PRINCIPLES AND ACCOUNTING POLICIES

A. Reporting Principles and Accounting Policies

1. These interim financial statements are presented in condensed format as of June 30, 2007 and for the six and three month periods then ended (hereinafter – the "Interim Financial Statements"), in accordance with Accounting Standard No. 14 of the Israel Accounting Standards Board. These financial statements should be read in conjunction with the audited annual financial statements of the Company as of December 31, 2006 and for the year then ended, together with their accompanying notes. In addition, the interim financial statements are presented in accordance with the provisions of Chapter D of the Securities Regulations (Periodic and Immediate Reports) – 1970.
2. The accounting principles applied in the presentation of the interim financial statements are consistent with those applied in the presentation of the annual financial statements, except as indicated in "C" below.
3. Measurement basis of the financial statements
 - A. The financial statements are prepared in reported New Israel Shekels. On January 1, 2004, Accounting Standard No. 12, "Discontinuance of Adjustment of Financial Statements for Inflation" went into effect. According to the Standard, financial statements are no longer adjusted for inflation commencing on the date the Standard went into effect. The adjusted amounts in the financial statements as of December 31, 2003 served as the point of departure for nominal financial reporting commencing on January 1, 2004.

B. Linked assets and liabilities or denominated in foreign currency

1. Data on the ICPI and U.S. dollar exchange rate are presented below:

	June 30,		March 31,		December 31,
	2007	2006	2007	2006	2006
Representative exchange rate US\$ 1= NIS	4.249	4.44	4.155	4.665	4.225
Israeli Consumer Price Index (base index 2000)	110.97	111.71	109.64	110.64	109.90

2. Data pertaining to the change in the ICPI and U.S. dollar exchange rate for the reported periods (in percents):

	Six month period		Three month period		Year ended
	ended June 30,		ended June 30,		December 31,
	2007	2006	2007	2006	2006
	%	%	%	%	%
Representative exchange rate of US\$ 1	0.56	(3.54)	2.26	(4.82)	(8.21)
Israeli Consumer Price Index	0.97	1.55	1.21	0.97	(0.1)

B. Restatement

The interim financial statements as of June 30, 2006 and for the six and three-month periods then ended were retroactively adjusted by way of restatement to reflect the following revisions: the recording of benefits granted by the Group to employees following retirement and payment of severance pay. These corrections included the recording of a liability, based on actuarial calculations, for the fringe benefits to which the Group's retirees are entitled, the major ones of which are holiday gifts, money to purchase Company products, and weekends, and the reduction of the liability for termination benefits which Carmel recorded in the past; the change in accounting treatment of the presentation of the investment in Haifa Basic Oils Ltd., from the proportionate consolidation method to the equity method, due to the absence of a written agreement between all of the shareholders in Haifa Basic Oils Ltd. regarding joint control; to retroactively reflect the agreement between the Company and the State of Israel pertaining to the leasing of real estate assets.

OIL REFINERIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)
In thousands of reported NIS

NOTE 2 – GENERAL REPORTING PRINCIPLES AND ACCOUNTING POLICIES (cont.)

B. Restatement (cont.)

The following tables summarize the effects of the aforementioned corrections on the consolidated financial statements:

1. Increase (decrease) in balance sheet items:

	June 30, 2006 Unaudited
Current assets	<u>(20,521)</u>
Long-term investments	<u>75,375</u>
Other fixed assets	<u>(80,904)</u>
Current liabilities	<u>(16,521)</u>
Liability in respect of employee termination benefits	<u>136,025</u>
Other long-term liabilities	<u>(5,162)</u>
Shareholders' equity	<u>(140,392)</u>

2. Decrease in net income:

	Six month period ended June 30, 2006 Unaudited
Decrease in net income in respect of benefits to employees after retirement and severance payments	(2,107)
Increase in net income deriving from a change in the liability in respect of a financing lease	<u>(65)</u>
	<u>(2,172)</u>

OIL REFINERIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)
In thousands of reported NIS

NOTE 2 – GENERAL REPORTING PRINCIPLES AND ACCOUNTING POLICIES (cont.)

C. Initial implementation of accounting standards

1. Accounting Standard No. 23 – "Accounting treatment of transactions between an entity and its controlling shareholder"

Since January 1, 2007, the Company has been implementing Accounting Standard No. 23 – "Accounting treatment of transactions between an entity and its controlling shareholder" (hereinafter - "Standard No. 23") issued in December 2006 by the Israel Accounting Standards Board.

Standard No. 23 does not apply to an entity that is not subject to the Israeli Securities Law – 1968. The Standard applies to all transactions between an entity and its controlling shareholder, except for a business combination transaction involving entities under common control. The Standard sets out the accounting treatment for common types of transactions. The provisions of Standard No. 23 will apply to all transactions (with the necessary changes) between an entity and its controlling shareholder, but, under certain circumstances, it will also apply to transactions with shareholders who are not controlling shareholders.

Assets and liabilities which were involved in a transaction between the entity and its controlling shareholder shall be measured at fair value. The difference between the fair value of the asset and its book value at the date of transfer shall be carried to the statement of income as income or a loss, and the difference between the fair value and the consideration stipulated in the transaction shall be carried to shareholders' equity. Any difference with a debit balance is in effect a dividend which reduces retained earnings. Any difference with a credit balance constitutes an investment by the owners and shall be presented separately as part of shareholders' equity under the title "Capital Reserve deriving from a transaction between the entity and its controlling shareholder".

An intangible asset having no active market, that was transferred to an entity from its controlling shareholder shall be presented in the entity's financial statements at the value in the financial statements of the controlling shareholder as of the date of transfer. Any difference between the consideration stipulated for such intangible asset and its value in the financial statements of the controlling shareholder shall be carried to shareholders' equity.

Upon initial recognition, a loan granted to or received from a controlling shareholder shall be presented in the financial statements of the entity at the fair value of the relevant asset or liability. The difference between the amount of the loan granted or received and its fair value on the date of initial recognition represents either an investment or a withdrawal of the owners and shall be carried to shareholders' equity. During the reporting period following the initial recognition, the loan shall be presented in the financial statements of the entity at its amortized value, after implementation of the effective interest rate method, except for cases in which according to generally accepted accounting principles it is presented at fair value. Standard No. 23 also sets out rules pertaining to the possibility of early repayment or a change in the terms of the loan.

Amounts debited to retained earnings or credited to a capital reserve in the financial statements of the entity as a result of a transaction with a controlling shareholder constitute, from the point of view of the controlling shareholder, an investment or withdrawal of the owners and shall be reported in the financial statements accordingly.

