



**OIL REFINERIES LTD.**

**Consolidated Financial Statements  
As of September 30, 2007**

**(Unaudited)**

# **OIL REFINERIES LTD.**

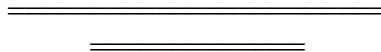
## **Consolidated Financial Statements**

**As of September 30, 2007**

**(Unaudited)**

### **Table of Contents**

	<b><u>Page</u></b>
<b>Description of the Business of the Group</b>	
<b>Report of the Board of Directors on the State of Affairs of the Group</b>	A – W
<b>Review Report of the Certified Public Accountants to the Shareholders</b>	2 – 3
<b>Consolidated Financial Statements as of September 30, 2007</b>	
Consolidated Balance Sheet	4 – 5
Consolidated Statement of Income	6
Statement of Changes in Shareholders' Equity	7 – 8
Consolidated Statement of Cash Flows	9 – 12
Notes to the Financial Statements	13 – 35



## **Report of the Board of Directors on the State of the Corporation's Affairs** **for the period ended September 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.

### **1. Description of the Company and its Business Environment**

#### **1.1 Description of the Company**

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 materials for the plastics industry. The facilities of the subsidiaries are integrated with those of the Company.

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 consolidated revenues of the Company during the first nine months of 2007. In conducting its activity in this area of operations, the Company purchases crude oil and interim products, mainly from the countries surrounding the Black Sea and the area of the Caspian Sea, 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 sells end fuel products and interim products to its customers in Israel and abroad and it 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 comprises 6% of the consolidated revenues of the Company during the first nine months of 2007. 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 consolidated revenues of the Company during the first nine months of 2007.

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.

The Company, Carmel and Gadiv have no significant dependency on customers or suppliers, except for the dependency of the subsidiaries on the supply of feedstocks from the Company. The Company has an operating dependency on Oil and Energy Infrastructures Ltd. and Eilat – Ashkelon Oil Pipeline Ltd. which provide it with crude oil transportation services at the terminals and in the pipelines.

### **Production volumes**

The following table presents the volume of refining and production of the Company and its subsidiaries (in metric tons):

	<b>1-9/2007</b>	<b>1-9/2006*</b>	<b>1-12/2006*</b>
Oil Refineries Ltd.	5,677	5,793	7,644
Gadiv Petrochemical Industries Ltd.	347	319	444
Carmel Olefins Ltd.	290	196	277

\* Pro forma

## **1.2 Company developments during and subsequent to the reporting period**

### **1.2.1 Corporate developments**

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. As of the balance sheet date, the Israel Corporation Ltd. holds 45.1% of the shares of the Company and Petroleum Capital Holdings holds 15.8% of the shares of the Company. The Israel Corporation Ltd. and Petroleum Capital Holdings notified the Company that they purchased the shares under a binding memorandum of understanding between them. 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 a letter of commitment by the Israel Corporation Ltd. to 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 release 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, an extraordinary general shareholders meeting made the initial selection and on November 8, 2007, the annual general shareholders meeting elected six members to the board of directors of the Company – Yossi Rosen, Avisar Paz, Ran Carroll, Nechama Ronen, Uri Slonim, and Uzi Netanel, in addition to the external directors serving at the Company – Prof. Yachin Cohen and Dr. Daphne Schwartz.

### **1.2.2 Business Developments**

On November 6, 2007, the board of directors of the Company passed a strategic plan designed to achieve rapid growth and an increase in the competitive capability of the Company in the coming years, with a massive investment of approximately \$1.1 billion in increasing the share of high added value products in the Company's product mix as well as in the areas of environmental quality, safety and security and in enhancing operational reliability.

The Company's vision, as publicized by it includes the following:

- To be a leader in the various fields of energy and petrochemicals – in Israel, the region, and internationally.
- To be a green and environmental friendly company in connection with its investments, current operations and training.
- To be an efficient, profitable, and growing company, as well as a yield-bearing company for its shareholders.
- A willingness to carry out vigorous investment programs.

In the field of refining, the plan is designed to improve assets in order to maximize their value to the Company, even in periods in which margins decline, by investing in existing assets and searching for opportunities to expand abroad.

In the field of petrochemicals, the plan is designed to expand operations in Israel and abroad, through development and enhancement of the capabilities of existing assets; searching for expansion opportunities abroad; focusing on unique high added value products in order to moderate industry volatility.

The strategic plan is also designed to fields which are tangential to the current fields of operations; electricity production, international trading activity, and transportation of fuels and chemicals.

Environmental protection also constitutes a business interest of the Company and, accordingly, as part of the strategic plan, the Company plans on enhancing the manufacture of products that improve environmental quality in relation to the products currently marketed in Israel and to invest in reducing the environmental impact of the Company's plants.

The strategic plan will be implemented through an investment plan according to the following blueprint:

- Accelerated investments in the area of refining which is the core business of the Company, mainly in increasing the complexity and efficiency of the Haifa Oil Refinery and in tangential areas, at an estimated amount of \$850 million, of which an amount of \$600 million is in respect of the expansion of the cracking capability of fuel products having a high added value, as well as identifying business opportunities outside of Israel;
- Expansion of the Company's petrochemical activity, by focusing on high added value products in Israel and abroad;
- Expansion of the commercial and logistics activity of oil products;
- Investments of approximately \$270 million in the areas of environmental quality, safety and security and enhancing operational reliability.

The board of directors of the Company decided to update the organizational structure of the Company so as to be in line with and in support of the new strategic plan, with a breakdown into three segments – refining, trade and petrochemicals.

The board of directors instructed Company Management to formulate plans and projects as part of the aforementioned strategic plan and to present them to the board for approval once they have been formulated, including the manner in which each is to be financed.

As part of the implementation of the strategic plan, the board approved investments in the fields of refining, environmental quality and safety, as follows:

- An investment of \$79 million in the project for the replacement of the gas oil desulphurization facility and the conversion of the HVGO facility to a moderate hydrogen cracking facility for purposes of increasing the quantity of diesel fuel manufactured by the Haifa refinery at the expense of HVGO, and for purposes of cracking part of the quantity of HVGO produced at the Haifa refinery. The interim phase of the project is expected to end at the beginning of 2009 and the entire project is expected to be completed in the middle of 2010.
- An investment of \$37 million in a preliminary project for the setting up of a hydrogen cracking facility at the Haifa refinery which, if approved in its entirety, is expected to be operational during the course of 2011. This will allow for progress on the process planning, securing supply time with the manufacturers of the major equipment and with planners, and preparation for obtaining the required permits. Concurrent with the carrying out of the preliminary stage of the project, the Company will carry out complimentary assessments for the scope of the entire investment required for the project and submit its findings to the board of directors in December 2007, prior to undertaking the major liabilities included in the preliminary stage of the project.
- An investment of \$50 million to upgrade its large crude oil refining facility, in order to expand the variety of the types of crude oils that can be refined by the facility. By increasing this flexibility, the Company will improve the rate of utilization of the facility (the investment was approved during the reporting period).
- An investment of \$61 million, mostly in connection with environmental quality which includes, among other things, infrastructure and preparation for the absorption of natural gas and a system for the reduction of emission of nitrogen oxides.

For more information on these investments, see paragraph 2.2 below.

Company Management will submit its final recommendations on the project to the board by the summer of 2008. The board of directors noted that in the event the project is cancelled within six months, the Company will be able to recoup a fourth of the investment in the preliminary stage of the project.

### **1.2.3 Developments in the area of petrochemicals**

On November 1, 2007, Carmel signed a letter of intent with a European company (the “European Company”) in connection with the possible purchase of the shares of the European Company in a petrochemical company and in connection with the entrance into a joint €20 million project in return for 49% of the share of the petrochemical company, subject to a mechanism that may grant the European company additional consideration on the basis of the mechanism set out in the letter of intent. A binding agreement for the purchase of the shares in the petrochemical company, to the extent that one will be signed, will contain representations, commitments, and indemnifications that are common to transactions of this type.

According to the letter of intent, Carmel will have a Call option, exercisable commencing on the date of the consummation of the transaction, until December 31, 2016, for the purchase of 51% of the shares of the petrochemical company held by the European Company, for an amount of €10 million (plus interest at a rate of 5% per annum commencing from the date of the consummation of the transaction until the date of the actual payment, less the dividends to be distributed to the European Company); the European Company will have a Put options, exercisable commencing on July 1, 2011 until December 31, 2016, for the sale of 51% of the shares of the petrochemical company held by the European Company, for an amount of €10 million (plus interest at a rate of 5% per annum commencing from the date of the consummation of the transaction until the date of the actual payment, less the dividends to be distributed to the European Company).

The letter of intent contained a “no shop” clause whereby until December 31, 2007, the European Company is not allowed to negotiate and/or make contact with any other party (either directly or indirectly) in connection with the sale of the shares in the petrochemical company, except with Carmel, unless the letter of intent is cancelled in accordance with the terms contained therein. Except in connection with a number of issues (the “no shop” clause, the confidentiality clause and the clause pertaining to jurisdiction), the letter of intent is not legally binding.

#### **TMA Project**

On September 25, 2007, Gadiv signed a memorandum of understanding (hereinafter – the “Memorandum”) for the purchase of 50% of the registered capital of a Chinese company (hereinafter – the “acquired company”) which benefits from the status of a Wholly Foreign Owned Enterprise (“WFOE”) in China. The acquired company will engage in the manufacturing of Tri-Maleic Anhydride (“TMA”), a product that is used mainly as a softener in the polymer industry and as a component in powder colors, and Para Diethyl Benzene (PDEB), a product used mainly in the manufacturing of Paraexylene.

The shares of the acquired company will be purchased by Gadiv from a foreign company registered in Hong Kong, which is not a related party to either Gadiv or the controlling shareholders of Gadiv (hereinafter – the “Seller”), and which is the owner of all of the issued share capital of the acquired company.

According to the memorandum, a company under the control of the Seller will transfer to the ownership of the acquired company, without consideration, an existing plant in China (excluding property of the plant that will be leased to the acquiring company without consideration) that manufactures TMA and PDEB (the “existing plant”) and all of the intellectual property, know-how and technology pertaining to the existing plant. In addition, the acquired company has been taking steps to set up an additional plant with facilities for the manufacture of TMA and PDEB through the know-how and technology that were transferred to its ownership. The additional plant will be set up in China on property on which the acquired company has usage rights.

Based on the estimates of the Seller and the acquired company that were given to Gadiv, the new PDEB facility is expected to commence commercial production activity by the end of November 2007 and the new TMA facility is expected to commence commercial production activity by the end of 2008.

The Memorandum replaced the previous memorandum of understanding that was signed regarding this transaction.

The principal terms of the Memorandum are as follows:

1. The Memorandum is subject to the completion of a due diligence to the complete satisfaction of Gadiv and to the signing of a detailed agreement, the wording of which must be approved by the boards of directors of the Seller and Gadiv (the “detailed agreement”) by October 31, 2007 or by

some later date to be agreed to by the parties. On November 15, 2007, the parties agreed to extend the Memorandum until November 25, 2007.

2. On the date of the closing, Gadiv will purchase from the Seller 50% of its shares in the acquired company for a total amount of \$33,500,000 (the "purchase price").
3. The purchase price will be paid in three installments, as follows: (a) 60% of the purchase price will be paid on the closing date of the detailed agreement; (b) 20% of the purchase price will be paid within 14 days after the new PDEB facility passes its test run successfully; (c) 20% of the purchase price will be paid within 14 days after the new TMA facility passes its test run successfully.
4. The closing of the detailed agreement is subject to pre-conditions, including the receipt of the necessary approvals from the Chinese authorities; the signing of accompanying agreements (including an agreement for the transfer of the existing plant to the acquired company, employment agreements with key employees and a non-competition agreement); receipt of an undertaking from Chinese banks to grant a loan to the acquired company in an amount of at least \$13 million for the completion of the construction of the new TMA plant and the new PDEB plant, without the shareholders having to furnish guarantees.
5. The memorandum includes arrangements pertaining to the joint management of the acquired company and to the relative shares of the shareholders which will be part of the detailed agreement, including a BMBY clause that will apply commencing seven years after the closing date of the agreement.

