

Oil Refineries Ltd.



BAZAN **بازان**
OIL REFINERIES LTD.

**Condensed Consolidated Interim
Financial Statements
as of 31 March 2008**

(Unaudited)

Oil Refineries Ltd.

Condensed Consolidated Interim Financial Statements as of 31 March 2008 (Unaudited)

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Oil Refineries Ltd.

Directors' Report on the State of the Company's Affairs for the period ended March 31, 2008

The report was prepared under the assumption that the reader has read the description of the business affairs of the Company and the Directors' Report for the year ended December 31, 2007.

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 operating in Israel and are engaged primarily in the production of oil products, feedstock for the petrochemical industry and materials for the plastics industry. The facilities of the subsidiaries are integrated with those of the Company.

In the reporting period the Company was engaged in four areas of activity which are reported as business segments in the Company's financial statements, as follows:

Refining segment: The Company's principal field of operations accounted for 87% of the Company's consolidated revenues in 2007. As part of its operations in this field, the Company purchased crude oil and interim materials, mainly from Black Sea and Caspian Sea countries, refines and separates them into various products, some of which are end products and others are raw materials for the manufacture of other products. This operation is performed directly by the Company. As part of its refining operations, the Company sells end and interim fuel products to its customers in Israel and abroad and provides power and heat services (electricity and steam) to industrial customers in the Haifa Bay, as well as infrastructure services (storage, pumping and truck loading of fuel products).

Trade segment: Most trade activities are integrated vertically with operations in the refining segment. In accordance with the strategic plan, commercial activities have been expanded. The operations are carried out in crude oil and its products and derivatives. The Company is examining directions for expanding shipping and logistics operations. The foreign trade operations are presented as a separate segment commencing from the first quarter in 2008.

Petrochemicals segment: This segment is made up of two operations: polymers and aromatics. These operations are carried out through two companies: Carmel Olefins Ltd. (hereinafter: Carmel Olefins) and Gadi Petrochemical Industries Ltd. (Gadi) and represents 13% of the Company's consolidated revenue in the reporting period. Carmel Olefins engages in the polymer segment, which represents 6% of the Company's revenue. Carmel Olefins is a private company that is proportionally consolidated with the Company, and produces ethylene, polyethylene and polypropylene, which are the principal raw materials in the plastics industry. Gadi operates in the aromatics segment, which represents 7% of the Company's revenue. Gadi is a private company that is wholly-owned by the Company. Gadi produces aromatic materials, mainly benzene, propylene, orthoxylene, and toluene, which are used as raw materials in the manufacture of other products.

The facilities of the subsidiaries are downstream facilities of the Company's and they receive the required feedstock entirely or mostly from the Company on an ongoing basis through pipelines, and return the products of their facilities or part thereof to it, as well as the feedstock not used in their operations. The Company's refinery operations are integrated with its polymer and aromatics operations.

In the Company's opinion, the integration and synergy between the various fields of operation leads to an increase in the aggregate margins flowing to the Company from all of its fields and a reduction in fluctuations of the Company's profits, since business turnover in the areas of the Company's operations and those of its subsidiaries do not necessarily overlap. In addition, the joint management of Gadi streamlines the activity of the companies and reduces expenses.

The Company, Carmel and Gadi 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 Petroleum and Energy Infrastructures Ltd. (PEI) and Eilat Ashkelon Pipeline Company Ltd. (EAPC) which provide it with crude oil transportation services at the terminals and in the pipelines.

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Production volumes

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

	<u>Q1 2008</u>	<u>Q1 2007</u>	<u>2007</u>
Refineries	2,028	1,881	7,759
Gadiv Petrochemical Industries Ltd.	129	116	474
Carmel Olefins Ltd.	192	140	323

1.2 Company developments during and subsequent to the reporting period

1.2.1 Corporate developments

On November 6, 2007, the board of directors of the Company approved a strategic plan designed to achieve rapid growth and an increase in the competitive capacity of the Company in the coming years, with a massive investment of approximately \$1.1 billion to increase 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 Refinery and in tangential areas, at an estimated amount of \$850 million, of which an amount of \$600 million is for the expansion of the cracking capacity of fuel products having a high added value. In addition, as part of the strategic plan, the Company will act to:

- Identify business opportunities relating to refineries and petrochemicals in Israel and abroad
- Expand the Company's petrochemical activity, by focusing on high added value products, in Israel and abroad
- Expand commercial and logistics activity of oil products
- Invest \$270 million in environmental quality, safety and security and in enhancing operational reliability

The board of directors of the Company resolved to update the organizational structure of the Company to comply with and support the new strategic plan, with a breakdown into three segments: refining, trade and petrochemicals.

Implementation of the strategic plan by segment

(1) **Refining:** completion of organization in the segment

(2) **Trade:** a modern commercial center was established and the information system for managing trade in oil products was implemented.

Trade operations in the segment commenced in the first quarter of 2008.

(3) **Petrochemicals**

- a. Increased production of paraxylene and benzene: – the project was approved and is in the process of implementation.
- b. Increased production of phthalic anhydride – in the implementation process
- c. Mergers and acquisitions in production and logistics – acquisition of part of Domo, a company producing polypropylene in the Netherlands, advanced examinations in other fields in Europe, the Mediterranean Basin and the Far East.

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(4) Major projects

- a.. Increased flexibility of refining at crude refining terminal 4 - in process
- b. Conversion of the desulfurization facility from heavy vacuum gas oil (HVGO) to moderate catalytic hydrosulfurization – in process
- c. Establishment of a hydrocracker – reactors were ordered, planning is in process and the project will be submitted for final approval in September 2008
- d. Various projects related to environmental quality in the scope of \$70 million were approved and are in different stages of implementation.
- e. Establishment of a power station: the configuration testing stage has been completed, will be submitted shortly for approval

(5) Company administration

- a. At the end of 2007 debentures were issued in the amount of NIS 1.8 billion to finance projects.
- b. The Company is examining ways to take advantage of business opportunities outside of Israel.
- c. Establishment of the team for business development and capital market was completed.
- d. Internal enforcement plans for antitrust issues and securities laws were adopted and assimilated.

1.2.2 Developments in petrochemicals

Acquisition of a company

On January 23, 2008, Carmel Olefins entered into an agreement through a wholly-owned subsidiary, Colland Polymers B.V., with Domo Chemicals N.V., a petrochemical company that manufactures and markets polypropylene, which is used as raw material in the plastics industry.

The main terms of the agreement are described below. Carmel Olefins will purchase 49% of the shares of Domo Polypropylene B.V. for €20 million. In addition, commencing from 2013, Domo Chemicals N.V. may be entitled to additional compensation, not to exceed an amount of €1 million a year for a five-year period, in accordance with the terms set out in the agreement. Under the agreement, on completion of the transaction, Colland enter into a joint venture agreement with Domo Polypropylene B.V. The companies agreed upon the terms of the agreement, and these form an appendix to the agreement. Carmel, through Colland, will have a call option until December 31, 2016, for the purchase of the balance of the shares for an additional €10 million, net of the dividends to be distributed to Domo Chemicals N.V., plus interest at a rate of 5% per annum, commencing from the date of completion and up to actual payment.

Domo Chemicals N.V. will have a put option, exercisable commencing on July 1, 2011 for the sale of the remaining 51% to Carmel Olefins at the same terms.

Consummation of the transaction as detailed in the share purchase agreement is subject to the approval of the relevant antitrust authorities and to receipt of an environmental report on the condition of the ground upon which the Domo Polypropylene plant is located (hereinafter: the pre-conditions). As of the date of the approval of the financial statements, the pre-conditions have not yet been fulfilled. In view of the above, the transaction is not reflected in the financial statements of Carmel Olefins.

The transaction was completed on May 6, 2008, after all the pre-conditions in the acquisition agreement were fulfilled.

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TMA project

On September 25, 2007, Gadiv signed a memorandum of intent (hereinafter: the memorandum of intent) for the purchase of 50% of the registered share capital of a Chinese company (hereinafter: the acquired company) which benefits in China from the status of a wholly-foreign owed company (WFOE) and which will manufacture Tri-Maleic-Anhydrid (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 production of paraxylene.

The validity of the memorandum of understanding expired on November 25, 2007, and the negotiations conducted by the Company on this matter ended without the parties reaching the required agreements for consummation of a binding transaction.

1.3 Business environment and Company profitability

The refining margin is the major factor affecting the results of operations in the refining segment. This margin 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, inter alia, by 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: one, supply and demand of crude oil and the other, supply and demand of the end products.

During the reporting period, refining margins dropped to \$27.1 per ton, compared to \$49.5 per ton in the corresponding period last year. In 2007 the refining margin of the Company amounted to \$57.7 per ton. The margins publicized by Reuters for an example of a Mediterranean refinery having the capability of cracking Ural-type crude oil (Reuters margin), amounted to \$27 per ton in the reporting period compared to \$41.6 per ton in the corresponding period last year. In 2006 the Reuters margin amounted to \$38.7 per ton. For further details, see section 3.3.