Standard No. 23 applies to transactions between an entity and its controlling shareholder conducted subsequent to the effective date. In respect of a loan granted to or received from a controlling shareholder prior to the effective date, the Standard shall apply to such loan as of the effective date.

Initial implementation of Standard No. 23 had no material impact on the results of operations, financial position and cash flows of the Company.

OIL REFINERIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.) In thousands of reported NIS

NOTE 2 – GENERAL REPORTING PRINCIPLES AND ACCOUNTING POLICIES (cont.)

C. Initial implementation of accounting standards (cont.)

2. Accounting Standard No. 26 – "Inventory"

Since January 1, 2007, the Company has been implementing Accounting Standard No. 26 – "Inventory" (hereinafter – the "Standard") issued in August 2006 by the Israel Accounting Standards Board. The Standard sets forth the accounting treatment of inventory.

The Standard stipulates, among other things, that inventory be measured at the lower of cost and net realizable value. Net realizable value is the estimated sales price during the normal course of business, less the estimated costs of completion and the estimated costs required to conduct the sale. Cost of the inventory includes purchase costs, manufacturing costs and other costs incurred in bringing the inventory to its current location and condition.

The Standard mandates specific identification of the cost of inventory items that are irreplaceable and of merchandise or services that were generated and separated for purposes of specific projects. The cost of other inventory should be determined on the basis of the first-in-first out formula or on the basis of the weighted average. A specific formula, as above, should be used for all inventory having a similar nature or use for the entity, unless some other costing formula is justified. Regarding allocation of inventory conversion costs, the Standard stipulates that when in a specific period an entity does not manufacture at its normal output capacity, it should not include in the cost of inventory additional fixed overhead costs in excess of the costs usually incurred in times of normal production. Such costs which were not allocated should be expensed in the period in which they were incurred. In accordance with the Standard, in cases in which the inventory was purchased on credit, and the arrangement contains a financing component, the inventory should be presented at the cash cost, and the financing component should be recognized as interest expense over the duration of the financing period.

When inventory is sold, the book value of the sold inventory should be recognized as an expense in the period in which the revenue from the sale was recognized. The amount of any decline in value of the inventory to its net realizable value and all losses in respect of inventory should be recognized in the period in which they were incurred. The amount of the cancellation of a decline in value deriving from an increase in the net realizable value should be recognized as a reduction in the amount of the inventory that is recognized as an expense in the period in which the cancellation occurred.

Initial implementation of the provisions of the Standard had no material impact on the financial statements.

3. Accounting Standard No. 27 – "Fixed Assets"

Since January 1, 2007 (the "Effective Date"), the Company has been implementing Accounting Standard No. 27 – "Fixed Assets" (hereinafter – the "Standard") issued in September 2006 by the Israel Accounting Standards Board. The Standard sets forth the accounting treatment for fixed assets.

In accordance with the Standard, a fixed asset item that qualifies as an asset shall be measured at its cost at the time of its initial recognition.

According to the Standard, cost includes, in addition to the purchase price, all of the costs that can be directly attributed to bringing the item to its present location and to the condition required to enable the item to operate in the manner intended by Company Management. Cost shall also include an estimate of the costs of dismantling and removal of the asset and rehabilitation of the site on which the asset is located if the entity has a commitment to perform such actions.

The Standard permits an entity to elect a measurement model once initial recognition has been achieved, either the cost model or the revaluation model, based on the fair value of the fixed asset item as of the date of revaluation, with the results of the revaluation being carried to a capital fund. According to the cost model, a fixed asset item should be presented at cost, net of accumulated depreciation, and net of accumulated impairment losses. The same measurement model must be applied to an entire class of fixed assets. According to the Standard, any part of the fixed asset the cost of which is significant to the total cost of the entire asset should be depreciated separately over the useful life of the part. The depreciation method should reflect the pattern in which the entity expects to derive economic benefits from the asset in the future.

OIL REFINERIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 2 – GENERAL REPORTING PRINCIPLES AND ACCOUNTING POLICIES (cont.)

C. Initial implementation of accounting standards (cont.)

3. Accounting Standard No. 27 – "Fixed Assets" (cont.)

The useful life of an asset is defined in terms of the forecasted benefit to be derived by the entity from the asset. The useful life of an asset may be shorter than its economic life.

According to the Standard, the book value of a fixed asset item should be derecognized when the item is disposed of, or when no future economic benefits are expected from use or disposal of the asset. The gain or loss on the derecognition of the fixed asset item should be carried to the statement of income when the item is derecognized. Such gains should not be classified as revenue.

The provisions of Standard No. 27 are to be implemented retroactively, except in connection with an entity which intends on adopting in the financial statements of periods commencing on January 1, 2008, one or more of the leniencies set out in International Financial Reporting Standard No. 1 pertaining to fixed assets, is entitled to adopt the same leniency or leniencies in the financial statements of periods commencing on January 1, 2007.

An entity that elects to adopt the leniency of fair value as deemed cost shall not restate comparative amounts relating to such fixed asset items. The entity shall disclose this fact and the fair value as of January 1, 2007 of each item handled in this manner. The Standard does not stipulate where in shareholders' equity the difference between the fair value of the asset as of January 1, 2007 and its book value is to be carried.

In an entity that elected on January 1, 2007 to use the revaluation model as its accounting policy regarding a group of fixed assets, the difference between the revalued book value of the asset as of January 1, 2007 and its book value will comprise its revaluation reserve on that date. Prior financial statements need not be restated in respect of implementation of the revaluation model.

Standard No. 27 provides a special transition provision in respect of an entity that did not include the costs of dismantling and removal of the asset in the cost of the fixed asset item upon initial recognition.

The Company elected to implement the cost basis.

Initial implementation of the provisions of the Standard did not have a material impact on the results of operations, financial position and cash flows of the Company.

4. Accounting Standard No. 30 – "Intangible assets"

Since January 1, 2007, the Company has been implementing Accounting Standard No. 30 – "Intangible Assets" (hereinafter - the "Standard"), issued in March 2007 by the Israel Accounting Standards Board, which prescribes the accounting treatment of intangible assets which are not dealt with in other standards.

The Standard defines the conditions and criteria for the recognition of an intangible asset, including in respect of research and development costs, how to measure the book value of such assets and requires certain disclosures in respect thereof. According to the Standard, an intangible asset is defined as an identifiable, non-monetary asset without physical substance.

Recognition of an item as an intangible asset requires the entity to prove that the item fulfills the following:

- a. the definition of an intangible asset, and;
- b. the recognition criteria – whereby an intangible asset is recognized as such if and only if the forecasted economic benefits that can be attributed to the intangible asset are expected to flow to the entity and that the cost of the asset can be measured reliably.