#### **1.2.4 Credit rating**

On November 11, 2007, Maalot notified the Company that the credit rating of its debentures was removed from the "watch list" and that a preliminary rating of AA/Stable would be granted to the debentures to be issued by the Company by way of a public issue, up to an amount of NIS 2 billion. The rating is also valid for the other series of debentures that the Company has in circulation.

### **1.3 Business environment and Company profitability**

The major factor impacting on the results of operations of the refining segment is the refining margin which is the difference between the revenue from the sale of the basket of products sold by the Company and the ex-refinery cost of the raw materials purchased by the Company (mainly crude oil). Global prices of crude oil and distillates are highly volatile and are set by, among other things, global supply and demand. They are also affected by geopolitical events which are not directly connected to the production of oil but which are viewed by the markets as having a potential impact on future production. The size of the refining margin is a result of the market forces active on two different planes – the first, supply and demand of crude oil and second, supply and demand of the end products.

The factors impacting on the supply and demand of crude oil and fuel distillates, as set out above, generate volatility and cyclicity of the profit levels of the refining industry.

Until the end of 2006, the maximum price at which the Company was allowed to sell most of its fuel products was subject to price control. Commencing on January 1, 2007, price control was lifted on the ex-refinery prices of most of the fuel distillates and in October 2007, changes were made to the method of supervision over the prices of the LPG sold by the company. Regarding fuel products for which there was no price control, supervision was effected solely through reporting procedures. Regarding LPG, it was stipulated that in certain circumstances, including the situation in which in 2 out of 12 succeeding months a refinery sells LPG at a price that exceeds the import price as defined in the Order, the company will be subject to a supervisory regime in respect of its requests for increases in price. The Company sets the price of its products on the basis of international prices, taking into consideration developments in the Mediterranean Basin and the local Israeli market.

Commencing on July 1, 2007, the Company is entitled to sell fuel products also to entities that are not fuel distribution companies.

During the reporting period, refining margins rose to \$61.0 a ton, versus \$55.9 a ton in the same period last year. The refining margins of the Company during the reporting period are higher than the average refining margins of the Mediterranean oil refineries having the capability of cracking "Ural"-type crude oil (which amounted to \$40.61 a ton). In the third quarter, refining margins declined in relation to the same quarter last year, from \$52.9 a ton to \$41.6 a ton. These margins are higher than the average margins published by

Reuters in respect of a sample Mediterranean oil refinery having the capability of cracking “Ural”-type crude oil, which amounted to \$27.8 a ton during the third quarter. For further details, see paragraph 3.1.2.

Please note that there are a number of differences between the refining margin of the Company and the margin published by Reuters. These differences include the composition of the crude oil (the Company also refines crude oils that are not “Ural”), the composition and quality of distillates produced by the oil refineries and the difference resulting from the fact that the quotation takes into account purchases and sales on the same day, while in practice, there is a time delay between the purchase of the crude and the sale of the distillates made therefrom.

Consolidated operating income amounted to NIS 937 million in the reporting period, compared with NIS 720 million in the same period last year, an increase of 30%.

Consolidated EBITDA during the reporting period amounted to NIS 1,194 million, compared with NIS 1,150 million in the same period last year, an increase of 4%.

For expanded details on the results of operations, including a breakdown by segment, see section 3.

The following table presents details of the principal factors involved in the increase in consolidated operating income (in NIS millions):

	<b>1-9/2007 compared with 1-9/2006</b>
Increase in margins of the Group	376
Increase in volume of Group sales	179
Decrease in Group sales turnover due to changes in the exchange rate of the shekel versus the dollar	(124)
Decrease in other income in the refining and aromatics segments	(31)
Increase in Group production expenses, mainly in the polymer segment	(109)
	<u>291</u>
Increase in selling, general and administrative expenses	<u>(74)</u>
	<u><u>217</u></u>

Consolidated operating income for the third quarter of the reporting period amounted to NIS 238 million, compared with NIS 57 million in the same quarter last year, an increase of 317%.

Consolidated EBITDA in the third quarter of the reporting period amounted to NIS 326 million, compared with NIS 144 million in the same quarter last year.

The following table presents details of the principal factors involved in the increase in consolidated operating income in the third quarter of this year versus the third quarter of last year (in NIS millions):

	<b>7-9/2007 compared with 7-9/2006</b>
Increase in margins of the Group (increase in margins in the polymer and aromatics segments offset by a decrease in the refining segment)	3
Increase in volume of Group sales	161
Increase in Group sales turnover due to changes in the exchange rate of the shekel versus the dollar	83
Increase in Group production expenses, mainly in the polymer segment offset by a decrease in the expenses of the refining segment	(42)
	<u>205</u>
Increase in selling, general and administrative expenses	<u>(24)</u>
	<u><u>181</u></u>

### **Financing expenses**

During the reporting period, consolidating financing expenses amounted to NIS 80 million, compared with NIS 92 million in the same period last year.

The NIS 12 million decrease in financing expenses derived mainly from the effect of the upward revaluation of the shekel on credit granted to Company customers versus the same period last year, from the reduction in the volume of short-term shekel credit, and from the reduction in other expenses, including a cessation in the capitalization of financing expenses at Carmel.

The decrease in expenses in respect of short-term credit was offset by the increase in expenses in respect of long-term linked shekel credit, mainly due to the increase in the Index and to an increase in the volume of the credit.

In the third quarter of the reporting period, financing income amounted to NIS 3 million, compared with financing expenses of NIS 24 million in the same period last year.

The NIS 27 million decrease in financing expenses derived mainly from the effect of the upward revaluation of the shekel.

For details, see paragraphs 3.1.5 and 3.2.4 below.

## **2. Financial position**

### **2.1 Current assets**

As of September 30, 2007, consolidated current assets amounted to approximately NIS 5,352 million, compared with NIS 5,967 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, mainly due to the increase in price which was offset by a decrease in the quantity of the inventory.

### **2.2 Fixed assets**

As of September 30, 2007, consolidated fixed assets (property, plant and equipment) net of depreciation amounted to approximately NIS 3,683 million, compared with approximately NIS 3,702 million as of December 31, 2006. The decrease of NIS 19 million derived mainly from additional investments of NIS 228 million (in Carmel and in the Metathesis facility, polypropylene – NIS 115 million, the Company – NIS 98 million in the power plant, in storage tanks in the desulfurization facility and other facilities, and in Gadiv, NIS 15 million), set off by depreciation for the period in an amount of NIS 247 million (the Company – NIS 165 million, Gadiv – NIS 35 million and Carmel – NIS 47 million).

During the reporting period, 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 light crude oil 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 \$61 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.

As mentioned above, on November 6, 2007, the board of directors of the Company approved a strategic plan designed to achieve rapid growth for the Company over the coming years. As part of the resolution, the board approved an investment of \$79 million in a project for the increase in the quantity of diesel fuel produced and an investment of \$37 million in the pre-construction project of a hydrogen cracking facility.

The Minister of Environmental Quality notified the Company that the Personal Order would be revised such that, among other things, the Company would use only gas fuel (instead of heavy diesel fuel which it currently uses and which was taken into consideration in the present order). Further to the notification of the Minister, the Company is taking steps to carry out the provisions of the Personal Order through the alternative of purchasing natural gas, as detailed above. As of the date of the report, the Personal Order has not yet been revised.

### **2.3 Current liabilities**

Consolidated current liabilities as of September 30, 2007 amounted to approximately NIS 3,407 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 512 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. In addition, there was an increase in the proposed dividend.

### **2.4 Long-term financial liabilities**

Consolidated long-term financial liabilities amounted to NIS 2,908 million as of September 30, 2007 (ORL – NIS 1,908 million, Gadiv – NIS 12 million, Carmel – NIS 988 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 153 million decrease derived mainly from a decrease in the volume of debentures of ORL, after the transfer of the short-term current maturities and net of the floating of the debentures of Carmel during the period.

### **2.5 Deferred taxes**

Deferred taxes amounted to NIS 540 million as of September 30, 2007, compared with NIS 498 million as of December 31, 2006. The NIS 42 million increase was the result of the accelerated depreciation claimed for income tax purposes, due to the additional investments of the Company and Carmel.

### **2.6 Shareholders' equity**

Shareholders' equity amounted to approximately NIS 3,105 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 390 million increase in the shareholders' equity of the Company derived from the net income of NIS 556 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 increases were offset by the declaration of a dividend of NIS 280 million and the 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 20% (on an annual basis - 27%). 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 47%.

## **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 Unaudited Nine months ended September 30,		In millions of NIS Unaudited Three months ended September 30,	
	2007 Actual	2006 Pro forma	2007 Actual	2006 Pro forma
<b>Revenues</b>				
Refining	14,555	15,013	5,133	4,985
Polymers	971	715	347	177
Aromatics	1,615	1,386	589	419
Cancellation of intercompany transactions	(893)	(408)	(262)	(128)
<b>Total</b>	<u>16,248</u>	<u>16,706</u>	<u>5,807</u>	<u>5,453</u>
<b>Cost of sales, refining and services</b>				
Refining	13,612	14,196	4,898	4,852
Polymers	832	661	296	189
Aromatics	1,449	1,300	537	407
Cancellation of intercompany transactions	(893)	(408)	(262)	(128)
<b>Total</b>	<u>15,000</u>	<u>15,749</u>	<u>5,469</u>	<u>5,320</u>
<b>Gross profit</b>				
Refining	943	817	235	133
Polymers	139	54	51	(12)
Aromatics	166	86	52	12
<b>Total</b>	<u>1,248</u>	<u>957</u>	<u>338</u>	<u>133</u>
<b>Sales, general and administrative expenses</b>				
Refining	192	149	55	46
Polymers	39	26	14	7
Aromatics	80	62	31	23
<b>Total</b>	<u>311</u>	<u>237</u>	<u>100</u>	<u>76</u>
<b>Operating income</b>				
Refining	751	668	180	87
Polymers	100	28	37	(19)
Aromatics	86	24	21	(11)
<b>Total</b>	<u>937</u>	<u>720</u>	<u>238</u>	<u>57</u>
Financing (expenses) income, net	<u>(80)</u>	<u>(92)</u>	<u>3</u>	<u>(24)</u>
Privatization grant (see paragraph 3.1.6 below)	<u>(119)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Income before taxes on income	738	628	241	33
Income tax	204	181	64	9
	<u>534</u>	<u>447</u>	<u>177</u>	<u>24</u>
Company's share in earnings of investee companies	<u>22</u>	<u>22</u>	<u>2</u>	<u>-</u>
<b>Net income for the period</b>	<u>556</u>	<u>469</u>	<u>179</u>	<u>24</u>

### 3.1.1 Sales turnover

The quantitative sales turnover of the refining segment (carried out through the Company) increased by 3.7% during the reporting period, compared with the same period last year. The average price per ton of the basket of 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 2,370 compared with approximately NIS 2,525 in the same period last year.