It is noted that there are differences in a number of parameters, between the refining margin of the Company and the margin publicized by Reuters. These include the composition of the crude oil (the Company also refines crude oil types that are not Ural), the composition and quality of the products produced by the refineries and the difference created as a result of the fact that the quote takes into account purchase and sale on the same day, while in practice, there is a gap between the date of the purchase of the crude and the date of the sale of the distillates made from the crude oil. The Company estimates that approximately \$15.3 per ton of the gap between the Company's margin and the Reuters' margin in 2007 (hereinafter: the gap) in the reporting period derives from timing difference of purchasing and selling due to the price increase. In the corresponding period last year, the gap was reduced by \$7.3 per ton, due to the differences in purchase and sales times (due to a decrease in prices). The Company estimates that \$16 per ton of the gap in 2007 is due to the difference in purchase and sales times due to increased prices. In addition, subsequent to adoption of IFRS, the gap is also affected by the method of accounting for derivative transactions on prices of goods and margins (accounting method for derivatives) under IFRS. For further details see section 6.2.2. The Company estimates that in the reporting period, the gap was reduced by \$5.9 per ton, due to the accounting method for derivatives. In the corresponding period last year, the gap was reduced by \$18 per ton due to the accounting method for derivatives. In 2007 the gap was reduced by \$2.6 per ton due to the same method.

Consolidated operating income amounted to NIS 16 million in the reporting period, compared to NIS 51 million in the corresponding period last year, a decrease of 69%.

Consolidated EBITDA amounted to \$33 million in the reporting period, compared to \$72 million in the corresponding period last year, a decrease of 54%.

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

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The following table presents details of the principal factors involved in the decrease in consolidated operating income (in \$ million):

	March 31, 2008 compared to March 31, 2007
	USD million
Decrease in Group margins	(66)
Decrease in losses for derivative transactions – see section 6.2	22
Increase in volume of Group sales	11
Increase in other income in the refining and aromatics segments	6
Increase in Group production expenses, mainly energy	(11)
	(38)
Decrease in selling, general and administrative expenses	3
	(35)

Financing expenses

In the reporting period, consolidated financing expenses amounted to \$17 million, compared to \$7 million in the corresponding period last year.

The following table presents details of the principal changes in financing expenses (in USD millions):

	March 31, 2008 compared to March 31, 2007
	USD million
Impact of the appreciation on shekel and linked debentures	60
Impact of the changes in fair value of derivatives on debentures	(50)
Increase in the cost of dollar credit mainly due to the increase in volume offset by a decrease in interest	7
Decrease in expenses of interest on long-term dollar loans mainly due to a decrease in volume and a decrease in the rate of interest	(2)
Increase in interest expenses for total customer credit due to the discount arrangement implemented in the Company in the reporting period	5
Increase in value of securities	(10)
Impact of the appreciation on financial items, net	(2)
Termination of discounting expenses	2
	10

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2. Financial position

2.1 Current assets

On March 31, 2008, consolidated current assets amounted to \$2,106 million, compared to \$1,910 million on December 31, 2007. The increase is mainly due to the increase in investments in marketable securities in the reporting period in the amount of \$162 million, the increase in inventories in the Group, mainly due to the price increase of \$119 million, the increase in trade receivables (after offsetting the increase in discounting expenses in the amount of \$187 million), in the amount of \$75 million, mainly due to the price increase, the increase in receivables and debit balances in the amount of \$38 million mainly due to VAT to receive, and the increase in tax advances of \$16 million and after offsetting the decrease in cash flow of \$217 million.

2.2 Investments and long-term loans

On March 31, 2008 consolidated investments and long-term loans amounted to \$208 million compared to \$148 million on December 31, 2007.

The increase is mainly due to an increase in the fair value of the financial derivatives in the reporting period in the amount of \$65 million, an increase in the loan to Company for early retirement in the amount of \$9 million, mainly due to the appreciation in the shekel exchange rate and offset by a decrease in the value of investments in subsidiaries the amount of \$9 million and offset by a decrease in loans and debit balances of \$4 million.

2.3 Current liabilities

Consolidated current liabilities on March 31, 2008 amounted to \$1,132 million, representing 45% of total liabilities, compared to \$889 million, representing 39% of total liabilities as of December 31, 2007. The \$243 million increase was mainly due to the increase in the debt to crude oil suppliers, mainly due to the price increase and to other suppliers and service providers in the amount of \$137 million, an increase in short-term dollar bank loans in the amount of \$66 million, with the addition of the fair value of the derivatives used for hedging transactions on future margins in the amount of \$23 million.

2.4 Long-term financial liabilities

Consolidated long-term financial liabilities amounted to \$1,210 million on March 31, 2008 (the Company - \$948 million, Gadiv - \$3 million, and Carmel Olefins - \$ 259 million), compared to \$1,169 million on December 31, 2007 (the Company - \$920 million, Gadiv - \$3 million, and Carmel Olefins - \$246 million). The increase of \$41 million was mainly due to an increase in the value of liabilities due to the impact of the change in the foreign currency exchange rate for shekel debentures, less repayments and current maturities.

2.5 Shareholders' equity

Shareholders' equity on March 31, 2008 amounted to \$ 803 million, representing 24% of the balance sheet, compared to \$800 million, representing 26% of the balance sheet on December 31, 2007. The increase in shareholders' equity was mainly due to earnings in the year and an increase in capital reserve due to options allotted to employees at the end of the prior year.

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3. Results of operations

3.1 The following table presents selected consolidated data from the Group's results for the reporting period and the corresponding period last year

	For the three months ended March 31, 2007	
	March 31, 2008	* March 31, 2007
	in USD millions	
Revenues		
Refining	1,562	902
Trade	79	-
Polymers	108	74
Aromatics	137	105
Total	1,886	1,081
	-----	-----
Cost of sales, refinery and services		
Refining	1,543	844
Trade	77	-
Polymers	104	64
Aromatics	121	94
Total	1,845	1,002
	-----	-----
Gross profit		
Refining	19	58
Trade	2	-
Polymers	4	10
Aromatics	16	11
Total	41	79
	-----	-----
Selling, general and administrative expenses		
Refining	14	17
Trade	-	-
Polymers	5	5
Aromatics	6	6
Total	25	28
	-----	-----
Operating income		
Refining	5	41
Trade	2	-
Polymers	(1)	5
Aromatics	10	5
Total	16	51
	-----	-----
Financing expenses, net	(17)	(7)
	-----	-----
Privatization grant	-	(28)
	-----	-----
Profit (loss) before taxes on income	(1)	16
Tax benefits (taxes) on income	8	(7)
	7	9
	-----	-----
Company's share in earnings (losses) of investees	(5)	2
	-----	-----
Net income for the period	2	11

See Note 10(E) to the financial statements

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3.2 Sales turnover

The sales turnover in the refining segment (carried out through the Company) amounted to \$1,562 million in the reporting period, compared to \$902 million in the corresponding period last year. The increase was mainly due to the increase in prices of oil products and an increase in sales volume. 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, to \$795 in the reporting period, compared to \$504 in the corresponding period last year.

The turnover of the trade segment (which commenced operations this year and is carried out through the Company) amounted to \$79 million.

In the reporting period, there was an increase of 6% in fuel consumption in the local market compared to the corresponding period last year. There was an increase of 10% in the consumption of distillates in the relevant periods, offset by a decrease of 11% in the consumption of fuel oil, due to the continued conversion to natural gas.

Sales turnover for the polymer segment (carried out through Carmel Olefins) increased by 46% compared to the turnover in the corresponding period last year. The increase is mainly due to the increase in sales volumes and the increase in product prices following the operation of the new facilities in the second half of 2007.

Sales turnover in the aromatics segment (carried out through Gadiv) increased by 30% in the reporting period compared to the turnover in the corresponding period last year. The increase is mainly due to an increase in sales prices due to the demand for downstream products in the petrochemicals industry and the shortage of global manufacturing capacity and from an increase in sales volume.

Revenues from the sale of products with a volume of over \$250 million in the reporting period were as follows: gasoline - \$374 million, diesel fuel - \$585 million, kerosene - \$155 million, crude oil \$190 million.

3.3 Gross profit

The following table presents details of the principal factors involved in the decrease in gross profit in the refining and trade segments in the reporting period, compared to the corresponding period last year (in USD millions):

	March 31, 2008 compared to March 31, 2007
Decrease in margin from refining and trade operations	(64)
Decrease in losses for derivative transactions – see section 6.2	22
Increase in volume of refining and sales	4
Increase in other revenues	4
Increase in production expenses	(3)
	<u>(37)</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 transactions for the inventory of crude oil and distillates, as described below in the chapter addressing risk management.

	<u>Q1</u>	<u>Annual</u>
2008	27.1	-
2007 *	49.5	57.7

* In the financial statements as of December 31, 2007, which were prepared according to generally accepted accounting practices in Israel (Israeli GAAP) (prior to implementation of IFRS) the

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margin for 1-3 2007 was \$67.5 per ton and in 2007 the margin was \$60.3 per ton.

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

For further details see the annual financial statements (paragraph 1.6.2 of the description of the business affairs of the company).

The decrease in refining margins in the Mediterranean area and in the Company was due mainly to speculator demands in the crude oil market following the crisis in financial markets. This resulted in an increase in oil prices and but not a corresponding increase in prices of oil products.

The increase in other income was mainly due to the sale of energy and water sales in the reporting period compared to the corresponding period last year, due mainly to the increase in sales volume.

The increase of \$3 million in production expenses in the reporting period compared to the corresponding period last year was mainly due to an increase in payroll costs and the volume of expenses for power and water services, offset by a decrease in depreciation and amortization.