An intangible asset that qualifies to be recognized as an asset shall be initially measured at cost.

Research costs shall be expensed when incurred. Costs in respect of development, at a stage in which it can be proven that the criteria detailed in the Standard have been fulfilled, should be capitalized as an asset that will be amortized over the useful life of the asset, commencing on the date that the asset is ready for use, i.e., when it is in the location and condition required for it to operate in the manner intended by management.

An expenditure in respect of an intangible item that was initially recognized as an expense shall not be recognized as part of the cost of an intangible asset at a later date.

OIL REFINERIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 2 – GENERAL REPORTING PRINCIPLES AND ACCOUNTING POLICIES (cont.)

C. Initial implementation of accounting standards (cont.)

4. Accounting Standard No. 30 – “Intangible assets” (cont.)

The Standard permits the entity to elect to measure the asset after initial recognition on the basis of the cost model or the revaluation model (only in respect of assets having an active market) which is based on the fair value of an intangible asset at the date of the revaluation, with the revaluation carried to a capital reserve. Measurement after the initial recognition of an intangible asset without an active market shall be done on the basis of the cost model. According to the cost model, an intangible item shall be presented at cost net of accumulated amortization, and net of accumulated impairment losses. The same policy must be implemented in respect of a group of intangible items.

An entity shall assess whether the useful life of an intangible asset is defined or undefined. After initial recognition, an intangible asset with a defined useful life shall be amortized over its useful life, subject to assessments for impairment. Such an intangible asset should be presented at cost less accumulated amortization and less accumulated impairment losses. In addition, an intangible asset with an undefined useful life shall not be amortized. Instead, the entity should test for impairment of the asset at least once a year, or more frequently if indications exist that there may have been a decline in value of the asset. The Standard shall be applied retrospectively, except as presented below.

An entity which intends on adopting in the financial statements of periods commencing on January 1, 2008, one or more of the leniencies set out in International Financial Reporting Standard No. 1 pertaining to intangible assets having an active market, is entitled to adopt the same leniency or leniencies in the financial statements of periods commencing on January 1, 2007. An entity which elects to adopt the leniency of fair value as deemed cost shall not restate comparative data that relate to such an intangible asset. The entity shall provide disclosure of this fact and the fair value as of January 1, 2007 of the item treated as above.

The Standard shall be implemented in respect of business combinations occurring on or after January 1, 2007. Regarding an R&D project in process which was purchased as part of a business combination prior to January 1, 2007, which fulfills the definition of an intangible asset on the date of purchase and which was expensed on the date of purchase, the entity shall recognize it on January 1, 2007 as an R&D project asset in process. The amount of the adjustment should be carried to retained earnings as of January 1, 2007.

Initial implementation of the Standard did not have a material impact on the results of operations, financial position and cash flows of the Company.

D. Disclosure of the effects of new accounting standards in the period prior to implementation

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

In July 2006, the Israel Accounting Standards Board issued Accounting Standard No. 29 – "Adoption of International Financial Reporting Standards (IFRS)" (hereinafter – the "Standard"). The Standard prescribes that entities that are subject to the Israeli Securities Law – 1968 and that are required to file reports under the provisions of this law shall present their financial statements in accordance with International Financial Reporting Standards (hereinafter – "IFRS Standards"). This stipulation applies to periods commencing on or after January 1, 2008 (i.e., the interim financial statements for the first quarter of 2008), with the entity's first comprehensive financial statements in accordance with IFRS Standards being the annual financial statements of 2008. The Standard permits and encourages such entities to present their financial statements, issued subsequent to July 31, 2006, in accordance with IFRS Standards.

An entity that presented its financial statements in the past not in accordance with international standards and is required or elects to present them in accordance with international standards shall implement International Financial Reporting Standard No. 1 (IFRS 1), "First-time Adoption of International Financial Reporting Standards", for transition purposes.

IFRS 1 provides guidelines as to the transition from reporting under previous accounting principles (accounting principles generally accepted in Israel) to reporting in accordance with international standards. In order to alleviate the transition, financial statements presented for the first time under International Financial Reporting Standards (the financial statements for the year ended December 31, 2008) are required to present comparative amounts in respect of only one year (as of December 31, 2007 and for the year then ended) instead of the two years that is the accepted practice in Israel.

OIL REFINERIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 2 – GENERAL REPORTING PRINCIPLES AND ACCOUNTING POLICIES (cont.)

D. Disclosure of the effects of new accounting standards in the period prior to implementation (cont.)

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

IFRS 1 stipulates that an entity implement the same accounting policy in its opening balance as of January 1, 2007 (hereinafter – "Opening Balance" or "Transition Date") in accordance with the IFRS that are in effect on the reporting date of the first annual financial statements. All comparative amounts presented in the financial statements must also be presented accordingly. In other words, the IFRS in effect on the reporting date of the first annual financial statements must be applied retrospectively. Changes and adjustments to balances to be included in the balance sheet that is presented for the first time in accordance with IFRS as opposed to the balances included in accordance with previously accepted accounting principles, should be carried directly to retained earnings (or, if appropriate, another category of equity).

IFRS 1 grants 12 limited exemptions from some requirements of other IFRS that an entity adopting IFRS Standards for the first time may elect to use (all or part thereof). In addition, it includes four prohibitions regarding the retrospective application of some aspects of other IFRS Standards.

The IFRS provisions for recognition and measurement of assets and liabilities, disclosure requirements, and reporting formats differ from, those generally accepted in Israel. Therefore, the initial adoption of IFRS Standards may have a material impact on the financial position and results of operations of the Company.

The Company intends on implementing IFRS commencing with the financial statements for the period beginning on January 1, 2008. See Item 8 in the report of the board of directors.

2. Accounting Standard No. 13 (Revised) – "Effects of Changes in Foreign Currency Exchange Rates"

In May 2007, the Israel Accounting Standards Board issued Accounting Standard No. 13 (Revised) – "The Effects of Changes in Foreign Currency Exchange Rates" (hereinafter - the "Standard") which deals with the determination of the functional currency of a foreign entity or activity, the translation of transactions in foreign currency, the translation of the financial statements of foreign activities, and the translation of financial statements from the functional currency to the reporting currency. The Standard replaces Accounting Standard No. 13, "The Effects of Changes in Foreign Currency Exchange Rates" issued in October 2001 and which was based on International Accounting Standard No. 21 (IAS 21).

The Standard requires all entities to determine the functional currency of each of their components (a subsidiary, branch, or other activity that constitutes part of any unit of the consolidated entity) on a stand-alone basis and to measure the results of operations and financial position of each such component on the basis of that currency.