During the reporting period, there was an increase in fuel consumption in the local market of approximately 8% versus the same period last year, of which 4% was in the second quarter of this year. There was a 10% increase in the consumption of distillates in the relevant periods, approximately 4% in the third quarter, 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 36% 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 16% 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 5,707 million, diesel fuel – NIS 3,898 million, kerosene – NIS 1,614 million, and fuel oil – NIS 2,757 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):

	<b>September 30, 2007 compared with September 30, 2006</b>
Increase in margin from refining operations	112
Increase in volume of refining and sales	98
Decrease as a result of the changes in the exchange rate of the shekel versus the dollar	(48)
Decrease in other revenues	(28)
Increase in production expenses	(8)
	<u>126</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:

	<b>First quarter</b>	<b>Second quarter</b>	<b>Third quarter</b>	<b>Average</b>	<b>Fourth quarter</b>	<b>Annual average</b>
2007	67.5	73.0	41.6	61.0	-	-
2006	53.1	61.7	52.9	55.9	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 \$61.0 per ton, compared with \$55.9 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 \$40.61 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. In the third quarter, the refining margin decreased from \$52.9 per ton to \$41.6 per ton, compared with a refining margin of Mediterranean Sea oil refineries having cracking capabilities in respect of Ural-type crude oil which was \$27.8 per ton in this quarter.

From the beginning of the third quarter, refining margins decreased sharply when compared with prior quarters, 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.

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 8 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 139 million, compared with NIS 54 million in the same period last year.

The following table presents details of the principal factors involved in the increase (in NIS millions):

	<b>September 30, 2007 compared with September 30, 2006</b>
Increase in margin from the basket of products	189
Increase in sales quantities	52
Decrease as a result of changes in the exchange rate of the shekel versus the dollar	(54)
Increase in production expenses as a result of the operation of the expanded monomers and polypropylene facilities	(102)
	<u>85</u>

Gross profit of the aromatics segment during the reporting period amounted to NIS 166 million, compared with NIS 86 million in the same period last year.

The following table presents details of the principal factors involved in the increase (in NIS millions):

	<b>September 30, 2007 compared with September 30, 2006</b>
Increase in margin from the basket of products	75
Increase in sales quantities	29
Decrease as a result of the changes in the exchange rate of the shekel versus the dollar	(22)
Decrease in processing revenues	(3)
Decrease in production expenses	1
	<u>80</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, Consolidated selling, general and administrative expenses amounted to approximately NIS 311 million, compared with approximately NIS 237 million in the same period last year. The NIS 74 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 751 million during the reporting period, compared with NIS 668 million during the same period last year, an increase of 12%. The NIS 83 million increase in operating income derived from the NIS 126 million increase in gross profit as explained above, offset by the NIS 43 million increase in selling, general and administrative expenses. The EBITDA of the refining segment amounted to NIS 921 million during the reporting period, compared with NIS 853 million in the same period last year, an increase of 8%.

The operating income of the polymer segment amounted to NIS 100 million during the reporting period, compared with NIS 28 million during the same period last year, an increase of 257%. The EBITDA of the polymer segment amounted to NIS 165 million during the reporting period, compared with NIS 58 million in the same period last year, an increase of 184%.

The operating income of the aromatics segment amounted to NIS 86 million during the reporting period, compared with NIS 24 million during the same period last year, an increase of 258%. The EBITDA of the aromatics segment amounted to NIS 121 million during the reporting period, compared with NIS 60 million in the same period last year, an increase of 102%.

Consolidated operating income during the reporting period amounted to NIS 937 million, compared with NIS 720 million in the same period last year, an increase of 30%.

Consolidated EBITDA during the reporting period amounted to NIS 1,194 million, compared with NIS 973 million in the same period last year, an increase of 23%.

### **3.1.5 Financing expenses**

During the reporting period, Consolidated financing expenses amounted to approximately NIS 80 million, compared with an expense of approximately NIS 92 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):

	<b>1-9/2007 compared with 1-9/2006</b>
Decrease in the cost of long-term dollar credit, mainly due to the effect of the upward revaluation of the exchange rate of the shekel (which was similar in both periods) on the increase in the volume of the credit in the reporting period compared with the same period last year	(80)
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	86
Increase in expenses, mainly due to the impact of the increase in the Index and in the volume of long-term shekel credit	60
Decrease in credit fees from customers of the Company due to the effect of the upward revaluation of the exchange rate of the shekel versus the same period last year	(33)
Decrease in the volume of short-term shekel credit	(35)
Decrease in other expenses, offset by current hedging transactions and including income on the securities portfolio	(10)
	<u>(12)</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 119 million (NIS 97 million for ORL and NIS 22 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 204 million, compared with approximately NIS 181 million in the same period last year. The NIS 23 million increase in tax expenses between the periods derived for the most part from the increase in pre-tax profit, and from 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 22 million, approximately the same amount as in the same period last year.

## **3.2 Results of the third quarter compared with the same quarter last year**

### **3.2.1 Sales turnover**

The dollar sales turnover of the refining segment in the third quarter increased by 8.2% compared with the same quarter last year. Due to the low exchange rate, shekel sales were eroded by 5%.

The sales turnover of the polymers segment increased by 96% due to an increase in sales quantities and an increase in prices. In this quarter, the expansion plant of Carmel was put into operations, contributing to an increase in turnover when compared with the turnover of the same period last year. Last year's turnover was especially low due to the Second Lebanese War and the resultant shutdown in activity. The increase in turnover derived mainly from an increase in quantities sold and partially due to the increase in selling prices, offset by the decrease in revenues in respect of war compensation.

The sales turnover of the aromatics segment increased by 41% 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 third quarter as follows: Gasoline – NIS 1,895 million, diesel fuel – NIS 1,376 million, fuel oil and bitumen – NIS 1,034 million.

### **3.2.2 Gross profit**

The gross profit of the refining segment in the third quarter amounted to NIS 235 million, compared with NIS 133 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 refining segment (in NIS millions):

	<b>7-9/2007 compared with 7-9/2006</b>
Decrease in margin from refining operations	(61)
Increase in volume of refining and sales	48
Increase as a result of the changes in the exchange rate of the shekel versus the dollar	102
Decrease in production expenses	13
	<u>102</u>

The gross profit of the polymer segment amounted to NIS 51 million, compared with a loss NIS 12 million in the same quarter last year.

The following table presents details of the principal factors involved in the increase in gross profit (in NIS millions):

	<b>7-9/2007 compared with 7-9/2006</b>
Increase in margin of basket of products	39
Increase in volume of refining and sales	82
Decrease as a result of changes in the exchange rate of the shekel versus the dollar	(8)
Increase in processing expenses	<u>(50)</u>
	<u>63</u>

The gross profit of the aromatics segment amounted to NIS 52 million, compared with NIS 12 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 NIS millions):

	<b>7-9/2007 compared with 7-9/2006</b>
Increase in margin of basket of products	25
Increase in quantities sold	31
Decrease as a result of changes in the exchange rate of the shekel versus the dollar	(11)
Increase in processing expenses	<u>(5)</u>
	<u>40</u>

### **3.2.3 Operating income and EBITDA**

The operating income of the refining segment in the third quarter amounted to NIS 180 million, compared with NIS 87 million during the same quarter last year, an increase of 106%.

The NIS 93 million increase in the operating income of the refining segment derived from the NIS 102 million increase in gross profit as explained above, offset by selling, general, and administrative expenses in an amount of NIS 9 million. The EBITDA of the refining segment amounted to NIS 236 million during the third quarter, compared with NIS 152 million in the same quarter last year.

The operating income of the polymer segment amounted to NIS 37 million during the third quarter, compared with NIS 19 million during the same quarter last year. The EBITDA of the polymer segment amounted to NIS 62 million during the third quarter, compared with a loss of NIS 9 million in the same quarter last year.

The operating income of the aromatics segment amounted to NIS 21 million during the third quarter, compared with a loss of NIS 11 million during the same quarter last year. The EBITDA of the aromatics segment amounted to NIS 32 million during the third period, compared with NIS 1 million in the same quarter last year.

Consolidated operating income during the third quarter amounted to NIS 238 million, compared with NIS 57 million in the same quarter last year, an increase of 317%.

Consolidated EBITDA during the third quarter amounted to NIS 326 million, compared with NIS 144 million in the same quarter last year.

### **3.2.4 Financing**

During the reporting period, Consolidated financing income amounted to approximately NIS 3 million, compared with an expense of approximately NIS 24 million in the same period last year.

The following table presents a breakdown of the changes (in NIS millions):

	<b>1-9/2007 compared with 1-9/2006</b>
Decrease in the cost of long-term dollar credit, mainly due to the effect of the upward revaluation of the exchange rate of the shekel versus the dollar	(74)
Increase in the cost of linked long-term shekel credit due to the increase in volume and to the increase in the Index	22
Decrease in the volume of short-term shekel credit mainly due to a decrease in volume	(21)
Increase in other expenses	46
	<u>(27)</u>

### **3.2.5 Income tax**

In the third quarter of the year, tax expenses amounted to NIS 64 million, compared with approximately NIS 9 million in the same quarter last year. The increase in tax expenses between the quarters derived for the most part from the increase in pre-tax profit.

## **4. Liquidity**

Working capital as of September 30, 2007 amounted to approximately NIS 1,945 million compared with NIS 2,025 million as of December 31, 2006. The current ratio as of September 30, 2007 was approximately 1.6 compared with approximately 1.5 as of December 31, 2006.

Consolidated cash flows provided by current operations in the reporting period amounted to approximately NIS 761 million. The investment of the Company in working capital during the reporting period amounted to NIS 380 million, including a payment to the tax authorities, an investment in inventory (mostly due to an increase in prices) and collections from customers and receivables.

Cash flows used in investment activity amounted to NIS 629 million, half of which was a loan to Haifa Early Pensions Ltd. (see Note 3) and the balance in investments in facilities and other assets, mainly at the Company and Carmel.

Net cash flows provided by financing activity during the reporting period amounted to NIS 248 million. During the reporting period, a net amount of NIS 159 million was raised in the form of loans and debentures, an amount of NIS 119 million was received in respect of the privatization grant, and a dividend was paid in an amount of NIS 20 million. 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 445 million.

## 5. Sources of financing

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

	<b>Nine month period ended September 30, 2007 (unaudited)</b>	<b>Year ended December 31, 2006 (audited)</b>
	<b>NIS Millions</b>	
<b>Sources</b>		
Proceeds from sale of Ashdod - Oil Refineries Ltd.	-	3,251
Cash from current operations (prior to changes in working capital)	718	552
Dividend from investee companies	43	-
Long-term loans and debentures	631	2,141
Receipt of short-term credit and deposits from customers	4	6
Privatization grant	119	-
	<u>1,523</u>	<u>5,950</u>
<b>Uses</b>		
Investments in fixed and other assets	325	1,001
Loan to Haifa Early Pensions Ltd.	304	-
Repayment of long term loans and debentures	471	266
Repayment of short-term credit	7	923
Payment of dividend	20	3,382
Payment of issuance costs on behalf of a controlling interest	4	1
Increase in working capital	380	377
	<u>1,523</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 2,908 million, and constitute approximately 28% 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 48% 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 4,026 million and constitute approximately 39% 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 56% 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 3.3 billion during the reporting period (in the Company NIS 2.3 billion, Carmel – NIS 1 billion, and Gadiv – NIS 24 million).

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

Long term loans (including current maturities) – 3,050, short term credit - 410, suppliers – 2,000, customers - 2,000.

## **6. Exposure to and methods of market risk management**

**6.1** 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.

### **6.2 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 – 5.2%), 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.