Gross profit in the reporting period in the polymers segment amounted to \$4 million, compared to \$10 million in the corresponding period last year.

The following table presents details of the principal factors involved in the decrease (in USD millions):

	March 31, 2008 compared to March 31, 2007
Decrease in margin from the basket of products	(8)
Increase in sales quantities	4
Increase in production expenses due to operation of the new facilities (mainly depreciation and payroll)	(2)
	<u>(6)</u>

Gross profit in the reporting period in the aromatics segment amounted to \$16 million, compared to \$11 million in the corresponding period last year.

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

	March 31, 2008 compared to March 31, 2007
Increase in margin from the basket of products	6
Increase in sales quantities	3
Increase in processing fees	2
Increase in production expenses, mainly energy	(6)
	<u>5</u>

3.4 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 \$25 million, compared to \$28 million in the corresponding period last year. The decrease in expenses is due to the single provision made in the corresponding period last year for requests to pay various levies and municipal taxes for land, which was offset by the increase in payroll in the Company.

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3.5 Operating income and EBIDTA (earnings before interest, taxes, depreciation and amortization)

Operating income in the refining and trade segments amounted to \$7 million in the reporting period, compared to \$41 million in the corresponding period last year, representing a decrease of 83%. The decrease of \$34 million in operating income was due to the increase in gross profit of \$37 million as explained above, offset by the decrease of \$3 million in selling, general and administrative expenses. EBITDA for the refinery segment amounted to \$17 million in the reporting period, compared to \$54 million in the corresponding period last year, a decrease of 69%.

Operating loss in the polymers segment amounted to \$1 million in the reporting period, compared to income of \$5 million in the corresponding period last year. EBITDA in the polymer segment amounted to \$5 million in the reporting period, compared to \$11 million in the corresponding period last year.

Operating income in the aromatics segment amounted to \$10 million in the reporting period, compared to \$5 million in the corresponding period last year, an increase of 100%. EBITDA in the aromatics segment amounted to \$11 million in the reporting period, compared to \$7 million in the corresponding period last year, an increase of 57%.

Consolidated operating income amounted to NIS 16 million in the reporting period, compared to NIS 51 million in the corresponding period last year, a decrease of 69%.

Consolidated EBITDA amounted to \$33 million in the reporting period, compared to \$72 million in the corresponding period last year, a decrease of 54%.

3.6 Income tax

In the reporting period, the Group recorded tax benefits of \$7 million, compared to tax expenses of \$7 million in the corresponding period last year. The decrease of \$14 million in tax expenses is due to the differences in earnings before tax and the impact of differences in the measurements between the financial statements denominated in the dollar and financial statements denominated in the shekel for tax purposes.

3.7 Company's share in earnings of investees

The Company's share in the losses of investees amounted to \$5 million in the reporting period, compared to earnings of \$2 million in the corresponding period last year. The decrease is mainly due to a decrease in the earnings of the companies: Petrochemicals Enterprises (\$5.7 million), Gadot Biochemical Industries Ltd. (\$1 million), Haifa Basic Oils Ltd. (\$0.7 million), offset by the increase in the earnings of Ionex (\$0.4 million).

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4. Liquidity

Working capital on March 31, 2008 amounted to \$974 million compared to \$1,021 million on December 31, 2007. The current ratio on March 31, 2008 was 1.8 compared to 2.1 on December 31, 2007.

Consolidated cash flows used in current operations in the reporting period amounted to \$34 million, after a decrease in working capital that amounted to \$117 million, including a payment to the tax authorities, investment in inventory, receivables and payables.

Cash flows used in investment activity amounted to \$189 million to finance investments in marketable securities and other assets, mainly in the Company and Carmel Olefins.

The net cash flows from financing activity in the reporting period amounted to \$19 million. \$149 million was received in short-term credit offset by \$114 million used to repay debentures and long-term loans and \$17 million in interest paid.

The cash flows used for financing activity of investment in working capital and investment activity resulted in a decrease of \$217 million in cash in the reporting period.

5. Sources of financing

The following table includes a description of the composition of the corporation's sources of financing:

	March 31, 2008	March 31, 2007
	(unaudited)	(audited)
	in millions of NIS	
Sources		
Cash from current operations (prior to changes in working capital)	53	359
Dividend from investees	-	11
Long-term loans and debentures	-	623
Receipt of short-term credit and deposits from customers	150	8
Privatization grant	-	27
Decrease in working capital	117	-
	320	1,028
Uses		
Investments in fixed and other assets	39	100
Loan to Haifa Early Pensions Ltd.	-	70
Investment in marketable securities	150	-
Repayment of long term loans and debentures	114	157
Interest paid	17	63
Repayment of short-term credit	-	72
Payment of dividend	-	74
Increase in working capital	-	492
	320	1,028

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Long-term loans and debentures

The long term loans and debentures (after deduction of current maturities) amounted to \$1,210 million, and represent 36% of the balance sheet compared to \$1,169 million which represented 38% on December 31, 2007. 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 60% and was 59% in the balance sheet of December 31, 2007.

Total financial liabilities

Financial liabilities: current financial liabilities plus long term loans and debentures amounted to \$1,515 million and represent 45% of the balance sheet compared to \$1,385 million which represented 45% of the balance sheet on December 31, 2007. Financial leverage of total financial liabilities to banks and other credit providers is 65% compared to 63% on December 31, 2007.

Long-term financial debt, net (long-term loans and debentures, including current maturities, less investments in securities and bank deposits) amounted to \$1.4 billion. (in the Company \$0.9 billion, Carmel Olefins - \$0.5 billion, and Gadiv - \$3 million).

Average volume of sources of finance in the reporting period

Long term loans (including current maturities) - \$1,030 million, short term credit - \$120 million, suppliers - \$630 million, customers – \$3 million.

6. Exposure to market risk and risk management methods

- 6.1** In the reporting period the risk management policy of the companies and the parties responsible for their management remained the same as the description in the Directors' Report as of December 31, 2007. For market risks resulting from changes in the foreign currency exchange rate, from January 1, 2008, with the adoption of IFRS and determining the dollar as the functional currency, the exposures between the changes in the dollar exchange rate and the other currencies in which the Company operates. (including the shekel).

The Company utilizes financial instruments, including derivatives, to minimize its exposure to these risks – see below.

For further details on the subject, see Note 10 – IFRS.

6.2 Implementation of derivative transactions according to IFRS

6.2.1 General

The Company's risk management policy is designed as a tool for the management to achieve the Company's business objectives, by assessing and limiting the possible results of exposure in accordance with criteria set by the Company's board of directors. Reporting subsequent to the implementation of the policy is carried out by the board committees. These criteria are based on estimating the risk and take into consideration developments in prices.

The Company utilizes financial instruments, including derivatives, to minimize its exposure to these risks.

According to Israeli GAAP, which was used as the basis for the preparation of the Company's financial reports until December 31, 2007, the conditions for hedge accounting were based primarily on financial criteria that generated an accounting comparison between the results of the hedged item and the results of the hedging instrument.

According to IFRS, before a transaction in financial instruments is recognized as hedge accounting, it has to fulfill certain conditions, including conditions relating to the purpose of the instrument, compliance with strict documentation requirements, and high hedging effectiveness at the beginning of and during the course of the entire hedge.

Changes in the fair value of derivative financial instruments that do not fulfill the conditions required for hedge accounting are immediately charged to the income statement in each period, however the results of the hedging instrument are only charged to the income statement at the exercise date.

The Company's transactions in the reporting period in financial instruments to reduce this exposure do not comply with the hedge conditions set out in IFRS, although their financial objective is purely hedging, and therefore, in the transition to IFRS, these financial instruments

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are measured at fair value, with the changes in the fair value immediately carried to the income statement, as described below.

6.2.2 Transactions in derivatives on the prices of goods and margins

In the first quarter of 2008, following the transition to IFRS accounting, the Company recorded net losses of \$11 million, compared to a loss of \$33 million in the corresponding period last year (before tax).

The loss is mainly due to derivatives on refining margins due to the Company at a future date defined in the agreement, a fixed amount equal to the margin between the cost of raw materials and the consideration for certain refinery products, as determined in the agreement. The decrease in fair value at the end of the reporting period compared to the beginning of the reporting period reflects the increase in the refining margin for the refining products in the agreement, compared to the fixed margin in the hedging transaction and is charged to the income statement in the reporting period. The absence of comparison is mainly accounting, as financially the Company is not expected to be affected by these changes, since at the future date determined in the transaction, the Company is expected to receive the margin determined in the transaction. According to GAAP (before adoption of IFRS), the loss is recognized when it is incurred, parallel to recognition in income from the physical transaction. According to IFRS, the Company charges the changes in fair value of the hedging transaction to the income statement for every reporting period until the consummation of the transaction.

6.2.3 Transactions in derivatives on foreign currency exchange rates and interest

In the first quarter of 2008, following the transition to accounting according to IFRS, the Company recorded net earnings of \$50 million for derivative transactions on foreign currency exchange rates and interest rates.

The earnings are attributed to financial hedging to reduce currency exposure resulting from issuance of shekel or shekel CPI-linked debentures in December 2007 (2007 debentures). As part of the hedging transaction, the Company converted its shekel liabilities to dollar liabilities at the same repayment dates as those of the 2007 debentures, and exchanged the fixed linked interest to variable dollar interest.