The major changes in the Standard when compared with original Standard No. 13 are as follows:

- a. Replacement of the term "reporting currency" with the following two terms:
 1. Functional currency – the currency of the principle economic environment in which the entity operates; and
 2. Presentation currency – the currency in which the financial statements are presented.
- b. Inclusion of factors which must be taken into consideration when determining the functional currency. The Standard emphasizes that when determining the functional currency, more emphasis should be placed on the currency which primarily impacts on the prices of the transactions and not necessarily on the currency in which the prices of the transactions are denominated.
- c. Cancellation of the differentiation between investee companies that are the "long arm" of the company and investee companies that are autonomous units. According to the Standard, the differentiation is between a unit whose functional currency is identical with the functional currency of the reporting entity and a unit whose functional currency is different than the functional currency of the reporting unit (foreign activity).

OIL REFINERIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 2 – GENERAL REPORTING PRINCIPLES AND ACCOUNTING POLICIES (cont.)

D. Disclosure of the effects of new accounting standards in the period prior to implementation (cont.):

2. Accounting Standard No. 13 (Revised) – "Effects of Changes in Foreign Currency Exchange Rates" (cont.)

- d. The standard permits the entity to present its financial statements in any currency (or currencies). The entity is required to translate the results of operations and financial position from the functional currency to the presentation currency (or currencies), through use of the method required to translate a foreign activity for purposes of inclusion in the financial statements of the reporting entity. In accordance with this method, assets and liabilities are translated at the closing rate and income and expense data are translated at the exchange rate on the transaction date (or average rate for the period, when such a rate constitutes a reasonable approximation).

The Standard applies to the financial statements of periods commencing on or after January 1, 2008. According to the transition provisions set out in the Standard, an entity shall implement the provisions of the Standard retroactively, except in connection with fair value adjustments and goodwill in respect of purchases made after the beginning of the period in which the Standard is initially implemented, which are to be handled prospectively.

The Company is assessing the ramifications of implementation of the Standard, but at present, it is unable to estimate the impact on the results of operations, financial position and cash flows.

NOTE 3 – LOAN TO HAIFA EARLY PENSIONS LTD.

According to the collective agreement for the early retirement and enhanced severance pay of Company employees, signed between the Company and representatives of the employees on June 14, 2006 (the "early retirement agreement"), a loan agreement was drafted and signed on that date between the Company and Haifa Early Pensions Ltd. ("HEP") whereby the Company granted a loan in an amount of NIS 300 million, linked to the ICPI, for purposes of purchasing pension rights for the employees, at any date or time, if HEP sees that the Company was in breach of the early retirement agreement. HEP will invest the loan in bank deposits or in debentures listed for trade on the stock exchange or in marketable government bonds. HEP will pay make annual payments in respect of interest and principal in accordance with the terms set forth in the loan agreement, with the first principal payment scheduled for the earlier of January 2010 or the date on which 75 employees retire under the early retirement agreement. The loan shall be in effect until the retirement of the last employee covered by the early retirement agreement, or until the date on which full rights are acquired under the early retirement agreement.

NOTE 4 – MAJOR EVENTS DURING THE REPORTED PERIOD

A. Changes in capital

The Company increased its registered share capital from NIS 381,280,000 to NIS 2,000,000,010 by the creation of 1,618,720,010 new ordinary "A" shares. For purposes of the increase in the share capital, an amount of NIS 1,080 million was transferred from retained earnings.

B. Privatization Grant

During the first quarter of 2007, the State of Israel completed the process of privatizing the Company. As part of the privatization process, the Government Companies Authority applied the entitlement to the privatization grant to employees of the Company and to employees of investee companies, proportionate to the percentage held by ORL (directly and indirectly) in each of those companies. The privatization grant, in an amount of NIS 118 million (NIS 97 million for ORL and NIS 21 million for the investee companies, including the payment of the privatization grant to senior officers, approved by the board of directors of the Company on August 19, 2007), was received from the State of Israel and paid to the employees of the Company and the investee companies. The privatization grant was recorded as an expense in the first quarter. The receipt from the State was carried to a capital reserve (a net amount of NIS 106 million after the tax effect).

OIL REFINERIES LTD.

NOTES TO THE FINANCIAL STATEMENTS (cont.)
In thousands of reported NIS

NOTE 5 – SEGMENT REPORTING

The Company operates in three major segments: Oil refining and production of fuel products; production of polymers and raw materials for the plastic industry; production of aromatic materials and solvents used in the chemical, plastics and other industries.

The following table summarizes segment activity (prior period data – pro forma):

For the six month period ended June 30, 2007 (unaudited) in thousands of NIS:

	Refining	Polymers	Aromatic Materials	Adjustments	Consolidated
Segment revenues	<u>9,422,231</u>	<u>624,349</u>	<u>1,025,857</u>	<u>(631,442)</u>	<u>10,440,995</u>
Results of segment operational income	<u>571,517</u>	<u>63,563</u>	<u>64,573</u>	<u>(306)</u>	<u>699,347</u>

For the six month period ended June 30, 2006 (unaudited) in thousands of NIS:

Pro forma

	Refining	Polymers	Aromatic Materials	Adjustments	Consolidated
Segment revenues	<u>10,028,278</u>	<u>537,691</u>	<u>967,367</u>	<u>(280,099)</u>	<u>11,253,237</u>
Results of segment operational income	<u>581,106</u>	<u>47,721</u>	<u>35,366</u>	<u>(344)</u>	<u>663,849</u>

For the three month period ended June 30, 2007 (unaudited) in thousands of NIS:

	Refining	Polymers	Aromatic Materials	Adjustments	Consolidated
Segment revenues	<u>5,102,038</u>	<u>313,080</u>	<u>545,012</u>	<u>(315,169)</u>	<u>5,644,961</u>
Results of segment operational income	<u>270,429</u>	<u>29,770</u>	<u>52,446</u>	<u>(32)</u>	<u>352,613</u>

For the three month period ended June 30, 2006 (unaudited) in thousands of NIS:

Pro forma

	Refining	Polymers	Aromatic Materials	Adjustments	Consolidated
Segment revenues	<u>5,520,817</u>	<u>249,129</u>	<u>536,156</u>	<u>(84,422)</u>	<u>6,221,680</u>
Results of segment operational income	<u>286,403</u>	<u>14,623</u>	<u>17,527</u>	<u>(344)</u>	<u>318,209</u>

For the year ended December 31, 2006 (audited) in thousands of NIS:

	Refining	Polymers	Aromatic Materials	Adjustments	Consolidated
Segment revenues	<u>19,329,854</u>	<u>992,880</u>	<u>1,902,790</u>	<u>(490,971)</u>	<u>21,734,553</u>
Results of segment operational income	<u>723,940</u>	<u>58,563</u>	<u>50,800</u>	<u>252</u>	<u>833,555</u>

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NOTES TO THE FINANCIAL STATEMENTS (cont.) In thousands of reported NIS

NOTE 6 – DEVELOPMENTS IN CONTINGENT LIABILITIES

The updates presented below should be read in conjunction with the financial statements as of December 31, 2006. During the reporting period, the following developments occurred in contingent liabilities:

1. Claim of the Movement for Quality Government in Israel against the agreement

On January 24, 2007, an amendment to the memorandum of principles was signed between the Company and the State of Israel with regard to the assets of the Company. Among other things, the amendment stipulated that in the event that the claim of the Movement for Quality Government is sustained and that the court determines that the disputed assets should have been returned to the State at the end of the concession period, the amendment would be considered as the resolution of the rights of the Company in the disputed assets.

The plaintiff requested permission from the court to amend the suit – according to the plaintiff – on the basis of the reasons given by the Supreme Court in the previous appeal filed by the plaintiff in the matter of the concession of the Company. The court rejected the request to amend and determined that in the absence of a new request to amend (that has not yet been filed), it would decide on the petitions of the defendants for a summary dismissal.

2. Litigation pertaining to the Kishon River

The Company and Carmel Olefins were served with third party notifications from parties being sued by the Haifa Rowing Club in a class action suit under the Law for the Prevention of Ecological Damage (Civil Suits) 1992. The plaintiffs petitioned for issuance of a restraining order that would put an immediate stop to the discharge of wastes that they claim pollute the River and prevent any discharge of such wastes in the future. They also requested a mandatory injunction to restore the River to its prior condition. Petitions were filed to have the suit, as well as the third party notices, against the Company and Carmel Olefins dismissed and the court ordered that the suit be summarily dismissed. An appeal with regard to the dismissal was filed with the Haifa District Court. The request of the Man, Nature and Law organization to join the proceedings as an *Amicus Curiae* (friend of the Court) was rejected subsequent to the balance sheet date.

During the period 2000 – 2004, suits of 95 soldiers in various units of the Israel Defense Forces were filed with the Haifa District Court against 4 defendants: Haifa Chemicals Ltd., the Haifa Municipal Union (Sewage), the Haifa Municipality and the Company. The suits were in respect of cancer and other illnesses which the plaintiffs allegedly contracted as a result of their presence in the waters of the Kishon River during their military service between the 1950s and the 1990s. All of the suits were consolidated into a single suit. Subsequent to the balance sheet date, the Court, with the consent of the parties, rejected the claims of 13 of the plaintiffs in these suits.

3. Class action suit – Kiryat Tivon

Subsequent to the balance sheet date, and after Carmel Olefins and its senior executives were acquitted of the criminal charges brought against them in respect of two events, the suit against Carmel and its CEO was erased with the consent of the plaintiffs.

4. Other litigation

A charge sheet was issued against the Company and the CEO of the Company for an alleged violation of the Law for Control of Prices of Goods and Services – 1996, claiming that the Company sold low-sulfur diesel fuel at a price that exceeded the maximum price stipulated in the law.

The request for a stay of proceedings filed by the Company was rejected. The Company requested that the court erase the indictment claiming that the facts do not reveal any illegal act, but the request was also rejected at this stage. The Court allowed the Company to raise its claims once again at a later date.

5. Two companies which hold the shares of Haifa Basic Oils Ltd. together with the Company filed suit against the Company in an amount of NIS 165 million and filed a motion to have the claim approved as a derivative claim of Haifa Basic Oils. The major claim of the plaintiffs is that the Company has been abusing its power and has not been acting in the best interests of Haifa Basic Oils. It has been confining the operations of the company and undermining its activities and development. According to the plaintiffs, the facility for the preparation of feedstocks, which is under the sole authority of the Company is an obsolete facility, is poorly maintained and has been suffering from recurring problems which seriously hamper the work of Haifa Basic Oils.

OIL REFINERIES LTD.

NOTES TO THE FINANCIAL STATEMENTS (cont.) In thousands of reported NIS

NOTE 6 – DEVELOPMENTS IN CONTINGENT LIABILITIES (cont.)

5. (cont.)

It was also claimed that the Company does not supply the proper feedstock, neither in the quality or the quantity needed for the operations of Haifa Basic Oils and over the years, the quality of the transferred feedstocks has declined significantly.

The plaintiffs claim that by virtue of convention and the practices between the parties over the years, the Company must supply Haifa Basic Oils with the proper quantity and quality of feedstocks. The claim does not point to any concrete and express commitment on the part of the Company to carry out the demands of the plaintiffs. However, it is claimed that the void of formal agreement, to the extent that it exists, should be filled by various legal tools.

The plaintiffs requested that their suit be approved as a derivative suit, claiming that due to the equality between the two blocks in control of Haifa Basic Oils, Haifa Basic Oils cannot exhaust its rights against the Company. As of the balance sheet date, the suit was still not recognized as a derivative suit.

The Company filed its response to the petition and the plaintiffs responded to the response. In its response, the Company claimed, among other things, that it never undertook to supply Haifa Basic Oils with certain feedstocks in quantities and of a composition that would maximize the profits of Haifa Basic Oils and that it operates in this matter as a supplier that is bound to take into consideration its own commercial interests. The Company also claims that it never restricted the option of Haifa Basic Oils to purchase feedstocks from it and that the Company is not bound, as a shareholder in Haifa Basic Oils, to prefer the interest of Haifa Basic Oils over the interest of the Company. Furthermore, the Company claimed that it has no obligation whatsoever, either in law or in agreement, to upgrade at its own expense, the feedstock preparation facility of Haifa Basic Oils. In addition, the Company claims that the alleged damages are exaggerated and baseless.

As a result of a change in the fuel oil standards as of August 2005, further to which the price of fuel oil was updated, the Company issued a demand, in June 2006, to the fuel companies and Haifa Basic Oils that they pay the Company the updated price of feedstocks supplied to Haifa Basic Oils, commencing on the date of the update. The debit balance of Haifa Basic Oils deriving from the difference between the up-to-date price of feedstocks and the price actually paid to the Company amounted to NIS 1,653 thousand as of December 31, 2006.

On April 30, 2007, a hearing was held on the motion to approve a derivative suit, at which it was decided that the board of directors of Haifa Basic Oils would discuss the decision regarding the upgrading of the feedstock facility and the parties were referred to a bridging process regarding the other disputes. The Company was notified that the board of directors of Haifa Basic Oils decided to approve the investment in the upgrade of the feedstock facility, subject to the agreement with the Company for the supply of feedstocks over the long term, at prices to be agreed upon and of quantities required to operate the feedstock facility at full output.