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

	Profit (loss)		Fair value 30.9.2007 4.013	Profit (loss)	
	+10%	+5%		-5%	-10%
Exchange rates	4.4143	4.21365	4.013	3.81235	3.6117
	In thousands of NIS				
Long-term dollar loans	(180,562)	(90,281)	(1,805,616)	90,281	180,562
Long-term dollar debentures	(2,352)	(1,176)	(23,521)	1,176	2,352
Interest SWAP transactions	531	266	5,314	(266)	(531)
Future contracts	(1,034)	(517)	(10,344)	517	1,034
SWAP hedging	2,760	1,380	27,602	(1,380)	(2,760)
Inventory	191,735	95,868	1,917,354	(95,868)	(191,735)
Trade accounts receivable	67,408	33,704	674,078	(33,704)	(67,408)
Trade accounts payable	(138,130)	(69,065)	(1,381,301)	69,065	138,130
Dollar-linked securities portfolio	2,750	1,375	27,498	(1,375)	(2,750)
	<u>(56,894)</u>	<u>(28,447)</u>	<u>(568,936)</u>	<u>28,447</u>	<u>56,894</u>

**6.2.2 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 30.9.2007	Profit (loss)	
	+10%	+5%		-5%	-10%
	In thousands of NIS				
Long-term dollar loans	(32)	(16)	(1,805,616)	16	33
Long-term dollar debentures	4	2	(23,521)	(2)	(4)
Interest IRS transactions	1,248	625	5,314	(627)	(1,255)
SWAP hedging	(70)	(35)	27,602	35	70
Dollar-linked securities portfolio	(837)	(419)	27,498	419	837
	<u>313</u>	<u>157</u>	<u>(1,768,723)</u>	<u>(159)</u>	<u>(319)</u>

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

	Profit (loss)		Fair value 30.9.2007	Profit (loss)	
	+10%	+5%		-5%	-10%
	In thousands of NIS				
Future contracts	(46,802)	(23,401)	(10,344)	23,401	46,802
SWAP hedging	(22,420)	(11,210)	27,602	11,210	22,420
Inventory	191,735	95,868	1,917,354	(95,868)	(191,735)
	<u>122,514</u>	<u>61,257</u>	<u>1,934,612</u>	<u>(61,257)</u>	<u>(122,514)</u>

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

	Profit (loss)		Fair value 30.9.2007	Profit (loss)	
	+10%	+5%		-5%	-10%
	In thousands of NIS				
ICPI-linked securities portfolio	(3,488)	(1,744)	210,522	1,744	3,488
ICPI-linked long-term shekel debentures	7,882	3,959	(891,718)	(3,995)	(8,028)
	<u>4,394</u>	<u>2,215</u>	<u>(681,196)</u>	<u>(2,251)</u>	<u>(4,540)</u>

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

Shekel securities portfolio	Profit (loss)		Fair value 30.9.2007	Profit (loss)	
	+10%	+5%		-5%	-10%
	In thousands of NIS				
	<u>(2,135)</u>	<u>(1,067)</u>	<u>191,037</u>	<u>1,067</u>	<u>2,135</u>

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

	Profit (loss)		Fair value 30.9.2007	Profit (loss)	
	+10%	+5%		-5%	-10%
	In thousands of NIS				
Long-term dollar loans	4,734	2,369	(1,805,616)	(2,374)	(4,752)
Long-term dollar debentures	74	37	(23,521)	(37)	(74)
Long-term shekel debentures	2,746	1,375	(891,718)	(1,379)	(2,763)
Interest IRS transactions	(3)	(2)	5,314	2	3
	<u>7,550</u>	<u>3,780</u>	<u>(2,715,540)</u>	<u>(3,789)</u>	<u>(7,586)</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 September 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	15,660	7,830	7,830	(15,660)
Trade accounts receivable – euro	4,805	2,402	(2,402)	(4,805)
Trade accounts receivable – sterling	1,940	970	970	(1,940)
Trade accounts payable – dollar	(8,234)	(4,117)	4,117	8,234
Long-term loans – dollar	(44,486)	(22,243)	22,243	44,486
Long-term loans – euro	(17,382)	(8,691)	8,691	17,382
Hedging transactions – dollar	74,900	37,450	37,450	(74,900)
Hedging transactions – euro	12,088	6,044	(6,044)	(12,088)
Hedging transactions – sterling	5,184	2,592	(2,592)	(5,184)

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

Change in interest rate	Profit (loss)		Fair value 30.9.2007	Profit (loss)	
	+10%	+5%		-5%	-10%
	In thousands of NIS				
Long-term dollar loans	2,853	1,431	446,743	(1,441)	(2,890)
Long-term euro loans	1,734	873	174,101	(881)	(1,770)

**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 30.9.2007	Profit (loss)	
	+10%	+5%		-5%	-10%
	In thousands of NIS				
ICPI-linked long-term shekel debentures	15,760	7,980	(421,672)	(8,319)	(16,580)

### 6.3 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 1.13 billion.

The maximum holding of derivatives for currency in the reporting period, of the total purchase positions was NIS 987 million and of the total sale positions was NIS 1,006 million.

### 6.4 Consolidated Linkage Bases

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

	<b>Index-linked</b>	<b>Foreign currency- linked (*)</b>	<b>Unlinked</b>	<b>Non- monetary</b>	<b>Total</b>
<b><u>Assets</u></b>					
Cash	-	57,197	21,149	-	78,346
Trade and other accounts receivable and debit balances	12,975	976,519	897,567	146,550	2,033,611
Inventory of fuel products	-	1,998,523	981,576	257,806	3,237,905
Affiliated companies	-	-	-	169,847	169,847
Deposits and loans(**)	-	-	55,132	-	55,132
Loan to Haifa Early Pensions Ltd.	303,664	-	-	-	303,664
Severance pay fund, net	-	-	-	36,400	36,400
Fixed assets	-	-	-	3,852,442	3,852,442
Quoted securities	210,522	27,498	191,037	-	429,057
Other assets	-	-	-	50,892	50,892
<b>Total assets</b>	<b><u>527,161</u></b>	<b><u>3,059,737</u></b>	<b><u>2,146,461</u></b>	<b><u>4,513,937</u></b>	<b><u>10,247,296</u></b>
<b><u>Liabilities</u></b>					
Short-term credit and loans	-	(260,786)	(1,864)	-	(262,650)
Trade and other accounts payable and credit balances	(56,448)	(1,320,228)	(630,305)	-	(2,006,981)
Proposed dividend	-	-	(280,000)	-	(280,000)
Deferred taxes	-	-	-	(539,697)	(539,697)
Long-term derivative instrument	-	(4,280)	-	-	(4,280)
Authorization fees	(29,187)	-	-	-	(29,187)
Liability for employee severance pay	-	-	-	(255,722)	(255,722)
Long-term loans (**)	(1,314,004)	(2,464,532)	-	14,541	(3,763,995)
<b>Total liabilities</b>	<b><u>(1,399,639)</u></b>	<b><u>(4,049,826)</u></b>	<b><u>(912,169)</u></b>	<b><u>(780,878)</u></b>	<b><u>(7,142,512)</u></b>
<b>Net balance</b>	<b><u>(872,478)</u></b>	<b><u>(990,089)</u></b>	<b><u>1,234,292</u></b>	<b><u>3,733,059</u></b>	<b><u>3,104,784</u></b>

(\*) 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.

## **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. 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**

In July 2006, the Israel Accounting Standards Board issued Accounting Standard No. 29 pertaining to the adoption of International Financial Reporting Standards (hereinafter – "IFRS"), see Note 2C1 of the financial statements. The Company has no intention of implementing early adoption of IFRS.

As part of the board of directors report as of June 30, 2007, the Company presented the estimated material financial impact of the transition to reporting under IFRS on the Company's balance sheets as of January 1, 2007 (the transition date) and as of June 30, 2007, and on the income statement for the six month period ended June 30, 2007, together with explanations for those consequences, on the basis of the Company's assessments as of those dates and subject to changes that may derive from the continued process of gathering information and adjustments to IFRS.

During the quarter ended September 30, 2007, no material changes or innovations occurred in connection with the transition to the adoption of IFRS and to the expected impact on the Company.

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

According to the work procedures of the Company's board of directors, as set down on August 15, 2007, the board of directors appointed an audit and balance sheet committee and instructed it, among its other duties, to discuss and make recommendations to the board in connection with the approval of the financial statements. Among the members of the audit committee are Mr. Avisar Paz and Mrs. Daphne Schwartz, the directors having accounting and financial expertise, as well as other directors.

The audit committee discusses the financial statements at its meeting at which senior officers of the Company and the external auditor of the Company are in attendance. The committee hears a detailed presentation made by the senior officers and others at the Company, including the CEO and the VP – Finance. The presentation includes the material issues contained in the financial reports, including material transactions not conducted in the normal

course of business (if any), the significant assessments and critical estimates applied in the financial statements, the accounting policy applied and changes thereto (if any), and the implementation of the fair disclosure principle in the financial statements and accompanying information. The committee assesses the various aspects of the control and risk management of the Company, both those reflected in the financial statements (e.g., the report on financial risks) and those that impact on the reliability of the financial statements. The opinion of the external auditor is also heard at the meeting.

Following receipt of the recommendation of the audit committee regarding the financial statements, the board of directors investigates the material issues included in the financial statements, including material transactions not conducted in the normal course of business (if any), the significant assessments and critical estimates applied in the financial statements, the accounting policy applied and changes thereto (if any), and the implementation of the fair disclosure principle in the financial statements and accompanying information. The board of directors assesses the various aspects of the control and risk management of the Company, both those reflected in the financial statements (e.g., the report on financial risks) and those that impact on the reliability of the financial statements. The board of directors also studies the recommendations of the audit committee regarding the financial statements being discussed, hears the opinion of the external auditor, and where necessary, requests that other matters be reviewed by the board, at its discretion.

The financial statements are submitted to the members of the audit committee and the board of directors a few days prior to the meetings at which they are discussed for purposes of approval.

During the course of the deliberations of the board of directors, questions are raised by the members of the board on various issues, including issues that arose during the audit. The goal of the entire process is to ensure that the financial statements faithfully present the financial position of the Company. The questions and issues raised are addressed when necessary by both Company Management through the CEO or the VP – Finance and by the external auditor of the Company. Following a discussion period, the chairman of the board calls for a vote on the approval of the financial statements after he ensures that members of the board have no more questions or issues that were not answered.

## **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 and the recommendations regarding implementation thereof as submitted to the Company by Adv. Dr. Yoram Danziger.

## **11. Meetings of the board of directors**

During the reporting period, 16 meetings of the board of directors were held, and 13 meetings were held of committees of the board of directors.

## **12. Salaries of senior officers and the considerations on which the board of directors bases such salaries**

As long as the Company was a government corporation (until February 21, 2007), the salaries of senior officers were in accordance with the guidelines of the Government Companies Authority and were approved by the board of directors of the Company.

In determining the current salaries of senior officers, as well as bonuses paid to them, the Company takes into consideration achievements in the areas of business and finance, degree of responsibility, specific contribution, and compliance with targets and work plans.

## **13. Subsequent events**

During and after the reporting period, the Company decided to allot options to the chairman of the board of directors, the C.E.O., and to nine additional senior officers. For more details, see Notes 4D and 8E of the financial statements.

---

Yossi Rosen  
Chairman of the Board

---

Yashar Ben Mordechai  
C.E.O.

November 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 Nine and Three-month Periods ended September 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 September 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 nine 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 September 30, 2007 constitute approximately 11% of total consolidated assets and whose revenues included in the condensed consolidated statement of income for the nine and three month periods ended September 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 nine and three-month periods ended September 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 nine and three month periods ended September 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.