Parallel to the earnings from this derivative, the Company recorded a loss of \$39 million due to the impact of the appreciation on the value of 2007 debentures.

6.2.4 Hedging transactions of the Company's shekel credit sales to customers – forward transactions

To hedge against exposure from the Company's shekel credit sales to its customers, the Company purchases dollars in forward transactions for the expected dates of customer intake. The results of the transaction offset the impact of the changes in the exchange rate for these sales. The results of the transaction offset the impact of the changes in the exchange rate for these sales.

6.3 Exposure to the impact of foreign currency fluctuations on the Company

A finance committee is a permanent part of the Company's management. This committee is made up of the CEO, VP trade, VP finance, VP business development and capital market, and CFO, who meet once a week to discuss and decide on various financial issues. This committee and the board of directors' finance committee discussed the Company's exposure to changes in the foreign currency exchange rates. The board of directors' finance and investment committee received a report from the management and held three meetings to discuss the Company's exposure to the impact of changes in foreign currency exchange rates. The resolutions of the finance committee on this subject aim to reduce the Company's exposure to changes in the shekel exchange rate and included the following issues:

The replacement of most of the Company's shekel loans with long-term dollar loans, neutralization of the exposure for the Company's sales to customers with shekel credit through forward transactions, short-term credit management in dollars and investment of the balance of the current moneys in dollar, and conversion of part of the index investments portfolio to dollar. No hedging transactions were made for shekel operating and maintenance expenses, taking into account the current dollar exchange rate and the reduced volume of expenses compared to total selling cost.

Since the beginning of the year, the board of directors has held two meetings to discuss the Company's hedging against changes in the currency exchange rates. In these meetings the board received reports from the management and approved the reports and decisions of the finance and investment committee as above. See section 1.3 for the impact of the appreciation on the results of the quarter.

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6.4 Sensitivity analysis of exposure to market risks

6.4.1 Summary of the differences in fair value in view of the sensitivity analysis of the dollar-shekel exchange rate

	<u>Profit (loss)</u>		<u>Fair value</u>	<u>Profit (loss)</u>	
	+10%	+5%		-5%	-10%
			March 31, 2008		
<u>Exchange rates</u>	<u>3.908</u>	<u>3.781</u>	<u>3.553</u>	<u>3.375</u>	<u>3.198</u>
	in USD thousands				
Long-term linked shekel debentures	77,334	40,824	(711,660)	(43,154)	(86,773)
Accounts receivable(NIS)	(23,787)	(11,893)	237,873	11,893	23,787
Accounts payable (NIS)	16,150	8,075	(161,504)	(8,075)	(16,150)
Securities (NIS)	(11,865)	(5,933)	118,654	5,937	11,865
Forward contracts	13,018	6,819	(540)	(7,537)	(15,910)
Swapping principal and interest	<u>(4,746)</u>	<u>(2,486)</u>	<u>52,208</u>	<u>2,486</u>	<u>4,746</u>
	<u>66,104</u>	<u>35,406</u>	<u>(464,969)</u>	<u>(38,450)</u>	<u>(78,435)</u>

6.4.2 Summary of the differences in fair value in view of the sensitivity analysis of the dollar interest rate:

	<u>Profit (loss)</u>		<u>Fair value</u>	<u>Profit (loss)</u>	
	+10%	+5%		-5%	-10%
			March 31, 2008		
<u>Interest for dollar loans</u>					
	in USD thousands				
Interest rate swaps (IRS)	1,289	644	(608)	(644)	(1,289)
Swap hedging	25	13	(22,494)	(13)	(25)
Dollar-linked securities	(8,393)	(4,196)	156,599	4,196	8,393
Forward contracts	22	11	(540)	(11)	(22)
Swapping principal and interest	<u>(1,422)</u>	<u>(725)</u>	<u>52,208</u>	<u>725</u>	<u>1,422</u>
	<u>(8,479)</u>	<u>(4,253)</u>	<u>185,165</u>	<u>4,253</u>	<u>8,479</u>

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6.4.3 Summary of the differences in fair value in view of the sensitivity analysis of the price of crude oil and distillates

	<u>Profit (loss)</u>		<u>Fair value</u>	<u>Profit (loss)</u>	
	<u>+10%</u>	<u>+5%</u>	March 31, 2008	<u>-5%</u>	<u>-10%</u>
	in USD thousands				
Inventory	107,145	53,572	1,071,445	(53,572)	(107,145)
Futures	(20,713)	(10,357)	7,551	10,357	20,713
Swap hedging	(3,884)	(1,942)	(22,494)	1,942	3,884
	<u>82,548</u>	<u>41,273</u>	<u>1,056,502</u>	<u>41,273</u>	<u>(82,548)</u>

6.4.4 Summary of the differences in fair value in view of the sensitivity analysis of shekel interest in real terms:

	<u>Profit (loss)</u>		<u>Fair value</u>	<u>Profit (loss)</u>	
	<u>+10%</u>	<u>+5%</u>	March 31, 2008	<u>-5%</u>	<u>-10%</u>
	in USD thousands				
CPI-linked securities	(904)	(452)	70,426	452	904
Long-term CPI-linked shekel debentures	53,069	27,512	(711,660)	(27,512)	(53,069)
Swapping principal and interest	11,998	6,048	52,208	(6,048)	(11,998)
	<u>64,163</u>	<u>33,108</u>	<u>(589,026)</u>	<u>(33,108)</u>	<u>(64,163)</u>

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Sensitivity analysis of the exposure to market risks at Carmel Olefins:

1. Summary of the differences in fair value in view of the sensitivity analysis of the foreign currency exchange rate

	Profit (loss)		Profit (loss)	
	+10%	+5%	-5%	-10%
	in USD thousands			
Trade receivables - NIS	2,386	1,193	(1,193)	(2,386)
Trade receivables - euro	1,480	740	(740)	(1,480)
Trade receivables - sterling	1,009	504	(504)	(1,009)
Trade payables - NIS	(2,138)	(1,069)	1,069	2,138
Long-term debentures - index	(24,796)	(12,398)	12,398	24,796
Long-term loans - euro	(9,026)	(4,513)	4,513	9,026
Swap transactions index dollar	17,495	9,164	(10,129)	(21,383)
Hedging transactions - NIS	7,057	3,529	(3,529)	(7,057)
Hedging transactions - euro	8,602	4,301	(4,301)	(8,602)
Hedging transactions - sterling	1,903	951	(951)	(1,903)

2. Summary of the differences in fair value in view of the sensitivity analysis of interest rates:

	Profit (loss)		Fair value	Profit (loss)	
	+10%	+5%	March 31, 2008	-5%	-10%
	in USD thousands				
Change in interest rate					
Long-term loan	815	409	90,495	(4,139)	(830)
Long-term loans - euro	1,383	693	213,012	(698)	(1,400)
Index-linked shekel debentures	8,468	4,284	240,149	(4,388)	(8,883)
Swap transactions dollar index	(2,446)	(1,228)	25,693	1,238	2,485

3. Future contracts for hedging against the expansion project - financial - on March 31, 2008

Future contracts	Transaction currency	Par value (transaction currency, thousands)	Par value USD thousands	Fair value USD thousands
Purchase of euro in return for USD	Euro	55,975	73,404	74,559

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6.5 Consolidated linkage-based report

As of March 31, 2008 (in thousands of dollars)

	<u>Index linked</u>	<u>Dollar linked</u>	<u>Non- linked</u>	<u>Non- financial</u>	<u>Total</u>
<u>Assets</u>					
Cash	-	(4,594)	46,452	-	41,858
Financial assets measured at fair value through the statement of income	-	7,555	2,834	-	10,389
Marketable securities	70,426	156,731	48,229	-	275,386
Trade and other accounts receivable and debit balances	32,536	327,095	244,949	10,716	615,296
Inventory of fuel products	-	1,108,553	5,448	47,465	1,161,466
Affiliates	-	-	-	44,552	44,552
Financial assets measured at fair value through the statement of income	656,010	(590,955)	-	-	65,055
Deposits and loans (*)	-	-	3,560	-	3,560
Loan to Haifa Early Pensions Ltd.	88,833	-	-	-	88,833
Severance pay fund, net	-	-	-	7,397	7,397
Fixed assets	-	-	-	1,005,136	1,005,136
Other assets	-	-	-	22,140	22,140
Total assets	847,805	1,004,385	351,472	1,137,406	3,341,068
<u>Liabilities</u>					
Short-term credit and loans	-	148,196	-	-	148,196
Trade and other accounts payable and credit balances	20,833	579,836	234,727	-	835,396
Long-term derivative instrument - current liabilities	-	22,808	-	-	22,808
Deferred taxes	-	-	-	116,363	116,363
Severance pay	-	-	-	71,611	71,611
Long-term loans *	655,255	554,207	142,444	7,855	1,344,051
Total liabilities	676,088	1,296,644	377,171	195,829	2,538,425
Net balance	171,717	(299,792)	(25,479)	956,197	802,643

* Including current maturities)

The Company's 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.