In the opinion of the Company, based on the legal counsel representing the Company in the suit, the Company has very good defense claims and it is more probable that the monetary suit against the Company in connection with prior periods will be rejected than the chances that it will be sustained.

6. A suit was filed against Carmel Olefins and its senior officers with regard to the emission of black smoke, as reported in the financial statements as of December 31, 2006. On March 25, 2007, the court acquitted Carmel Olefins and the senior officers. In handing down its decision, the court determined that Carmel Olefins complied with all of the provisions of the personal order that it received and, therefore, it was not possible to convict it. On May 8, 2007, the Ministry of Environmental Quality appealed the decision to the District Court and requested that the decision of the Magistrates Court on the conviction of the defendants be vacated. The appeal has not yet been deliberated.
7. On March 20, 2007, an indictment was issued against Carmel Olefins and one of its senior executives regarding the running of a business for the production of hazardous, inflammable, poisonous or radioactive materials without a business license, pursuant to the Law for Business Licenses – 1968. The relief requested in the indictment is the immediate and absolute termination of the business at Carmel Olefins' facility on HaHistadrut Street in Haifa, by closure of the premises. The trial was set for January 30, 2008.

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Please note that on August 27, 2006, Carmel Olefins submitted a request for a business license for the aforementioned facility from the Haifa Municipality. A representative of the district attorney's office informed Carmel Olefins that if such a business license is obtained, they will withdraw the indictment.

In the opinion of Carmel Olefins, based on its legal counsel, in the event that Carmel Olefins does not obtain a license and the district attorney's office continues investigation of the indictment, the chances of the charges being sustained are greater than the chances of the charges being dismissed. In the opinion of Carmel Olefins, if it is convicted by the court, it will be fined. Notwithstanding the fact that the maximum fine set out in the law is NIS 134,600 (with the Justice Minister being empowered to issue an order changing the amount of the fine on the basis of the changes that occurred in the Consumer Price Index), legal counsel of Carmel Olefins believes that the court will fine Carmel Olefins in a smaller amount. In the opinion of Carmel Olefins, based on its legal counsel, it is reasonable to assume that the Court will not order a cessation of business activity at the facility of Carmel Olefins by closing down the premises. No provision was included by Carmel in respect of this matter.

8. A major customer of Carmel Olefins, undergoing liquidation proceedings, filed a number of suits against Carmel. Two of the suits filed were erased subsequent to the balance sheet date by the courts in which they were filed.

Commitments

Further to the Company's efforts to break into the manufacturing of TMA in China and to the memorandum of understanding signed between the Company and a Chinese company regarding the establishment of a joint project (for which a detailed agreement has not yet been signed), the Company has been conducting negotiations with the owners of a Hong-Kong registered company with a goal of purchasing from it half of the rights to a project in China dealing with the manufacture and marketing of TMA and PDEB (material used in the manufacture of Parexylene). Consummation of the transaction is subject to the positive culmination of the negotiations, verification to the complete satisfaction of the Company of the correctness of the representations of the seller and the approval of the institutions of the Company.

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NOTES TO THE FINANCIAL STATEMENTS (cont.) In thousands of reported NIS

NOTE 7 – PRO FORMA DATA

On September 28, 2006, the Company sold all of its shares in Ashdod Oil Refinery (“ORA”) to Paz Oil Company Ltd. for an amount of NIS 3.25 billion. On that same date, assets, rights, employees, and liabilities which constituted the Ashdod oil refinery were transferred to ORA. In addition, the agreement covering the granting of services and other agreements went into effect. As a result of the sale of ORA, the Company recorded a capital gain in an amount of NIS 1.7 billion which was included in the financial statements as of December 31, 2006.

In accordance with the organizational structure of the Company, until that date, responsibility for the planning and execution of crude oil purchases for both the Haifa and the Ashdod sites, the channeling of the crude oil to each of the sites on the basis of the planned production breakdown between the refining facilities in Haifa Bay and in Ashdod and the setting of the sales targets for the products (to the local market and for export) rested with the Company, under the VP – Marketing and Trade, located at Company headquarters. The Company's facilities were constructed at two sites, on the basis of planning that maximizes the benefit to the Company as a whole. Therefore, the processing capacity of the downstream and finishing facilities at each of the sites does not necessarily match the refining capacity of the crude refining facilities at the same site.

Accordingly, interim materials were transferred from site to site as needed, through pipes as well as maritime and overland shipping. Therefore, the Company under the VP – Marketing and Trade at Company headquarters treated all of the refining and finishing facilities at the two sites as one single production unit that services the needs of the Company as a single entity. Accordingly, the breakdown of the production between the refining and finishing facilities at the two sites, including the transfer of interim products between the two, is based on a linear model that calculates the optimal production framework, with the goal of maximizing the Company's overall profits.

The consolidated pro forma statements of income reflect the separation of activities actually carried out by ORL at both production sites, the Ashdod site and the Haifa site, based on, among other things, assumptions and estimates detailed below. Notwithstanding the above, these assumptions and estimates involve a significant amount of uncertainty. Furthermore, in making calculations, it is possible to make use of alternative estimates and assumptions and it is also possible that changes may occur from period to period in the estimates and assumptions used. Such changes may have a material impact on the data presented.

Moreover, in view of the fact that the Company carried out operations until September 28, 2006 from the standpoint of the two sites constituting one economic unit, the overall results of operations of ORL do not necessarily equal the arithmetic sum of the results of operations of each of the sites had each site conducted operations in an independent manner, for each of the reported periods. The reason for the above, among other reasons, is the loss of overall optimization.

In addition, we draw attention to the significant changes expected to occur in the business environment and in the regulation that will apply to the activities of the Haifa and Ashdod refineries after the spin-off and privatization including, but not limited to, the following:

- A. The Supervisory Order on Prices of Goods and Services – 1992 was amended so that in the event that at least two refineries operate in Israel, with each one being owned by a separate entity and there is no cooperation between the two refineries regarding their sales networks, the maximum ex-refinery price of oil distillates will be cancelled. With regard to liquefied petroleum gas, the method of price control will be changed at the end of the twelve month period following the consummation of the sale and transfer of ownership of the Ashdod refinery.
- B. Whereas prior to the spin-off and privatization, Company activity was subject to the provisions and restrictions set forth in the Government Companies Law, subsequent to the spin-off and privatization, the Company ceased being a government company. Therefore, the aforementioned provisions and restrictions no longer apply to the Company.
- C. Another material change is expected to occur when the restriction of the Company to operate in the marketing segment is removed, activities which the Company was prevented from doing prior to the privatization.
- D. As a direct result of the above, as well as other possible changes in the financing structure of each entity following the spin-off, and other factors, changes may take place to the volume of activity, to the marketing base, the customer base and segmentation, and to the management and planning framework of critical functions.