Head Office:  
Levinstein Tower  
23 Menachem Begin Rd.  
Tel-Aviv 66184  
PO Box 36172, Tel-Aviv 61361  
Israel

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, November 19, 2007

Head Office:  
Levinstein Tower  
23 Menachem Begin Rd.  
Tel-Aviv 66184  
PO Box 36172, Tel-Aviv 61361  
Israel

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

	<b>September 30,</b>	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>	
	<b>Unaudited</b>	<b>Audited</b>	
<b>Current assets</b>			
Cash and cash equivalents	78,346	2,098,848	523,570
Trade accounts receivable	1,591,932	2,051,003	2,175,459
Accounts receivable and debit balances	444,256	372,912	454,701
Inventory	<u>3,237,905</u>	<u>2,864,922<sup>(*)</sup></u>	<u>2,813,392<sup>(*)</sup></u>
	<u>5,352,439</u>	<u>7,387,685</u>	<u>5,967,122</u>
<b>Long-term investments and loans</b>			
Investee companies	169,847	181,075	191,002
Loan to Haifa Early Pensions Ltd.	303,664	-	-
Long-term loans and debit balances	52,555	10,991	7,409
Excess of funded amounts over the liability for severance pay, net	<u>36,400</u>	<u>40,807</u>	<u>45,458</u>
	<u>562,466</u>	<u>232,873</u>	<u>243,869</u>
<b>Fixed assets</b>			
Property, plant and equipment	3,682,683	3,658,521	3,701,744
Materials and spare parts	169,759	116,613 <sup>(*)</sup>	125,301 <sup>(*)</sup>
Fund for investment in fixed assets	<u>429,057</u>	<u>408,376</u>	<u>414,749</u>
	<u>4,281,499</u>	<u>4,183,510</u>	<u>4,241,794</u>
<b>Other assets and deferred expenses</b>	<u>50,892</u>	<u>48,880</u>	<u>48,100</u>
	<u>10,247,296</u>	<u>11,852,948</u>	<u>10,500,885</u>

(\*) Reclassified.

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

**OIL REFINERIES LTD.**  
**CONSOLIDATED BALANCE SHEET**  
**In thousands of reported NIS**

	<b>September 30, 2007</b>	<b>2006</b>	<b>December 31, 2006</b>
	<b>Unaudited</b>		<b>Audited</b>
<b>Current liabilities</b>			
Credit from banking institutions and other credit providers	1,118,226	1,100,904	899,142
Suppliers and service providers	1,500,022	1,448,144	2,214,883
Accounts payable and credit balances	508,477	1,537,001	785,309
Proposed dividend	280,000	16,535	20,000
	<u>3,406,725</u>	<u>4,102,584</u>	<u>3,919,334</u>
<b>Long-term liabilities</b>			
Debentures	974,246	890,021	854,799
Loans and liabilities	1,934,173	725,783	2,205,647
Long-term derivative instrument	4,280	-	-
Deferred taxes	539,697	489,152	498,352
Liability in respect of financing lease	29,187	29,303	29,275
Liability for employee termination benefits, net	254,204	283,182	278,801
	<u>3,735,787</u>	<u>2,417,441</u>	<u>3,866,874</u>
<b>Total liabilities</b>	<u>7,142,512</u>	<u>6,520,025</u>	<u>7,786,208</u>
<b>Shareholders' equity</b>	<u>3,104,784</u>	<u>5,332,923</u>	<u>2,714,677</u>
	<u>10,247,296</u>	<u>11,852,948</u>	<u>10,500,885</u>

\_\_\_\_\_  
**Yossi Rosen**  
Chairman of the Board

\_\_\_\_\_  
**Yashar Ben-Mordechai**  
C.E.O

\_\_\_\_\_  
**Jacob Hirsh**  
VP – Finance

Date of approval: November 19, 2007

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

**OIL REFINERIES LTD.**

**CONSOLIDATED STATEMENT OF INCOME**

**In thousands of reported NIS**

	<b>Nine month period ended September 30, 2007                      2006</b>		<b>Three month period ended September 30, 2007                      2006</b>		<b>Year ended December 31, 2006</b>
	<b>Unaudited</b>		<b>Unaudited</b>		<b>Audited</b>
Revenues	16,248,209	23,481,249	5,807,214	7,896,602	28,497,803
Cost of sales, refining and services	<u>14,999,682</u>	<u>21,941,001</u>	<u>5,468,311</u>	<u>7,551,713</u>	<u>26,764,492</u>
Gross profit	1,248,527	1,540,248	338,903	344,889	1,733,311
Selling expenses	96,965	70,245	37,020	24,211	94,702
General and administrative expenses	<u>215,121</u>	<u>192,560</u>	<u>64,789</u>	<u>60,607</u>	<u>247,345</u>
Operating income	936,441	1,277,443	237,094	260,071	1,391,264
Financing (income) expenses, net	<u>80,309</u>	<u>152,069</u>	<u>(3,266)</u>	<u>41,531</u>	<u>166,843</u>
	856,132	1,125,374	240,360	218,540	1,224,421
Gain on sale of Ashdod Oil Refinery Ltd. (*)	-	1,655,593	-	1,655,593	1,655,593
Privatization grant (see Note 4B)	(118,529)	-	-	-	-
Expenses in respect of early retirement	<u>-</u>	<u>(81,000)</u>	<u>-</u>	<u>(81,000)</u>	<u>(81,000)</u>
Income before taxes on income	737,603	2,699,967	240,360	1,793,133	2,799,014
Taxes on income	<u>204,202</u>	<u>786,136</u>	<u>64,220</u>	<u>534,558</u>	<u>828,551</u>
	533,401	1,913,831	176,140	1,258,575	1,970,463
Company's share in income (losses) of affiliated companies	<u>22,165</u>	<u>21,501</u>	<u>2,002</u>	<u>(129)</u>	<u>32,570</u>
Net income for the period	<u>555,566</u>	<u>1,935,332</u>	<u>178,142</u>	<u>1,258,446</u>	<u>2,003,033</u>
Earnings per 1 ordinary share (in NIS)	<u>0.28</u>	<u>0.97</u>	<u>0.09</u>	<u>0.63</u>	<u>1.001</u>

(\*) See Statements of Cash Flows.

**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**

**Nine month period ended September 30, 2007**

**Unaudited**

	<b>Share capital</b>	<b>Adjustments deriving from the translation of financial statements of autonomous unit</b>	<b>Capital reserve</b>	<b>Retained earnings</b>	<b>Dividend declared subsequent to balance sheet date</b>	<b>Total</b>
Balance as of January 1, 2007	919,650	(435)	-	1,795,462	-	2,714,677
Net income for the period	-	-	-	555,566	-	555,566
Share of Company in capital reserve of affiliated company	-	(310)	-	-	-	(310)
Payment of issuance costs on behalf of controlling shareholder	-	-	-	(3,879)	-	(3,879)
Options allotted to employees (see Note 4D)	-	-	201	-	-	201
Increase in share capital (see Note 4A)	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
Dividend	-	-	-	(280,000)	-	(280,000)
Balance as of September 30, 2007	<u>2,000,000</u>	<u>(745)</u>	<u>118,730</u>	<u>986,799</u>	<u>-</u>	<u>3,104,784</u>

**Nine month period ended September 30, 2006**

**Unaudited**

	<b>Share capital</b>	<b>Adjustments deriving from the translation of financial statements of autonomous unit</b>	<b>Capital reserve</b>	<b>Retained earnings</b>	<b>Dividend declared subsequent to balance sheet date</b>	<b>Total</b>
Balance as of January 1, 2006	919,650	-	-	2,489,690	702,442	4,111,782
Net income for the period	-	-	-	1,935,332	-	1,935,332
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	-	-	52	-	-	52
Translation differences	-	(435)	-	-	-	(435)
Dividend	-	-	-	-	(702,442)	(702,442)
Dividends declared subsequent to the financial statements	-	-	-	(2,700,000)	2,700,000	-
Balance as of September 30, 2006	<u>919,650</u>	<u>(435)</u>	<u>52</u>	<u>1,713,656</u>	<u>2,700,000</u>	<u>5,332,923</u>

**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 September 30, 2007**  
**Unaudited**

	<b>Share capital</b>	<b>Adjustments deriving from the translation of financial statements of autonomous unit</b>	<b>Capital reserve</b>	<b>Retained earnings</b>	<b>Dividend declared subsequent to balance sheet date</b>	<b>Total</b>
Balance as of July 1, 2007	2,000,000	(752)	118,529	808,657	280,000	3,206,434
Net income for the period	-	-	-	178,142	-	178,142
Share of Company in capital reserve of an investee company	-	7	-	-	-	7
Options allotted to employees (see Note 4D)	-	-	201	-	-	201
Dividend	-	-	-	-	(280,000)	(280,000)
Balance as of September 30, 2007	<u>2,000,000</u>	<u>(745)</u>	<u>118,730</u>	<u>986,799</u>	<u>-</u>	<u>3,104,784</u>

**Three month period ended September 30, 2006**  
**Unaudited**

	<b>Share capital</b>	<b>Adjustments deriving from the translation of financial statements of autonomous unit</b>	<b>Capital reserve</b>	<b>Retained earnings</b>	<b>Dividend declared subsequent to balance sheet date</b>	<b>Total</b>
Balance as of July 1, 2006	919,650	-	32	3,155,210	-	4,074,892
Net income for the period	-	-	-	1,258,446	-	1,258,446
Share of Company in capital reserve of affiliated company	-	-	20	-	-	20
Translation differences	-	(435)	-	-	-	(435)
Dividends declared subsequent to the financial statements	-	-	-	(2,700,000)	2,700,000	-
Balance as of September 30, 2006	<u>919,650</u>	<u>(435)</u>	<u>52</u>	<u>1,713,656</u>	<u>2,700,000</u>	<u>5,332,923</u>

**OIL REFINERIES LTD.**

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

**Year ended December 31, 2006**  
**Audited**

	<b>Share capital</b>	<b>Adjustments deriving from the translation of financial statements of autonomous unit</b>	<b>Retained earnings (*)</b>	<b>Dividend declared subsequent to balance sheet date</b>	<b>Total</b>
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>