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6.6 Consolidated linkage-based report

As of December 31, 2007 (in USD thousands)

	<u>Index- linked</u>	<u>Dollar linked</u>	<u>Non- linked</u>	<u>Non- financial</u>	<u>Total</u>
<u>Assets</u>					
Cash	-	236,688	22,637	-	259,325
Marketable securities	63,509	6,395	43,131	-	113,035
Future purchase	-	-	77,006	-	77,006
Trade and other accounts receivable and debit balances	10,486	251,985	221,645	28,871	512,987
Hedging on debentures – loans given	300,799	-	-	-	300,799
Inventory of fuel products	-	575,661	440,331	26,553	1,042,545
Affiliates	-	-	-	53,958	53,958
Deposits and loans *	-	-	2,707	-	2,707
Loan to Haifa Early Pensions Ltd.	80,038	-	-	-	80,038
Severance pay fund, net	-	-	-	7,519	7,519
Fixed assets	-	-	-	978,412	978,412
Other assets	-	-	-	22,924	22,924
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total assets	454,832	1,070,729	807,457	1,118,237	3,451,255
<u>Liabilities</u>					
Short-term credit and loans	-	948	-	-	948
Trade and other accounts payable and credit balances	18,486	512,300	167,864	-	698,650
Future sales	-	77,000	-	-	77,000
Hedging on debentures – loans received	-	298,329	-	-	298,329
Deferred taxes	-	-	-	125,287	125,287
Severance pay	-	-	-	67,358	67,358
Long-term loans *	680,135	581,168	130,005	(7,428)	1,383,880
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total liabilities	698,621	1,469,745	297,869	185,217	2,651,452
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Net balance	(243,789)	(399,016)	509,588	933,020	799,803

* Including current maturities

The Company's 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.

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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 9.A. 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 9.A 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 of 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, the 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 9.B regarding the dependency of the Company on receipt of services from infrastructure companies.

8. Disclosure of the process for 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 (for example, reporting on financial risks) and those impacting on the reliability of the financial statements. The opinion of the external auditor is also heard at the meeting.

After receiving the recommendation of the audit committee regarding the financial statements, the board of directors is investigating 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 committee assesses the various aspects of the Company's control and risk management, both those reflected in the financial statements (for example, reporting on financial risks) and those impacting 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.

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The questions and issues raised are addressed when necessary by both Company management through the CEO or VP - Finance and by the external auditor of the Company. Following a discussion, the chairman of the board calls for a vote on the approval of the financial statements after ensuring that members of the board have no further questions and there are no unanswered issues.

9. Corporate governance

As part of the changes in the institutions of the Company, further to the completion of privatization, 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.

10. Meetings of the board of directors

During the reporting period, there were 4 board meetings and 13 meetings of board committees.

11. Salaries of senior officers and considerations on which the board of directors bases such salaries

In determining the 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.

12. Subsequent events

12.1 Acquisition of a company

On January 23, 2008, Carmel Olefins entered into an agreement through a wholly-owned subsidiary, Colland Polymers B.V., with Domo Chemicals N.V., a petrochemical company engaging in the manufacture and marketing of polypropylene, which is used as raw material in the plastics industry.

The main terms of the agreement are described below. Carmel Olefins will purchase 49% of the shares of Domo Polypropylene B.V. for €20 million. In addition, commencing from 2013, Domo Chemicals N.V. may be entitled to additional compensation, not to exceed an amount of €1 million a year for a five-year period, in accordance with the terms set out in the agreement. Under the agreement, on completion of the transaction, Colland will enter into a joint venture agreement with Domo Polypropylene B.V. The parties agreed upon the terms of the agreement, and these form an appendix to the agreement. Carmel, through Colland, will have a call option until December 31, 2016, for the purchase of the balance of the shares for an additional €10 million, net of the dividends to be distributed to Domo Chemicals N.V., plus interest at a rate of 5% per annum, commencing from the date of completion and up to actual payment. Domo Chemicals N.V. will have a put option, exercisable commencing on July 1, 2011 for the sale of the remaining 51% to Carmel Olefins at the same terms.

Consummation of the transaction as detailed in the share purchase agreement is subject to the approval of the relevant antitrust authorities and to receipt of an environmental report on the condition of the ground upon which the Domo Polypropylene plant is located (hereinafter: the pre-conditions). As of the date of the approval of the financial statements, the pre-conditions have not yet been fulfilled. In view of the above, the transaction is not reflected in the financial statements of Carmel Olefins.

The transaction was completed on May 6, 2008, after all the pre-conditions in the acquisition agreement were fulfilled.

12.2 On April 28, 2008 the general meeting approved distribution of a dividend in the amount of NIS 240 million, which will be paid on May 20, 2008.

12.3 Subsequent to the date of the balance sheet, the Company and Israel Petrochemical Enterprises Ltd. are examining the possibility of a merger between Carmel Olefins and the Company. If the transaction is completed, the Company will hold the full issued capital of Carmel Olefins.

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On May 20, 2008 the board of directors approved negotiations for an agreement to purchase the remaining 50% of Carmel Olefins shares held by Israel Petrochemical Enterprises Ltd. (hereinafter: Israel Petrochemicals), in addition to the 50% held by the Company (hereinafter: the transaction), under the following terms:

- A. The transaction will be carried out under a share swap agreement whereby in return for the sale of 50% of Carmel Olefin shares owned by Israel Petrochemicals the Company will allocate its shares to Israel Petrochemicals.
- B. Completion of the transaction shares will be based, inter alia, on the assessment of Carmel Olefins and the Company carried out by Prof. Yitzhak Suary & Co. for the Company and Israel Petrochemicals together.
- C. Israel Petrochemicals informed the Company that in consideration for the sale of Carmel Olefins it is requesting the Company's shares that will constitute, subsequent to the allocation, at least 20% of the Company's equity. The Company will examine this position and negotiate accordingly and subject to the principles described in this report.
- D. Prior to the share swap, ORL will distribute a cash dividend at an amount agreed upon between the Company and Israel Petrochemicals. The amount of the dividend will not exceed NIS 200 million.
- E. In addition, as part of the transaction, Israel Petrochemicals will purchase its shares held by the Company (12.3% of Israel Petrochemical shares) at a price to be determined between the parties, inter alia, based on the assessed value prepared for the parties by Prof. Yitzhak Suary & Co. The proceeds received by the Company will be distributed as a cash dividend after completion of the share swap. The decision to distribute the dividend, if made, will be subject to the applicable law for distribution of a dividend.
- F. The transaction will be subject to various suspending conditions, including approval of the agreement by the audit committee, board of directors and general meeting, pursuant to Section 275 of the Companies Law 5759-1999 and subject to ministerial approval in accordance with the Government Companies (Declaration of the State's Vital Interests in Oil Refineries Ltd) Order, 5767-2007, and any other permits that may be required.
- G. In order to approve the transaction by the organs of the Company, the audit committee appointed Prof. Amir Barnea, who is unrelated to the Company and is not an interested party therein, to prepare and submit his opinion of the fairness of the transaction towards the Company (hereinafter: the fairness opinion) under the abovementioned terms.

The abovementioned principles of the transaction do not obligate the Company. The Company and/or Israel Petrochemicals have no obligation to engage in the transaction at all, and under the abovementioned terms in particular, and it is uncertain whether this transaction will materialize. The possibility that an agreement for executing the transaction is subject to the parties' agreement of the transaction terms and upon the receipt of all the permits required for the transaction and its terms as required by law.

- 12.4** On April 10, 2008 the Ministry of Environmental Protection sent a letter to Carmel Olefins claiming that on April 9, 2008 black smoke was emitted from the company's polypropylene plant for cumulative periods of over six minutes an hour, which, according to the Ministry, constitutes breach of the provisions of the Personal Order. Following the alleged event, Carmel Olefins was summoned to the offices of the district director of the Ministry of Environmental Protection on May 1, 2008.

It is noted that in the hearing held on August 19, 2007 following a similar event of smoke emission, Carmel Olefins was informed that any further deviation from the provisions of the Personal Order will result in an investigation by the Ministry of Environmental Protection.

Carmel Olefins informed the Company that on May 19, 2008 it received the minutes of the hearing regarding the incident that led to a demand for the immediate shutdown of operations at the monomer plant until fulfillment of all the requirements according to the best available technique, including the backup required to prevent malfunctions, to the satisfaction of the Ministry and the Haifa District Municipal Association (hereinafter: the demand).

Carmel Olefins also stated that, to the best of its understanding, this refers to the cracking plant that produces, inter alia, ethylene and propylene at the monomer plant.

Carmel Olefins also informed the Company that it is studying the minutes and examining the options open for operations in view of the minutes received and the demand.

As of the date of the financial statements, the Company is unable to assess the implications of the event.

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- 12.5** In May 2008 the Company submitted a draft shelf prospectus for the issuance of shares, debentures, convertible debentures, option warrants for ordinary shares and option warrants for debentures, as set forth in the prospectus.
- 12.6** In May 2008 Carmel Olefins submitted a draft prospectus to list for trade debentures issued in 2007.
- 12.7** Subsequent to the date of the balance sheet the shekel appreciated against the dollar by 5% and the CPI rose by 1.5% as described in Note 25 to the financial statements as of December 31, 2007 and in section 6 of this report. The Company is exposed to changes in the CPI and the exchange rate.
- 12.8** On May 12, 2008 a hearing was held in the Haifa offices of the Ministry of Environmental Protection. The hearing was attended by Petroleum and Energy Infrastructure Company Ltd. (PEI), Eilat Ashkelon Pipeline Company Ltd. (EAPC) and the Company, after the Ministry of Environmental Protection alleged that it discovered findings that could indicate pollution near the fishing harbor in the PEI strip where Haifa Refinery and EAPC pipeline works are carried out, and that soil suspected as polluted was removed from the area to the Haifa Refinery. At the hearing, the Company stated that it patrols the strip, the pipeline has cathode protection and the pipeline is tested before any inflow. The test results indicate that there was no leakage from the pipeline. Notwithstanding the aforesaid, the Company cannot rule out the possibility that there is exposure on this matter, in amounts that it cannot estimate at this stage, inter alia, because the scope of the pollution, if it exists, is unknown. In addition, the Company does not know if there is any pollution, when it was created and who is responsible.