OIL REFINERIES LTD.

NOTES TO THE FINANCIAL STATEMENTS (cont.) In thousands of reported NIS

NOTE 7 – PRO FORMA DATA (cont.)

In view of the above, the results reported in the pro forma financial statements should not necessarily be construed as an indication of the future results of the Company following the completion of the sale of the Ashdod oil refinery.

In the opinion of Company Management, the pro forma financial statements fairly reflect the results obtained, based on the assumptions detailed below:

A. Balance sheet

In the pro forma consolidated balance sheet as of December 31, 2006, certain balances were adjusted as part of the Company's working capital with the goal of reflecting the volume of Company activity following the sale of ORA.

B. Statements of income

The consolidated pro forma statements of operations are presented under the assumption that the date of the completion of the sale of the shares of the Company and the State of Israel in ORA (the effective date) occurred on January 1, 2006. Accordingly, certain revenues and expenses related to the sold Ashdod refinery were deducted on the basis of the following assessments and calculations:

- Revenues – on the basis of the quantities actually produced in Ashdod and on the basis of the average prices of Company sales to the local and export markets for each of the products during the relevant periods.
- Cost of sales – on the basis of the quantities actually refined in Ashdod during the relevant periods and in accordance with average prices of each of the types of crude oil imported by the Company and refined in ORA.
- Feedstocks consumed and transferred between the two refineries – on the basis of the consumed quantities and in accordance with the prices that were traded during the period in the Mediterranean Basin.
- General and administrative expenses – those that relate to the activity of the Ashdod oil refinery.
- Financing expenses – financing expenses that relate to the loans and debentures transferred to ORA were neutralized. In addition, financing expenses were adjusted on the basis of the forecasted reduction in the working capital of the continued operations of the Haifa oil refinery.
- Taxes on income – in accordance with the effective tax rates of each period.
- The results of Company operations commencing from the last quarter of 2006 and the first quarter of 2007 reflect the operations of the Haifa oil refinery only. The results of operations of the last quarter of 2006 included the effects of the dividend distribution mechanism that was part of the commercial services package that the Company rendered to ORA until December 31, 2006.

OIL REFINERIES LTD.

NOTES TO THE FINANCIAL STATEMENTS (cont.)
In thousands of reported NIS

NOTE 7 – PRO FORMA DATA (cont.)

A. Consolidated balance sheet

	June 30, 2007 Actual Unaudited	December 31, 2006 Pro forma Audited
Current assets		
Cash and cash equivalents	48,571	141,570
Trade accounts receivable	1,855,135	1,604,299
Receivables and debit balances	493,159	454,701
Inventory	3,370,580	2,791,167 ^(*)
	<u>5,767,445</u>	<u>4,991,737</u>
Long-term investments and loans		
Investee companies	190,848	191,002
Loan to Haifa Early Pensions Ltd.	299,592	300,000
Long-term loans and other debit balances	16,641	7,409
Excess of funded amounts over the liability for severance pay, net	50,906	45,458
	<u>557,987</u>	<u>543,869</u>
Fixed assets		
Property, plant and equipment	3,728,025	3,701,744
Materials and spare parts	174,604	147,526 ^(*)
Fund for investment in fixed assets	432,442	414,749
	<u>4,335,071</u>	<u>4,264,019</u>
Other assets and deferred expenses	49,630	48,100
	<u>10,710,133</u>	<u>9,847,725</u>
Current liabilities		
Credit from banking institutions and other credit providers	1,205,988	899,142
Suppliers and service providers	1,828,342	1,561,723
Payables and credit balances	556,340	785,309
Declared dividend	-	20,000
	<u>3,590,670</u>	<u>3,266,174</u>
Long-term liabilities		
Debentures	974,717	854,799
Bank loans	2,120,019	2,205,647
Deferred taxes	517,057	498,352
Liability in respect of financing lease	29,217	29,275
Liability for severance pay, net	272,017	278,801
	<u>3,913,027</u>	<u>3,866,874</u>
Total liabilities	<u>7,503,697</u>	<u>7,133,048</u>
Shareholders' equity	<u>3,206,436</u>	<u>2,714,677</u>
	<u>10,710,133</u>	<u>9,847,725</u>

(*) Reclassified.

OIL REFINERIES LTD.

NOTES TO THE FINANCIAL STATEMENTS (cont.)
In thousands of reported NIS

NOTE 7 – PRO FORMA DATA (cont.)

B. Consolidated statements of income

	Appendix	Six month period ended June 30,		Three month period ended June 30,		Year ended December 31,
		2007 Actual Unaudited	2006 Pro forma Unaudited	2007 Actual Unaudited	2006 Pro forma Unaudited	2006 Pro forma Audited
Revenues	(1)	10,440,995	11,253,237	5,644,961	6,221,680	21,734,553
Cost of sales, refining and services	(2)	<u>9,531,371</u>	<u>10,428,128</u>	<u>5,195,551</u>	<u>5,823,092</u>	<u>20,584,260</u>
Gross profit		909,624	825,109	449,410	398,588	1,150,293
Selling expenses	(3)	59,945	46,621	29,366	22,304	94,634
General and administrative expenses	(4)	<u>150,332</u>	<u>114,639</u>	<u>67,431</u>	<u>58,075</u>	<u>222,104</u>
Operating income		699,347	663,849	352,613	318,209	833,555
Financing expenses, net	(5)	<u>83,573</u>	<u>68,481</u>	<u>85,781</u>	<u>40,860</u>	<u>106,589</u>
		615,774	595,368	266,832	277,349	726,966
Privatization grant		<u>(118,529)</u>	-	-	-	-
Income before taxes on income		497,245	595,368	266,832	277,349	726,966
Taxes on income		<u>139,982</u>	<u>172,074</u>	<u>49,938</u>	<u>79,539</u>	<u>221,539</u>
		357,263	423,294	216,894	197,810	505,427
Company's share in income of investee companies		<u>20,163</u>	<u>21,630</u>	<u>11,007</u>	<u>11,032</u>	<u>32,570</u>
Net income for the period		<u><u>377,426</u></u>	<u><u>444,924</u></u>	<u><u>227,901</u></u>	<u><u>208,842</u></u>	<u><u>537,997</u></u>
Earnings per 1 ordinary share (in NIS)		<u><u>0.189</u></u>	<u><u>0.222</u></u>	<u><u>0.114</u></u>	<u><u>0.104</u></u>	<u><u>0.269</u></u>

OIL REFINERIES LTD.