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

**OIL REFINERIES LTD.**

**CONSOLIDATED STATEMENT OF CASH FLOWS**

In thousands of reported NIS

	Nine month period ended September 30, 2007                      2006		Three month period ended September 30, 2007                      2006		Year ended December 31, 2006
	Unaudited		Unaudited		Audited
<b>Cash flows from operating activities</b>					
Net income for the period	555,566	1,935,332	178,142	1,258,446	2,003,033
Income and expense items not constituting a flow of funds (Appendix A)	<u>200,971</u>	<u>(1,512,175)</u>	<u>19,910</u>	<u>(1,642,604)</u>	<u>(1,450,645)</u>
	756,537	423,157	198,052	(384,158)	552,388
Changes in the current assets and liabilities (Appendix B)	<u>(824,511)</u>	<u>274,563</u>	<u>95,236</u>	<u>251,758</u>	<u>119,014</u>
Cash provided by (used in) operating activities	<u>(67,974)</u>	<u>697,720</u>	<u>293,288</u>	<u>(132,400)</u>	<u>671,402</u>
<b>Cash flows from investment activities</b>					
Net proceeds from sale of Ashdod Oil Refineries Ltd. (Appendix D)	-	3,251,409	-	3,251,409	3,251,409
Repayment of long-term loans from others, net	(93)	829	(385)	591	1,235
Loan to Haifa Early Pensions Ltd.	(299,592)	-	-	-	-
Purchase of fixed assets	(280,116)	(849,471)	(55,376)	(2215,612)	(995,620)
Proceeds from realization of fixed assets	68	36	68	-	36
Investments in other assets and deferred expenses	<u>(45,273)</u>	<u>(15,939)</u>	<u>(41,496)</u>	<u>(7,078)</u>	<u>(6,112)</u>
Cash provided by (used in) investment activities	<u>(625,006)</u>	<u>2,386,864</u>	<u>(97,189)</u>	<u>3,029,310</u>	<u>2,250,948</u>
<b>Cash flows from financing activities</b>					
Repayment of short-term credit	(6,900)	(341,007)	(63,909)	(791,262)	(923,911)
Receipt (repayment) of deposits from customers – net	(78)	6,793	(2,086)	620	6,097
Dividend paid	(20,000)	(702,442)	-	-	(3,382,442)
Issuance expenses paid on behalf of a controlling shareholder	(3,879)	-	-	-	(1,126)
Issuance of debentures	425,000	-	-	-	-
Redemption of debentures	(57,524)	(16,633)	(20,440)	(16,633)	(34,442)
Receipt of long-term loans	206,430	235,547	42,457	21,252	2,140,733
Redemption of long-term loans	(413,822)	(196,631)	(122,346)	(35,936)	(232,326)
Receipt of privatization grant	<u>118,529</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Cash provided by (used in) financing activities	<u>247,756</u>	<u>(1,014,373)</u>	<u>(166,324)</u>	<u>(821,959)</u>	<u>(2,427,417)</u>
Total increase (decrease) in cash and cash equivalents	(445,224)	2,070,211	29,775	2,074,951	494,933
Balance of cash and cash equivalents at beginning of the period	<u>523,570</u>	<u>28,637</u>	<u>48,571</u>	<u>23,897</u>	<u>28,637</u>
Balance of cash and cash equivalents at end of the period	<u>78,346</u>	<u>2,098,848</u>	<u>78,346</u>	<u>2,098,848</u>	<u>523,570</u>

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

**OIL REFINERIES LTD.**

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

**Appendix A – Income and expense items not constituting a flow of funds:**

	<b>Nine month period ended September 30,</b>		<b>Three month period ended September 30,</b>		<b>Year ended December 31,</b>
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>	<b>2006</b>
	<b>Unaudited</b>		<b>Unaudited</b>		<b>Audited</b>
Gain on sale of Ashdod Oil Refineries Ltd.	-	(1,655,593)	-	(1,655,593)	(1,655,593)
Depreciation and amortization	256,586	310,047	87,998	105,418	407,771
Gain (loss) on realization of fixed assets	(21)	(35)	(21)	-	336
Decrease (increase) in the value of marketable securities	(14,308)	(11,869)	3,385	(4,762)	(18,242)
Company's share in income (losses) of investee companies	(22,165)	(21,501)	(2,002)	129	(32,570)
Dividend received from investee companies	43,011	4,630	23,011	-	5,793
Increase (decrease) in liability for employee termination benefits, net	(17,099)	83,817	(3,533)	85,361	74,180
Increase (decrease) in deferred taxes, net	42,950	(175,932)	20,889	(146,488)	(164,412)
Erosion and exchange rate variances of liabilities	(87,983)	(45,739)	(109,817)	(26,669)	(67,908)
	<u>200,971</u>	<u>(1,512,175)</u>	<u>19,910</u>	<u>(1,642,604)</u>	<u>(1,450,645)</u>

**Appendix B – Changes in current assets and current liabilities**

Decrease (increase) in trade and other accounts receivable and debit balances	585,696	(199,092)	295,421	144,830	(434,059)
Increase (decrease) in trade and other accounts payable and credit balances	(985,694)	476,142	(355,085)	(244,151)	504,761
Decrease (increase) in inventory	(424,513)	(2,487)	154,900	351,079	48,312
	<u>(824,511)</u>	<u>274,563</u>	<u>95,236</u>	<u>251,758</u>	<u>119,014</u>

**Appendix C – Material non-cash activities**

Purchase of fixed assets on supplier credit	<u>8,651</u>	<u>25,887</u>	<u>(211)</u>	<u>21,514</u>	<u>14,198</u>
Credit costs capitalized to fixed assets	<u>1,565</u>	<u>(35,380)</u>	<u>1,735</u>	<u>(18,396)</u>	<u>(40,968)</u>
Expenses in respect of sale of Ashdod Oil Refineries Ltd.	<u>-</u>	<u>118,126</u>	<u>-</u>	<u>118,126</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>

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

**OIL REFINERIES LTD.**

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

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

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

**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 45.1% and 15.8% 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.

**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 September 30, 2007 and for the nine 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. 1. Data on the Israel Consumer Price Index ("ICPI") and U.S. dollar exchange rate are presented below:

	<b>September 30,</b>		<b>June 30,</b>		<b>December 31,</b>
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>	<b>2006</b>
Representative exchange rate US\$ 1= NIS	4.013	4.302	4.249	4.44	4.225
Israeli Consumer Price Index (base index 2000)	112.41	110.86	110.97	111.71	109.90

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

	<b>Nine month period</b>		<b>Three month period</b>		<b>Year ended</b>
	<b>ended September 30,</b>		<b>ended September 30,</b>		<b>December 31,</b>
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>	<b>2006</b>
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
Representative exchange rate of US\$ 1	(5.02)	(6.54)	(5.55)	(3.11)	(8.21)
Israeli Consumer Price Index	2.28	0.78	(0.76)	(0.76)	(0.1)

## 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. 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.)

##### B. Initial implementation of accounting standards (cont.)

##### 2. Accounting Standard No. 24 – "Share-based payments"

Since January 1, 2007, the Company has been implementing Accounting Standard No. 24 – "Share-based payments" (hereinafter – the "Standard") issued in September 2005 by the Israel Accounting Standards Board.

According to the provisions of the Standard, the Company recognizes in its financial statements share-based payment transactions, including transactions with employees or other parties settled with capital instruments, cash, or other assets. Share-based payment transactions in which goods or services are received in consideration of the payment are recorded at fair value.

The Company recognizes the benefit generated upon the grant of option warrants to employees as part of payroll expenses, with a concurrent increase in shareholders' equity, on the basis of the fair value of the options on the date of the grant, using the Black & Scholes model. The benefit is spread out over the vesting period of the options on the basis of the estimate of the Company regarding the number of shares it believes will vest.

##### 3. 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.

##### 4. 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.

## OIL REFINERIES LTD.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

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

##### B. Initial implementation of accounting standards (cont.)

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

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.

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.

##### 5. 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.

## OIL REFINERIES LTD.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

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

##### B. Initial implementation of accounting standards (cont.)

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

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.

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.

## OIL REFINERIES LTD.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

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

##### C. 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.

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.

###### 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.

## OIL REFINERIES LTD.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

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

##### C. 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.)

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).
- 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 intends on implementing IFRS commencing with the financial statements for the period starting on January 1, 2008.

#### 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 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.

## OIL REFINERIES LTD.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

#### 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 received from the State amounted to NIS 119 million (NIS 97 million for ORL and NIS 22 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). 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).

- C. During the reporting period, the board of directors of the Company approved an investment of \$50 million to upgrade its large crude oil refining facility, in order to expand the variety of the types of crude oil that can be refined in the facility. Completion of the upgrade is expected in the first half of 2009. Following completion of the project, the Company will be able to refine types of heavy crude oil during periods in which their refining margin is higher, and focus on the refining of types of crude oil having medium to low density, when the refining margin of such crudes is higher, being able to make the transition from one type of crude oil to another without the need to shut down the facility with a resultant loss of work days. This increase in flexibility will improve the utilization rate of the facility.

In addition, the board of directors of the Company approved an investment of \$61 million, mostly related to environmental issues, including among other things, infrastructure and preparation for the absorption of natural gas and a system for the reduction of nitrogen oxide emissions.

Further to the decision of the board of directors of the Company to invest in examining alternatives for the increase in the cracking capability of the Company's facilities (an investment that will permit for the full utilization of the surplus HVGO (heavy vacuum gas oil) and an improvement in flexibility and profitability), the Company expects to examine these alternatives and recommend investments in this area to the board of directors if it finds them to be economically feasible. The Company estimates that the time needed to implement the selected alternative will be three to three and a half years.

The Minister of Environmental Quality notified the Company that the personal order will be revised so that, among other things, the Company will use only gas fuel (instead of fuel oil which it currently uses and which was taken into consideration in the current personal order). Further to the notification of the Minister, the Company has been taking steps to implement the personal order through an option of purchasing natural gas as described above. As of the date of this report, the personal order has not yet been revised.

- D. On September 23, 2007, the general shareholders meeting of the Company approved the terms of employment of the chairman of the board of the Company, as follows:

1. His monthly salary will be NIS 75 thousand, commencing on July 1, 2007;
2. The fringe benefits will be the accepted benefits granted to senior executives of the Company, including the payment of an education fund and social benefits, vacation, recreation pay, and telephone expense reimbursement;
3. The Company will provide the chairman with a car that is suitable to his position with the Company and a driver;
4. The agreement with the chairman of the board will be for a fixed period of three years. If the chairman requests to terminate his tenure, he will have to give advance notice of six months;
5. The chairman of the board will be entitled to engage in other endeavors that are not part of his position at the Company (including paid positions), on condition that the amount of time that he devotes to his position at the Company is not less than a 2/3 position.

## OIL REFINERIES LTD.

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

#### NOTE 4 – MAJOR EVENTS DURING THE REPORTED PERIOD (cont.)

- E. On September 5, 2007, as part of the approval of a general option plan to officers and senior employees of the Company, the board of directors approved the allotment of 9,000,000 option warrants to a trustee on behalf of the chairman of the board of directors and the CEO of the Company (4.5 million options each).

In addition, at the same time, the board of directors approved an option plan for the future allotment of 21,000,000 additional option warrants to officers and employees who are not officers of the Company. The identity of the recipients and the terms under which the option warrants will be granted, if any such options are granted to them, will be determined by the remunerations committee of the board of directors, the board of directors and the audit committee of the Company (to the extent that the matter is necessary in connection with the officers), subject to the approval of the option plan by the tax authority.

On September 23, 2007, the general shareholders meeting approved the allotment of the options to the chairman of the board.

The securities being offered are non-negotiable option warrants, each one of which entitles the offeree to purchase one ordinary share of the Company, par value NIS 1 each. The options will be allotted under a capital track (with a trustee) pursuant to article 102 of the Israel Income Tax Ordinance. The exercised shares will be registered for trade on the Tel Aviv Stock Exchange and, commencing on the date of the allotment, the shares will be equal in all rights to the existing ordinary par value NIS 1 shares of the Company.

The exercise price of the option warrants is NIS 3.25, which is the average price of the shares of the Company during the 30-day period ending on the day prior to the date of approval by the board of directors of the allotment of the aforementioned option warrants to the offerees (September 4, 2007). The date on which the board of directors approved the allotment, September 5, 2007, shall be referred to as the "effective date". The exercise price is subject to adjustments as described below.

The option warrants vest over the three-year period following the effective date, in three equal portions, at the end of each of the three years. Options vesting as above will be exercisable commencing one year after the end of the vesting period, for a period of one year.

In addition, rules were set down for termination of service or employment of the offerees and provisions were set down for the protection of the offerees. On the date of exercise of the options, the offerees will be entitled to a quantity of shares to be determined on the basis of the value of the offer.

The economic value of each option as calculated by the Black & Scholes model amounted to NIS 0.7 for the first portion, NIS 0.8 for the second portion and NIS 1 for the third portion, on each of the days.

The cost of the inherent benefit of the options granted as above, based on the fair value on the grant date, for the first portion, second portion and third portion amounted to NIS 2.1 million, NIS 3.5 million, and NIS 2.8 million, respectively. These amounts will be carried to the income statement over the vesting period of each portion.