Yossi Rosen
Chairman of the board of directors

Yashar Ben Mordechai
CEO

March 20, 2008

Oil Refineries Ltd.

Update to the State of the Company's Affairs **in the Periodic Report as of December 31, 2007**

In accordance with Regulation 39A of the Securities Regulations (Periodic and Immediate Reports), 5730 – 1970.

1. Update to section 1.3 – “Investments in the Company's equity and share transactions”

On April 6, 2008 the Company submitted an initial draft of the shelf prospectus to the Securities Authorities, based on the Company's financial statements as of December 31, 2007. On May 1, 2008 the Company submitted a second draft of the shelf prospectus.

2. Financial information concerning the Company's operations

**Update of the general developments of the Company's business in accordance with the detailed sections
International Financial Reporting Standards (IFRS)**

Following the transition to IFRS, the Company presented its financial statements in the reporting period and the comparative information for the corresponding quarter last year and the year ended December 31, 2007 according to IFRS. Accordingly, the data presented in the Directors' Report and the comparative information are presented in accordance with IFRS. The main accounting policy, in accordance with IFRS, is presented in Note 3 to the Company's financial statements as of March 31, 2008.

In respect of the effect on the financial situation, results of operations, liquidity and financing sources of the Company as a result of the transition to IFRS accounting and the accounting implications and adjustments, see Note 10 to the Company's financial statements as of March 31, 2008.

3. Financial information concerning the Company's operations

See Note 5 to the financial statements



The Board of Directors
Oil Refineries Limited
HAIFA

Review of the unaudited condensed consolidated interim financial statements for the three-month period ended March 31, 2008

At your request, we have reviewed the condensed interim balance sheet of Oil Refineries Limited as of March 31, 2008, and the condensed interim statement of income, condensed consolidated interim statement of comprehensive income and expenses, and the condensed consolidated interim statement of cash flows for the three months period then ended.

Our review was carried out in accordance with procedures prescribed by the Institute of Certified Public Accountants in Israel and included, inter alia, reading the abovementioned 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 proportionally consolidated subsidiary whose assets included in the condensed consolidated balance sheet as of March 31, 2008 constitute 17% of assets included in the condensed consolidated interim balance sheet and whose revenues included in the condensed consolidated statements constitute 6% of the total income included in the condensed consolidated interim statement of income for the three-month period then ended. In addition, we were furnished with reports of other auditors of affiliates in which the Company invested \$44.552 million as of March 31, 2008 and the Company's share in their losses is \$5.07 million for the three-month period then ended.

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

During 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 abovementioned financial statements in order for them to be in conformity with International Accounting Standard (IAS) 34, Interim Financial Reporting, and in accordance with Section D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

We call attention to:

1. The contents of Note 9A(1) 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 9A(2) 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 of 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, the 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 9.B regarding the dependency of the Company on receipt of services from infrastructure companies.

Sincerely,

Somekh Chaikin Certified Public Accountants

May 20, 2008

Tel Aviv, May 20, 2008

The Board of Directors
Oil Refineries Limited
HAIFA

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Review of the unaudited condensed consolidated interim financial statements for the three-month period ended March 31, 2007

At your request, we have reviewed the condensed interim balance sheet of Oil Refineries Limited as of March 31, 2007, and the condensed interim statement of income, condensed consolidated interim statement of comprehensive income and expenses, and the condensed consolidated interim statement of cash flows for the three months period then ended.

Our review was carried out in accordance with procedures prescribed by the Institute of Certified Public Accountants in Israel and included, inter alia, reading the abovementioned 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 subsidiaries whose assets as of March 31, 2007 constitute 7% of assets included in the condensed consolidated interim balance sheet and whose revenues constitute 10% of the total income included in the condensed consolidated interim statement of income for the three-month period then ended. In addition, we were furnished with reports of other auditors of affiliates in which the Company invested \$56.017 million as of March 31, 2007 and the Company's share in their profits is \$1.971 million for the three-month period then ended.

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

During 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 abovementioned financial statements in order for them to be in conformity with International Accounting Standard (IAS) 34, Interim Financial Reporting, and in accordance with Section D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

We call attention to:

1. The contents of Note 9A(1) 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 9A(2) 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 of 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, the 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 9B regarding the dependency of the Company on receipt of services from infrastructure companies.

Sincerely,

Fahn Kanne & Co.
Certified Public Accountants

Oil Refineries Ltd.

**Condensed consolidated interim balance sheet as of March 31, 2008
(in USD thousands)**

	<u>March 31, 2008</u>	<u>March 31, 2007</u>	<u>December 31, 2007</u>
	<u>(unaudited)</u>	<u>(unaudited)</u>	<u>(audited)</u>
Assets			
Cash and cash equivalents	41,858	47,507	259,325
Derivatives at fair value through profit and loss	10,389	794	6,513
Investment in financial assets at fair value through profit and loss	275,386	101,543	113,035
Trade receivables	469,185	437,771	394,470
Receivables and debit balances	121,628	98,092	84,029
Income tax	26,004	-	10,153
Inventory	1,161,466	673,076	1,042,545
Total current assets	<u>2,105,916</u>	<u>1,358,783</u>	<u>1,910,070</u>
Investments and long-term loans			
Investees	44,552	56,017	53,958
Loan to Haifa Early Pensions Ltd.	88,833	72,104	80,038
Long term loans and debit balances	2,039	1,767	6,202
Derivatives at fair value through profit and loss	65,055	-	-
Excess of funded amounts over the liability for severance pay, net	7,397	6,924	7,519
	<u>207,876</u>	<u>136,812</u>	<u>147,717</u>
Fixed assets, net	1,005,136	967,228	978,412
Intangible assets and deferred expenses, net	<u>22,140</u>	<u>12,572</u>	<u>22,924</u>
Total non-current assets	<u>1,235,152</u>	<u>1,116,612</u>	<u>1,149,053</u>
Total assets	<u>3,341,068</u>	<u>2,475,395</u>	<u>3,059,123</u>

The accompanying notes are an integral part of the financial statements

Oil Refineries Ltd.

Condensed consolidated interim balance sheet as of March 31, 2008
(in USD thousands)

	March 31, 2008 (unaudited)	March 31, 2007	December 31, 2007 (audited)
Current liabilities			
Credit from banking institutions and other credit providers	282,423	329,597	216,021
Trade payables	698,994	316,195	561,232
Other payables	100,690	78,427	92,253
Derivatives at fair value through profit and loss	22,808	9,677	-
Income tax	-	15,086	-
Provisions	27,309	26,384	19,950
Total current liabilities	<u>1,132,224</u>	<u>775,366</u>	<u>889,456</u>
Long term liabilities			
Debentures	772,287	237,621	717,302
Bank loans	437,537	529,189	452,154
Deferred taxes	116,363	114,105	125,287
Liabilities for financing lease	8,403	7,039	7,763
Liabilities for severance pay, net	71,611	77,911	67,358
Total non-current liabilities	<u>1,406,201</u>	<u>965,865</u>	<u>1,369,864</u>
Total liabilities	<u>2,538,425</u>	<u>1,741,231</u>	<u>2,259,320</u>
Shareholders' equity			
Share capital – 2,000,000 ordinary shares of NIS 1 par value	472,478	472,478	472,478
Capital reserves	29,783	29,393	29,036
Retained earnings	300,382	232,293	298,289
Total equity attributed to equity holders of the Company	<u>802,643</u>	<u>734,164</u>	<u>799,803</u>
Total liabilities and capital	<u><u>3,341,068</u></u>	<u><u>2,475,395</u></u>	<u><u>3,059,123</u></u>

Yossi Rosen
Chairman of the Board

Yashar Ben Mordechai
CEO

Jacob Hirsh
CFO

Date of approval: May 20, 2008

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

Oil Refineries Ltd.

**Condensed consolidated interim statement of income as of March 31, 2008
(in USD thousands)**

	For the three months ended		For the year ended
	March 31, 2008 (unaudited)	March 31, 2007	December 31, 2007 (audited)
Revenues	1,885,696	1,081,001	5,236,945
Cost of sales, refinery and services	1,833,520	969,930	4,805,066
Revaluation of open positions in derivatives on prices of goods and margins, net	11,141	33,128	20,156
Total cost of sales	<u>1,844,661</u>	<u>1,003,058</u>	<u>4,825,222</u>
Gross profit	41,035	77,943	411,723
Selling expenses	10,468	7,650	33,518
General and administrative expenses	14,732	19,164	68,027
Privatization grant	-	28,360	28,360
Operating income	<u>15,835</u>	<u>22,769</u>	<u>281,818</u>
Financing income	69,425	7,941	34,625
Financing expenses	(86,097)	(14,676)	(136,750)
Company's share in earnings (losses) of investees	(5,070)	1,971	6,913
Earnings (loss) before income tax	<u>(5,907)</u>	<u>18,005</u>	<u>186,606</u>
Tax benefits (taxes on income)	<u>8,000</u>	<u>(6,667)</u>	<u>(44,937)</u>
Net earnings for the period	<u>2,093</u>	<u>11,338</u>	<u>141,669</u>
Earnings per ordinary share			
Net basic and diluted earnings per ordinary share (in USD)	<u>0.001</u>	<u>0.006</u>	<u>0.071</u>

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

Oil Refineries Ltd.