NOTES TO THE FINANCIAL STATEMENTS (cont.)
In thousands of reported NIS

NOTE 7 – PRO FORMA DATA (cont.)

Appendix 1 – Revenues:

	Six month period ended June 30,		Three month period ended June 30,		Year ended December 31,
	2007 Actual	2006 Pro forma Unaudited	2007 Actual	2006 Pro forma Unaudited	2006 Pro forma Audited
Local market	6,433,255	7,674,113	3,230,637	3,965,970	14,970,902
Export	3,962,871	3,518,128	2,391,140	2,226,187	6,624,135
	<u>10,396,126</u>	<u>11,192,241</u>	<u>5,621,777</u>	<u>6,192,157</u>	<u>21,595,037</u>
Services provided to outsiders and other income	44,869	60,996	23,184	29,523	139,516
	<u>10,440,995</u>	<u>11,253,237</u>	<u>5,644,961</u>	<u>6,221,680</u>	<u>21,734,553</u>

Appendix 2 – Cost of sales, refining and services

	Six month period ended June 30,		Three month period ended June 30,		Year ended December 31,
	2007 Actual	2006 Pro forma Unaudited	2007 Actual	2006 Pro forma Unaudited	2006 Pro forma Audited
Consumed material	8,966,044	10,117,950	4,932,954	5,709,625	19,070,866
Salary and related expenses	144,441	130,735	70,138	61,982	258,700
Maintenance of facilities, buildings and equipment (1)	83,349	78,635 ^(*)	45,016	46,137 ^(*)	179,221 ^(*)
Amortization of periodic maintenance	51,250	44,355 ^(*)	25,641	23,710 ^(*)	93,237 ^(*)
Depreciation and amortization	106,598	113,050	50,878	56,460	238,289
Others	210,178	176,348	116,746	85,547	386,023
Decrease (increase) in product inventory	(30,489)	(232,945)	(45,822)	(160,369)	357,924
	<u>9,531,371</u>	<u>10,428,128</u>	<u>5,195,551</u>	<u>5,823,092</u>	<u>20,584,260</u>
(1) Including salaries and related expenses	<u>21,854</u>	<u>18,479</u>	<u>10,810</u>	<u>8,946</u>	<u>38,549</u>

(*) Reclassified.

Appendix 3 – Selling expenses

	Six month period ended June 30,		Three month period ended June 30,		Year ended December 31,
	2007 Actual	2006 Pro forma Unaudited	2007 Actual	2006 Pro forma Unaudited	2006 Pro forma Audited
Salary and related expenses	5,729	5,096	2,697	2,608	10,814
Shipping and storage	47,171	35,036	22,816	16,544	70,255
Others	7,045	6,489	3,853	3,152	13,565
	<u>59,945</u>	<u>46,621</u>	<u>29,366</u>	<u>22,304</u>	<u>94,634</u>

OIL REFINERIES LTD.

NOTES TO THE FINANCIAL STATEMENTS (cont.)
In thousands of reported NIS

NOTE 7 – PRO FORMA DATA (cont.)

Appendix 4 – General and administrative and expenses

	Six month period ended June 30,		Three month period ended June 30,		Year ended December 31,
	2007 Actual	2006 Pro forma Unaudited	2007 Actual	2006 Pro forma Unaudited	2006 Pro forma Audited
Salary and related expenses	59,375	47,874	34,842	22,148	96,993
Insurance, taxes and levies	69,804	34,249	25,924	17,194	67,301
Depreciation	2,907	4,085	1,367	2,034	8,034
Others	18,246	28,431	5,298	16,699	49,776
	<u>150,332</u>	<u>114,639</u>	<u>67,431</u>	<u>58,075</u>	<u>222,104</u>

Appendix 5 – Financing expenses, net

	Six month period ended June 30,		Three month period ended June 30,		Year ended December 31,
	2007 Actual	2006 Pro forma Unaudited	2007 Actual	2006 Pro forma Unaudited	2006 Pro forma Audited
Long-term loans and debentures received	143,639	35,425	141,215	7,370	45,369
Long-term loans granted	(107)	(176)	(49)	(93)	(239)
Short-term loans and advances from customers	716	49,827	(700)	42,420	97,339
Gains on marketable securities	(17,541)	(6,940)	(10,457)	(2,580)	(17,915)
Other items, net	(43,134)	(9,655)	(44,228)	(6,257)	(17,965)
	<u>83,573</u>	<u>68,481</u>	<u>85,781</u>	<u>40,860</u>	<u>106,589</u>

OIL REFINERIES LTD.

NOTES TO THE FINANCIAL STATEMENTS (cont.)

In thousands of reported NIS

NOTE 8 – SUBSEQUENT EVENTS

- A.** Subsequent to the balance sheet date, the board of directors of the Company approved an investment of \$50 million to upgrade its large crude refining facility in order to expand the different types of crude oil that the facility can refine. Completion of the upgrade of the facility is expected during the first half of 2009. After completion of the work, the Company will be able to refine types of heavy crude oil during periods in which its refining margin is higher and focus on the refining of crude oil with a mid and low density during periods in which their refining margin is higher, allowing the Company to make the transition from one type of crude to the other without having to shut down the facility and experience a loss of operating days. Increasing this flexibility will improve the utilization rate of the facility.

In addition, the board of directors approved an investment of \$52 million, mostly in connection with environmental quality which includes infrastructure and preparation for the absorption of natural gas and a system for the reduction of emission of nitrogen oxides.

Further to the decision of the board of directors of the Company to invest in the assessment of alternatives to increase the cracking capability of the Company's facilities (an investment that will allow for full utilization of surplus HVGO and an improvement in flexibility and profitability), the Company expects to check out these alternatives and recommend investments in this area to the board of directors should it find them to be economically feasible. In the opinion of the Company, the time needed to implement the alternative to be selected is three to three and a half years.

The Minister of Environmental Quality notified the Company that the personal decree will be revised such that, among other things, the Company will be able to use only gas fuel (instead of fuel oil which is currently used and which was taken into consideration in the current decree). Further to the notification of the Minister, the Company is making preparations to implement the personal decree through the alternative of the purchase of natural gas as described above. As of the date of the report, the personal decree has not yet been revised.

- B.** Subsequent to the balance sheet date, the board of directors recommended to the general shareholders meeting to distribute a dividend in an amount of NIS 280 million to the shareholders of the Company.