**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 nine month period ended September 30, 2007 in thousands of NIS (unaudited):**

	<b>Refining</b>	<b>Polymers</b>	<b>Aromatic Materials</b>	<b>Adjustments</b>	<b>Consolidated</b>
Segment revenues	<u>14,554,815</u>	<u>970,711</u>	<u>1,615,214</u>	<u>(892,531)</u>	<u>16,248,209</u>
Results of segment operational income	<u>751,207</u>	<u>99,954</u>	<u>85,689</u>	<u>(409)</u>	<u>936,441</u>

**For the nine month period ended September 30, 2006 in thousands of NIS (unaudited):**

**Pro forma**

	<b>Refining</b>	<b>Polymers</b>	<b>Aromatic Materials</b>	<b>Adjustments</b>	<b>Consolidated</b>
Segment revenues	<u>15,012,912</u>	<u>715,139</u>	<u>1,386,234</u>	<u>(408,440)</u>	<u>16,705,845</u>
Results of segment operational income	<u>667,929</u>	<u>28,626</u>	<u>23,560</u>	<u>(382)</u>	<u>719,733</u>

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

	<b>Refining</b>	<b>Polymers</b>	<b>Aromatic Materials</b>	<b>Adjustments</b>	<b>Consolidated</b>
Segment revenues	<u>5,132,584</u>	<u>346,362</u>	<u>589,357</u>	<u>(261,089)</u>	<u>5,807,214</u>
Results of segment operational income (loss)	<u>179,690</u>	<u>36,391</u>	<u>21,116</u>	<u>(103)</u>	<u>237,094</u>

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

**Pro forma**

	<b>Refining</b>	<b>Polymers</b>	<b>Aromatic Materials</b>	<b>Adjustments</b>	<b>Consolidated</b>
Segment revenues	<u>4,984,634</u>	<u>177,448</u>	<u>418,867</u>	<u>(128,341)</u>	<u>5,452,608</u>
Results of segment operational income (loss)	<u>86,823</u>	<u>(19,097)</u>	<u>(11,806)</u>	<u>(38)</u>	<u>55,882</u>

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

**Pro-forma**

	<b>Refining</b>	<b>Polymers</b>	<b>Aromatic Materials</b>	<b>Adjustments</b>	<b>Consolidated</b>
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>

## OIL REFINERIES LTD.

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

#### NOTE 6 – SIGNIFICANT 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 twice 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. As of the date of the report, the Company and the rest of the defendants were asked to respond to the last request of the plaintiff on this matter.

##### 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.

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. During the reporting period, the Court, with the consent of the parties, rejected the claims of 19 of the plaintiffs in these suits and an additional suit – similar in nature – was filed by 17 additional plaintiffs. The bridging process on the suits of the soldiers, initiated by the President of the Haifa District Court, was unsuccessful and the adjudication of the suit is expected to continue in a normal manner.

##### 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. Subsequent to the reporting period, the parties submitted to the court a petition to approve a compromise arrangement which was reached by the parties. The process of approving a compromise in a class action suit is subject to the Class Action Suit Law - 2006.

##### 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.

## **OIL REFINERIES LTD.**

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

#### **NOTE 6 – DEVELOPMENTS IN CONTINGENT LIABILITIES (cont.)**

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.

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 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 September 30, 2007.

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. As of the date of the report, the parties are involved in a bridging process.

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. In connection with the granting of approval for the transfer of ownership of the Ashdod oil refinery, the Company received demands from the Ashdod Municipality to pay various fees and development levies in an amount of NIS 78 million and a betterment tax of NIS 19 million. The Company filed an appeal, an administrative appeal, and another assessment in respect of the aforementioned demands.

## **OIL REFINERIES LTD.**

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

#### **NOTE 6 – DEVELOPMENTS IN CONTINGENT LIABILITIES (cont.)**

7. 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. Subsequent to the reporting period, the appeal was partially accepted, whereby Carmel was convicted of the crimes attributed to it in the charge sheet and the case was returned to the Magistrates Court for sentencing. The acquittal of the senior officers was sustained.
8. A suit was filed against Carmel by a former major customer, as described in Note 16(6) of the financial statements as of December 31, 2006. On July 23, 2007, a preliminary hearing on the case was held. According to the recommendation of the court, the suit against Carmel was erased. However, the court allowed the customer to file a new financial suit against Carmel, with the approval of the Liquidation Court. On November 7, 2007, a suit was filed against Carmel in an amount of NIS 49 million.
9. Regarding the Personal Order pursuant to the provisions of the Law for the Prevention of Nuisances – 1961, there are a number of provisions of the Personal Order which pertain primarily to the dates of submission of various plans with which the Company is still not in compliance. These discrepancies derive mainly from the Personal Order that has still not yet been updated to reflect a situation in which the oil refinery will run on natural gas, something which is expected to occur at the beginning of 2009, while the plans requested by the Order that was issued in 2006 were designed to run on fuel oil. The Company has been taking steps with the authorities to update the demands of the Order and, the Company does not expect there to be any material consequences as a result thereof, that have not been set out in the financial statements.

The companies usually set up provisions in their accounting records for litigation which, in the opinion of their managements, based on their legal counsels, have good chances of being realized. The provision is based on the estimated amounts to be paid in the settlement of the liability. The uncovered exposure in respect of which there is no provision amounts to NIS 400 thousand (excluding claims presented in the financial statements as of December 31, 2006 in subparagraphs 17B(1), 17B(2)a, b, c, e and 17B(3)).

#### **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.

## OIL REFINERIES LTD.

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

#### NOTE 7 – PRO FORMA DATA (cont.)

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.

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.

## **OIL REFINERIES LTD.**

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

#### **NOTE 7 – PRO FORMA DATA (cont.)**

##### **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 periods 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**

	<b>September 30, 2007 Actual Unaudited</b>	<b>December 31, 2006 Pro forma Audited</b>
<b>Current assets</b>		
Cash and cash equivalents	78,346	141,570
Trade accounts receivable	1,591,932	1,604,299
Accounts receivable and debit balances	444,256	454,701
Inventory	3,237,905	2,760,546 <sup>(*)</sup>
	<u>5,352,439</u>	<u>4,961,116</u>
<b>Long-term investments and loans</b>		
Investee companies	169,847	191,002
Loan to Haifa Early Pensions Ltd.	303,664	300,000
Long-term loans and other debit balances	52,555	7,409
Excess of funded amounts over the liability for employee termination benefits, net	36,400	45,458
	<u>562,466</u>	<u>543,869</u>
<b>Fixed assets</b>		
Property, plant and equipment	3,682,683	3,701,744
Materials and spare parts	169,759	178,147 <sup>(*)</sup>
Fund for investment in fixed assets	429,057	414,749
	<u>4,281,499</u>	<u>4,294,640</u>
<b>Other assets and deferred expenses</b>		
	50,892	48,100
	<u>10,247,296</u>	<u>9,847,725</u>
<b>Current liabilities</b>		
Credit from banking institutions and other credit providers	1,118,226	899,142
Suppliers and service providers	1,500,022	1,561,723
Accounts payable and credit balances	508,477	785,309
Proposed dividend	280,000	20,000
	<u>3,406,725</u>	<u>3,266,174</u>
<b>Long-term liabilities</b>		
Debentures	974,246	854,799
Loans and liabilities	1,934,173	2,205,647
Long-term derivative instrument	4,280	-
Deferred taxes	539,697	498,352
Liability in respect of financing lease	29,187	29,275
Liability for employee termination benefits, net	254,204	278,801
	<u>3,735,787</u>	<u>3,866,874</u>
<b>Total liabilities</b>	<u>7,142,512</u>	<u>7,133,048</u>
<b>Shareholders' equity</b>	<u>3,104,784</u>	<u>2,714,677</u>
	<u>10,247,296</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 statement of income**

	Appendix	Nine month period ended September 30,		Three month period ended September 30,		Year ended
		2007	2006	2007	2006	December 31,
		Actual	Pro forma	Actual	Pro forma	2006
		Unaudited		Unaudited		Pro forma
						Audited
Revenues	(1)	16,248,209	16,705,845	5,807,214	5,452,608	21,734,553
Cost of sales, refining and services	(2)	<u>14,999,682</u>	<u>15,748,614</u>	<u>5,468,311</u>	<u>5,320,488</u>	<u>20,584,260</u>
Gross profit		1,248,527	957,231	338,903	132,120	1,150,293
Selling expenses	(3)	96,965	70,245	37,020	23,624	94,634
General and administrative expenses	(4)	<u>215,121</u>	<u>167,253</u>	<u>64,789</u>	<u>52,614</u>	<u>222,104</u>
Operating income		936,441	719,733	237,094	55,882	833,555
Financing (income) expenses, net	(5)	<u>80,309</u>	<u>91,814</u>	<u>(3,266)</u>	<u>23,333</u>	<u>106,589</u>
		856,132	627,919	240,360	32,549	726,966
Privatization grant		<u>(118,529)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Income before taxes on income		737,603	627,919	240,360	32,549	726,966
Taxes on income		<u>204,202</u>	<u>180,564</u>	<u>64,220</u>	<u>8,491</u>	<u>221,539</u>
		533,401	447,355	176,140	24,058	505,427
Company's share in income (losses) of affiliated companies		<u>22,165</u>	<u>21,501</u>	<u>2,002</u>	<u>(129)</u>	<u>32,570</u>
Net income for the period		<u><u>555,566</u></u>	<u><u>468,856</u></u>	<u><u>178,142</u></u>	<u><u>23,929</u></u>	<u><u>537,997</u></u>
Earnings per share, par value NIS 1 each (in NIS)		<u>0.29</u>	<u>0.23</u>	<u>0.10</u>	<u>0.01</u>	<u>0.27</u>

**OIL REFINERIES LTD.**

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

**NOTE 7 – PRO FORMA DATA (cont.)**

**Appendix 1 – Revenues:**

	Nine month period ended September 30,		Three month period ended September 30,		Year ended
	2007	2006	2007	2006	December 31,
	Actual	Pro forma	Actual	Pro forma	2006
	Unaudited		Unaudited		Pro forma
					Audited
Domestic market	10,173,836	11,750,832*	3,740,581	4,076,719*	14,970,902*
Export	<u>5,995,980</u>	<u>4,850,620</u>	<u>2,033,109</u>	<u>1,332,492</u>	<u>6,624,135</u>
	16,169,816	16,601,452	5,773,690	5,409,211	21,595,037
Services provided to outsiders and other income	<u>78,393</u>	<u>104,393*</u>	<u>33,524</u>	<u>43,397*</u>	<u>139,516*</u>
	<u>16,248,209</u>	<u>16,705,845</u>	<u>5,807,214</u>	<u>5,452,608</u>	<u>21,734,553</u>

(\*) Reclassified.

**Appendix 2 – Cost of sales, refining and services**

	Nine month period ended September 30,		Three month period ended September 30,		Year ended
	2007	2006	2007	2006	December 31,
	Actual	Pro forma	Actual	Pro forma	2006
	Unaudited		Unaudited		Pro forma
					Audited
Consumed material	14,194,243	14,927,964	5,228,199	4,810,014	19,070,866
Salary and related expenses	222,219	202,495	77,778	71,760	258,700
Maintenance of facilities, buildings and equipment (1)	133,981	140,613*	50,632	61,978*	179,221*
Depreciation and amortization	238,445	239,124*	80,597	81,719*	331,526*
Others	323,141	254,970	112,963	78,624	386,023
Decrease (increase) in product inventory	<u>(112,347)</u>	<u>(16,552)</u>	<u>(81,858)</u>	<u>216,393</u>	<u>357,924</u>
	<u>14,999,682</u>	<u>15,748,614</u>	<u>5,468,311</u>	<u>5,320,488</u>	<u>20,584,260</u>
(1) Including salaries and related expenses	<u>33,330</u>	<u>29,485</u>	<u>11,476</u>	<u>11,318</u>	<u>38,549</u>

(\*) Reclassified.