Condensed consolidated interim statement of comprehensive income and expenses as of March 31, 2008

(in USD thousands)

	For the three months ended		For the year ended
	March 31, 2008 (unaudited)	March 31, 2007	December 31, 2007 (audited)
Actuarial earnings from a defined benefit plan	-	-	5,231
Other total income for the period, net of tax	-	-	5,231
Income for the period	2,093	11,338	141,669
Total income for the period attributed to equity holders of the Company	2,093	11,338	146,900

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

Oil Refineries Ltd.

Condensed consolidated interim statement of cash flows as of March 31, 2008
(in USD thousands)

	For the three months ended		For the year ended
	March 31, 2008 (unaudited)	March 31, 2007	December 31, 2007 (audited)
Cash flows from operating activities			
Income for the period	2,093	11,338	141,669
Adjustments:			
Depreciation and amortization	17,894	18,736	71,880
Net financing costs	16,672	6,735	102,125
Changes in fair value of derivatives	21,766	28,347	10,432
Share in the losses (profits) of investees accounted by the equity method	5,070	(1,971)	(6,913)
Dividends received from investees	-	4,772	10,920
Proceeds from the sale of fixed assets	-	-	(10)
Severance pay	3,763	333	(10,078)
Share-based payment expenses	747	-	558
Income tax benefits (expenses)	(8,000)	6,667	43,724
	57,912	63,619	222,638
Change in inventory	(118,910)	(18,409)	(387,889)
Change in trade receivables and other receivables	(77,708)	103,038	112,296
Change in trade payables and other payables	118,179	(201,273)	47,849
	(78,439)	(116,644)	(227,744)
Income tax paid	(15,557)	(76,898)	(128,964)
Net cash (used for operations) from current operations	(33,991)	(118,585)	7,599
Cash flows for investing activities			
Interest received	1,254	-	2,023
Proceeds from sale of property, plant and equipment	-	-	28
Long-term loans from others, net	(136)	6	(424)
Loan to Haifa Early Pensions Ltd.	-	(71,630)	(71,630)
Purchase of marketable securities available for trade, net	(150,000)	-	-
Purchase of property, plant and equipment	(40,356)	(24,115)	(89,021)
Purchase of other assets	(15)	(99)	(11,458)
Net cash used in investing activities	(189,253)	(95,838)	(170,482)

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

Oil Refineries Ltd.

**Condensed consolidated interim statement of cash flows as of March 31, 2008 (cont)
in USD thousands**

	For the three months ended		For the year ended
	March 31, 2008	March 31, 2007	December 31, 2007
	(unaudited)		(audited)
Cash flow from financing activities			
Receipt (repayment) of short-term credit	131,524	52,046	(71,974)
Receipt of deposits from customers	2,270	8,032	8,028
Interest paid in cash	(17,198)	(17,920)	(62,950)
Proceeds from issuing debentures	-	100,903	573,697
Repayment of debentures	(84,286)	(4,097)	(22,529)
Payment of issuance expenses for interested parties	-	(890)	(1,046)
Bank loans received	-	38,006	48,684
Repayment of bank loans	(29,795)	(33,066)	(134,090)
Proceeds for derivatives on debentures	918	454	-
Privatization grant	-	-	28,526
Dividends paid	-	(4,734)	(69,410)
Net cash flows provided by financing activities	3,433	138,734	296,936
Net increase (decrease) in cash and cash equivalents	(219,811)	(75,689)	134,053
Effect of fluctuations in the rate of exchange on cash balances	2,344	(725)	1,351
Cash and cash equivalents at the beginning of the period	259,325	123,921	123,921
Cash and cash equivalents at the end of the period	41,858	47,507	259,325

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

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008

NOTE 1 – GENERAL

Oil Refineries Ltd. (the Company or ORL) is a company domiciled in Israel. The Company and its subsidiaries are industrial companies which operate in Israel and are engaged primarily in the production of oil products, feedstock for the petrochemical industry and materials for the 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 26 to the financial statements of December 31, 2007), 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.

The Group's consolidated financial statements as of March 31, 2008 include the statements of the Company and its subsidiaries (hereinafter together: the Group) and the Group's interests in investees. The Company's shares are traded on the Tel Aviv Stock Exchange. As of the date of the balance sheet, the Israel Corporation Ltd. and Petroleum Capital Holdings Ltd. (PCH) hold 45.08% and 15.76% of the Company's shares, respectively.

Note 2 - Basis of Preparation

A. Statement of compliance

The condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs). These are the Group's first IFRS condensed consolidated interim financial statements for part of the period covered by the first IFRS annual financial statements and IFRS 1 *First-time adoption of International Financial Reporting Standards* has been applied.

The condensed consolidated interim financial statements have been prepared in accordance with IAS 34, *Interim Financial Reporting*, and do not include all of the information required for full annual financial statements. They should be read in conjunction with the financial statements for the year ended December 31, 2007 (hereinafter – the annual financial statements).

An explanation of how the transition to IFRSs has affected the reported financial position, financial performance and cash flows of the Company is provided in Note 10.

The condensed consolidated interim financial statements were authorized for issuance by the Company's Board of Directors on May 20, 2008.

B. Functional and presentation currency

The condensed financial statements are presented in the US dollar, which is the Company's functional currency, and have been rounded to the nearest thousand

The US dollar is the currency that represents the principal economic environment in which the Group operates.

C. Basis of measurement

The financial statements are prepared on the historical cost basis except for the following assets and liabilities that are stated at fair value: derivative financial instruments and financial instruments at fair value through profit or loss.

Non-current assets are stated at the lower of carrying amount and fair value less costs to sell.

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008

Note 2 - Basis of Preparation (cont'd)

D. Use of estimates and judgments

The preparation of the condensed financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed by management of the Company on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

The estimates and judgments that were used by management in order to implement the accounting policies and prepare the interim financial statements were identical to those it used in the preparation of the consolidated financial statements for December 31, 2007.

In 2007, management reassessed the useful life of certain manufacturing facilities (see Note 27D6 of the annual financial statements).

The effect of the change on the condensed consolidated interim financial statements is as follows:

	Balances before change in estimate	Effect of change in estimate	Balances in the financial statements (after change in estimate)
	\$ thousands		
For the three-month period ended			
March 31, 2008 (unaudited)			
Depreciation and amortization expenses	27,603	(9,709)	17,894
Loss before taxes on income	(15,616)	9,709	(5,907)
Net income	(5,189)	7,282	2,093
Earnings (loss) per share (dollar)	(0.002)	0.003	0.001
For the three-month period ended			
March 31, 2007 (unaudited)			
Depreciation and amortization expenses	21,163	(2,427)	18,736
Income before taxes on income	15,578	2,427	18,005
Net income	9,250	2,088	11,338
Earnings per share (dollar)	0.005	0.001	0.006
For the year ended			
December 31, 2007 (audited)			
Depreciation and amortization expenses	81,589	(9,709)	71,880
Income before taxes on income	176,897	9,709	186,606
Net income	134,508	7,161	141,669
Earnings per share (dollar)	0.067	0.004	0.071

The effect of the change in estimate on the results of operations of the Group for each one of the next 29 years is a decrease in depreciation expenses in the amount of \$ 9.7 million per year, compared with the depreciation expenses that were included in respect of these manufacturing facilities in the previous periods.

Note 2 - Basis of Preparation (cont'd)

E. Capital management – objectives, procedures and processes

Management's policy is to maintain a strong capital base in order to maintain the ability of the Company to continue operating so that it may provide a return on capital to its shareholders, benefits to other holders of interests in the Company such as credit providers and employees of the Company, and sustain future development of the business. The Board of Directors monitors the level of dividends to ordinary shareholders. The Company and the subsidiary Carmel Olefins Ltd. (hereinafter – Carmel) are subject to compliance with financial covenants, including a minimum balance of equity (see Note 11B and Note 15 of the annual financial statements).

Note 3 - Significant Accounting Policies

These condensed consolidated interim financial statements have been prepared on the basis of international financial reporting standards and their related interpretations (hereinafter – IFRSs) in issue that are effective or available for early adoption at the Group's first IFRS annual reporting date, December 31, 2008, and were the basis for the Group's accounting policy.

The IFRSs that will be effective or available for voluntary early adoption in the annual financial statements for the period ended December 31, 2008 are still subject to change and to the issue of additional interpretation(s) and therefore cannot be determined with certainty. Accordingly, the accounting policies for that annual period that are relevant to this interim financial information will be determined only when the first IFRS financial statements are prepared at December 31, 2008.

The preparation of the condensed consolidated interim financial statements in accordance with IAS 34 resulted in changes to the accounting policies as compared with the most recent annual financial statements prepared under Israeli GAAP. The accounting policies set out below have been applied consistently to all periods presented in these condensed consolidated interim financial statements. They also have been applied in preparing an opening IFRS balance sheet at January 1, 2007 for the purposes of the transition to IFRSs, as required by IFRS 1. The impact of the transition from Israeli GAAP to IFRSs is explained in Note 10.