**OIL REFINERIES LTD.**

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

**NOTE 7 – PRO FORMA DATA (cont.)**

**Appendix 3 – Selling expenses**

	Nine month period ended September 30, 2007		Three month period ended September 30, 2007		Year ended December 31, 2006
	Actual Unaudited	Pro forma Unaudited	Actual Unaudited	Pro forma Unaudited	Pro forma Audited
Salary and related expenses	8,670	7,258	2,941	2,162	10,814
Shipping and storage	77,150	52,862	29,979	17,826	70,255
Others	11,145	10,125	4,100	3,636	13,565
	<u>96,965</u>	<u>70,245</u>	<u>37,020</u>	<u>23,624</u>	<u>94,634</u>

**Appendix 4 – General and administrative and expenses**

	Nine month period ended September 30, 2007		Three month period ended September 30, 2007		Year ended December 31, 2006
	Actual Unaudited	Pro forma Unaudited	Actual Unaudited	Pro forma Unaudited	Pro forma Audited
Salary and related expenses	78,150	73,541	30,321	25,667	96,993
Insurance, taxes and levies	88,365	49,956	18,561	15,707	67,301
Depreciation	5,097	6,043	1,761	1,958	8,034
Others	43,509	37,713	14,146	9,282	49,776
	<u>215,121</u>	<u>167,253</u>	<u>64,789</u>	<u>52,614</u>	<u>222,104</u>

**Appendix 5 – Financing expenses, net**

	Nine month period ended September 30, 2007		Three month period ended September 30, 2007		Year ended December 31, 2006
	Actual Unaudited	Pro forma Unaudited	Actual Unaudited	Pro forma Unaudited	Pro forma Audited
Long-term loans and debentures received	79,896	43,303*	(49,508)	7,488*	43,333*
Long-term loans granted	(152)	(269)	(45)	(93)	(239)
Short-term loans and advances from customers	4,024	68,064*	3,308	18,899*	99,308*
Gains on marketable securities	(13,945)	(11,665)	3,596	(4,725)*	(17,965)*
Other items, net	10,486	(7,619)*	39,383	1,764*	(17,848)*
	<u>80,309</u>	<u>91,814</u>	<u>(3,266)</u>	<u>23,333</u>	<u>106,589</u>

(\*) Reclassified.

## OIL REFINERIES LTD.

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

#### NOTE 8 – SUBSEQUENT EVENTS

- A. In October 2007, the Company paid a dividend of NIS 280 million.
- B. On October 25, 2007, the Company submitted a draft prospectus to the Israel Securities Authority on the basis of the Company's financial statements as of June 30, 2007, whereby the Company requested to issue a number of series of debentures. The terms of the issue have not yet been determined, including the volume and timing of the issue and there is no certainty that the course of action as described will actually take place.
- C. On November 1, 2007, Carmel signed a letter of intent with a European company (the "European Company") in connection with the possible purchase of the shares of the European Company in a petrochemical company and in connection with the entrance into a joint €20 million project in return for 49% of the share of the petrochemical company, subject to a mechanism that may grant the European company additional consideration on the basis of the mechanism set out in the letter of intent. A binding agreement for the purchase of the shares in the petrochemical company, to the extent that one will be signed, will contain representations, commitments, and indemnifications that are common to transactions of this type.

According to the letter of intent, Carmel will have a Call option, exercisable commencing on the date of the consummation of the transaction, until December 31, 2016, for the purchase of 51% of the shares of the petrochemical company held by the European Company, for an amount of €10 million (plus interest at a rate of 5% per annum commencing from the date of the consummation of the transaction until the date of the actual payment, less the dividends to be distributed to the European Company); the European Company will have a Put options, exercisable commencing on July 1, 2011 until December 31, 2016, for the sale of 51% of the shares of the petrochemical company held by the European Company, for an amount of €10 million (plus interest at a rate of 5% per annum commencing from the date of the consummation of the transaction until the date of the actual payment, less the dividends to be distributed to the European Company).

The letter of intent contained a "no shop" clause whereby until December 31, 2007, the European Company is not allowed to negotiate and/or make contact with any other party (either directly or indirectly) in connection with the sale of the shares in the petrochemical company, except with Carmel, unless the letter of intent is cancelled in accordance with the terms contained therein. Except in connection with a number of issues (the "no shop" clause, the confidentiality clause and the clause pertaining to jurisdiction), the letter of intent is not legally binding.

- D. On November 6, 2007, the board of directors of the Company passed a strategic plan designed to achieve rapid growth and an increase in the competitive capability of the Company in the coming years, with a massive investment of approximately \$1.1 billion in increasing the share of high added value products in the Company's product mix as well as in the areas of environmental quality, safety and security and in enhancing operational reliability.

The strategic plan will be implemented through an investment plan according to the following blueprint:

- Accelerated investments in the area of refining which is the core business of the Company, mainly in increasing the complexity and efficiency of the Haifa Oil Refinery and in tangential areas, at an estimated amount of \$850 million, of which an amount of \$600 million is in respect of the expansion of the cracking capability of fuel products having a high added value, as well as identifying business opportunities outside of Israel;
- Expansion of the Company's petrochemical activity, by focusing on high added value products in Israel and abroad;
- Expansion of the commercial and logistics activity of oil products;
- Investments of approximately \$270 million in the areas of environmental quality, safety and security and enhancing operational reliability.

The board of directors of the Company decided to update the organizational structure of the Company so as to be in line with and in support of the new strategic plan, with a breakdown into three segments – refining, trade and petrochemicals.

The board of directors instructed Company Management to formulate plans and projects as part of the aforementioned strategic plan and to present them to the board for approval once they have been formulated, including the manner in which each is to be financed.

## OIL REFINERIES LTD.

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

#### NOTE 8 – SUBSEQUENT EVENTS (cont.)

##### D. (cont.)

As part of the implementation of the strategic plan, the board approved investments in the fields of refining, environmental quality and safety, as follows:

- An investment of \$79 million in a project for the increase in the quantity of diesel fuel produced in the Haifa refinery. The interim phase of the project is expected to end at the beginning of 2009 and the entire project is expected to be completed in the middle of 2010.
- An investment of \$37 million in a preliminary project for the setting up of a hydrogen cracking facility at the Haifa refinery which, if approved in its entirety, is expected to be operational during the course of 2011. This will allow for progress in advance of the construction of the facility. The Company expects to decide on the construction of the entire facility by the summer of 2008.

- E. On November 6, 2007, the board of directors approved an allotment of an additional 10.95 million options out of the option plan it approved on September 5, 2007 to 9 senior officers of the Company.

For information on the terms of the securities offered, see Note 4D.

The exercise price of the options is NIS 3.174 per unit. The economic value of the options as calculated by the Black & Scholes model is an average of NIS 0.9 for all of the portions.

The cost of the inherent benefit of the options granted as above, based on the fair value on the grant date, included in the three portions is NIS 9.8 million.

- F. On November 8, 2007, the annual shareholders meeting of the Company took place. The following resolutions were passed at the meeting: to reappoint all of the current directors of the Company, in addition to the external directors serving at the Company; to expand the directors and senior officers indemnification insurance so as to include coverage for the recruitment of capital through a prospectus for the issuance of debentures expected to be released in the current quarter; to approve the granting of a commitment in advance in respect of indemnification of directors and senior officers; to approve the granting in advance of a release from liability to directors and senior officers of the Company in respect of damages incurred as a result of a breach of their fiduciary responsibility toward the Company, subject to the provisions of the Companies Law. In addition, the general shareholders meeting was also presented with the financial statements, board of directors report, and the periodic report of the Company for 2006.

##### G. TMA Project

On September 25, 2007, Gadiv signed a memorandum of understanding (hereinafter – the “Memorandum”) for the purchase of 50% of the registered capital of a Chinese company (hereinafter – the “acquired company”) which benefits from the status of a Wholly Foreign Owned Enterprise (“WFOE”) in China. The acquired company will engage in the manufacturing of Tri-Maleic Anhydride (“TMA”), a product that is used mainly as a softener in the polymer industry and as a component in powder colors, and Para Diethyl Benzene (PDEB), a product used mainly in the manufacturing of Paraaxylene.

The shares of the acquired company will be purchased by Gadiv from a foreign company registered in Hong Kong, which is not a related party to either Gadiv or the controlling shareholders of Gadiv (hereinafter – the “Seller”), and which is the owner of all of the issued share capital of the acquired company.

According to the memorandum, a company under the control of the Seller will transfer to the ownership of the acquired company, without consideration, an existing plant in China (excluding property of the plant that will be leased to the acquiring company without consideration) that manufactures TMA and PDEB (the “existing plant”) and all of the intellectual property, know-how and technology pertaining to the existing plant. In addition, the acquired company has been taking steps to set up an additional plant with facilities for the manufacture of TMA and PDEB through the know-how and technology that were transferred to its ownership. The additional plant will be set up in China on property on which the acquired company has usage rights.

## OIL REFINERIES LTD.

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

#### NOTE 8 – SUBSEQUENT EVENTS (cont.)

##### G. TMA Project (cont.)

Based on the estimates of the Seller and the acquired company that were given to Gadiv, the new PDEB facility is expected to commence commercial production activity by the end of November 2007 and the new TMA facility is expected to commence commercial production activity by the end of 2008.

The Memorandum replaced the previous memorandum of understanding that was signed regarding this transaction.

The principal terms of the Memorandum are as follows:

1. The Memorandum is subject to the completion of a due diligence to the complete satisfaction of Gadiv and to the signing of a detailed agreement, the wording of which must be approved by the boards of directors of the Seller and Gadiv (the “detailed agreement”) by October 31, 2007 or by some later date to be agreed to by the parties. On November 15, 2007, the parties agreed to extend the Memorandum until November 25, 2007.
2. On the date of the closing, Gadiv will purchase from the Seller 50% of its shares in the acquired company for a total amount of \$33,500,000 (the “purchase price”).
3. The purchase price will be paid in three installments, as follows: (a) 60% of the purchase price will be paid on the closing date of the detailed agreement; (b) 20% of the purchase price will be paid within 14 days after the new PDEB facility passes its test run successfully; (c) 20% of the purchase price will be paid within 14 days after the new TMA facility passes its test run successfully.
4. The closing of the detailed agreement is subject to pre-conditions, including the receipt of the necessary approvals from the Chinese authorities; the signing of accompanying agreements (including an agreement for the transfer of the existing plant to the acquired company, employment agreements with key employees and a non-competition agreement); receipt of an undertaking from Chinese banks to grant a loan to the acquired company in an amount of at least \$13 million for the completion of the construction of the new TMA plant and the new PDEB plant, without the shareholders having to furnish guarantees.
5. The memorandum includes arrangements pertaining to the joint management of the acquired company and to the relative shares of the shareholders which will be part of the detailed agreement, including a BMBY clause that will apply commencing seven years after the closing date of the agreement.

##### H. Credit rating

On November 11, 2007, Maalot notified the Company that the credit rating of its debentures was removed from the “watch list” and that a preliminary rating of AA/Stable would be granted to the debentures to be issued by the Company by way of a public issue, up to an amount of NIS 2 billion. The rating is also valid for the other series of debentures that the Company has in circulation.