The accounting policies of IFRSs have been applied consistently throughout the Group companies.

A. Basis of consolidation

The consolidated financial statements include the financial statements of the Company and the subsidiary (100%) Gadiv Petrochemical Industries Ltd. (hereinafter – Gadiv), as well as the proportionate consolidation (50%) of Carmel, a jointly controlled company.

(1) Subsidiaries

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Company.

Note 3 - Significant Accounting Policies (cont'd)

A. Basis of consolidation (cont'd)

(2) Jointly controlled company

A jointly controlled company is a company over whose activities the Group has joint control, established by contractual agreement and requiring unanimous consent for strategic financial and operating decisions. The jointly controlled company is accounted for on a proportionate consolidation basis. The consolidated financial statements include the Group's proportionate share of the jointly controlled company's assets, liabilities, revenue and expenses, which are accounted for on the proportionate consolidation basis, after adjustments to align the accounting policies with those of the Group, from the date that joint control commences until the date that joint control ceases.

(3) Affiliates

Affiliates are those entities for which the Group has significant influence, but not control, over the financial and operating policies. The investment in affiliates is accounted for using the equity method. The consolidated financial statements include the Group's share of the revenues and expenses of affiliates on an equity accounted basis, after adjustments to align the accounting policies with those of the Group, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in an entity accounted for by the equity method, the Group's carrying amount is reduced to nil (including any long-term investment) and recognition of further losses is discontinued except to the extent that the Group has an obligation to support the entity or has made payments on its behalf.

(4) Transactions eliminated on consolidation

Intra-group balances and any unrealized income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealized gains arising from transactions with affiliates are eliminated against the investment to the extent of the Group's interest in these investments.

B. Foreign currency transactions

Transactions in currencies other than the functional currency of the Group (hereinafter – foreign currencies) are translated into the functional currency of the Group at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between the cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortized cost in foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to the functional currency at the exchange rate at the date that the fair value was determined.

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008

Note 3 - Significant Accounting Policies (cont'd)

C. CPI-linked assets and liabilities that are not measured at fair value

The Company has balances of CPI-linked financial instruments. In the opinion of management of the Company, based on the position paper that was published by the Israel Accounting Standards Board, there are a number of possible methods for accounting for CPI-linked financial instruments. For purposes of these financial statements, the Company has adopted the accounting treatment by which the carrying value of the instrument and the payments derived accordingly are remeasured every period in accordance with the actual increase in the CPI. The measurement of CPI-linked financial instruments according to IFRS is currently under examination and in this framework the professional committee of the Israel Accounting Standards Board plans to request from the International Financial Reporting Interpretations Committee (IFRIC) its position regarding the accounting treatment of CPI-linked liabilities and assets according to IFRS.

In light of the above, it is possible that the aforementioned accounting treatment is not possible under IFRS and that a different accounting policy that takes into consideration expected inflation rates when measuring the financial instrument is more appropriate (on this matter see instructions 7AG and 8AG of IAS 39). If a decision is made to this effect, the Company will be required to examine the significance of such a decision, including transitional provisions, if and to the extent any are provided, on its financial statements and accompanying notes that were and will be published until the date of the decision according to IFRS.

Details regarding the CPI and exchange rate of the dollar:

	<u>March 31, 2008</u>	<u>March 31, 2007</u>	<u>December 31, 2007</u>
CPI (2000 average basis)	113.74	109.64	113.63
Representative exchange rate of 1 dollar / NIS	3.553	4.155	3.846

Details regarding the rate of change in the CPI and the exchange rate of the dollar in the reported periods:

	<u>Three months ended</u>		<u>Year ended</u>
	<u>March 31, 2008</u>	<u>March 31, 2007</u>	<u>December 31, 2007</u>
	%	%	%
CPI	0.097	(0.24)	3.39
Representative exchange rate of 1 dollar	(7.62)	(1.66)	(8.97)

Note 3 - Significant Accounting Policies (cont'd)

D. Financial instruments

(1) Non-derivative financial instruments

Non-derivative financial instruments comprise investments in equity and debt securities, trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Non-derivative financial instruments are recognized initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

A financial instrument is recognized when the Group assumes upon itself the contractual conditions of the instrument. Financial instruments are derecognized when the contractual rights of the Group to the cash flows deriving from the financial assets expire, or when the Group transfers to others the financial assets without retaining control over the asset or actually transfers all the risks and benefits deriving from the asset. Regular way purchases and sales of financial assets are recognized on the date of the transaction, meaning on the date the Group undertook to purchase or sell the asset. Financial liabilities are derecognized when the obligation of the Group, as specified in the agreement, expires or when it is settled or cancelled.

a. Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

b. Investments in securities at fair value through profit or loss

An instrument is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Group manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Group's documented risk management or investment strategy. Upon initial recognition, attributable transaction costs are recognized in profit or loss when incurred. These financial instruments are measured at fair value, and changes therein are recognized in profit or loss.

c. Other financial instruments

Other non-derivative financial instruments are measured at amortized cost using the effective interest method, less any impairment losses.

(2) Derivative financial instruments

The Group companies use derivative financial instruments in order to hedge against risks relating to prices of commodities and against foreign currency risks and interest risk. A transaction in financial instruments will be considered an accounting hedge if it meets certain conditions, including conditions regarding designation of the instrument, strict documentation requirements and high effectiveness of the hedge at the beginning and throughout the hedge.

Note 3 - Significant Accounting Policies (cont'd)

D. Derivative financial instruments (cont'd)

(2) Derivative financial instruments (cont'd)

Hedge accounting is not applied to derivative instruments serving as an economic hedge. Changes in fair value of derivative financial instruments that do not meet accounting hedge requirements are immediately recognized in profit or loss as incurred.

The Company's transactions in financial instruments that reduce economic exposures, as aforementioned, do not meet the accounting hedge conditions of IFRS, and therefore the said financial instruments are measured at fair value with the changes in fair value being recognized immediately in profit or loss.

Derivative financial instruments are recognized initially at fair value; attributable transaction costs are included in profit or loss when incurred. Changes in fair value of derivatives on prices of commodities and refining margins are classified as a separate item of cost of sales whereas changes in fair value of derivatives on foreign currency and interest rates are classified as financing expenses.

(3) Share capital

Incremental costs directly attributable to the issue of ordinary shares and share options are recognized as a deduction from equity.

E. Inventory

Inventory is stated at the lower of cost and net realizable value. Cost is determined on the basis of the moving average method, and it includes the costs incurred in acquiring the inventory and bringing it to its existing location and condition. In the case of finished goods, cost includes the attributable portion of overheads based on normal operating capacity. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. The cost of inventory of crude oil is determined on the basis of international prices.

F. Fixed assets

1. Recognition and measurement

Fixed asset items are measured at cost less accumulated depreciation and any accumulated impairment losses.

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials, direct labor, financing costs and any other costs directly attributable to bringing the asset to the location and condition necessary for it to begin operating in the manner intended by management. Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment. Investment grants were deducted from cost. Maintenance and repairs, other than periodic maintenance of facilities, is included in the statement of income as incurred.

Note 3 - Significant Accounting Policies (cont'd)

F. Fixed assets (cont'd)

1. Recognition and measurement (cont'd)

The cost of certain fixed asset items of Carmel was determined according to their fair value as at January 1, 2007, the date of transition to IFRSs (deemed cost).

2. Depreciation

Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of a fixed asset item. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term. Land is not depreciated.

Depreciation periods for the assets are as follows:

	Years	
Refining and cracking facilities	37-50	
Storage facilities	50	
Sulfur installations	15	
Facilities for manufacturing aromatic materials	(*)	
Facilities for manufacturing polymer products	4-33	(mainly 33)
Other equipment	25-50	
Buildings	50	
Computers	6	
Furniture and equipment	5-10	
Vehicles	7	

(*)Facilities for the production of aromatic materials

	Years
Production facilities	15-49
Storage facilities	50
Control system	30
Other equipment	31-50

Depreciation methods, useful lives and residual values are reviewed at each reporting date. Estimates in respect of the useful lives of certain fixed assets were revised in 2007 (see Note 2D above).

3. Catalysts are presented at cost less accumulated depreciation. The catalysts are depreciated over the period of their expected useful lives (2-10 years).
4. Costs actually incurred in respect of the periodic maintenance of facilities are amortized over the period until the next planned maintenance (approximately 4 years).
5. Spare parts are valued at cost, using the moving average method. The spare parts are depreciated on the basis of the average useful lives of the machinery and equipment (20 years).

Note 3 - Significant Accounting Policies (cont'd)

G. Intangible assets

Intangible assets that are acquired by the Group and have a definite useful life are stated at cost less accumulated amortization and impairment losses.

Amortization is recognized in profit or loss on a straight-line basis over the estimated useful lives of intangible assets, from the date that they are available for use, as follows:

1. Prepaid royalties in respect of know-how are amortized over the agreement period, usually 8 years.
2. Water and electricity rights are amortized over 25 years.

The estimates regarding the amortization method and useful life are reassessed at each reporting date.

H. Leased assets

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Other leases are operating leases and the leased assets are not recognized on the Group's balance sheet.

Leases of land from the Israel Lands Administration ("the Administration"), which are not accounted for as investment property, are operating leases. Prepaid lease fees to the Administration are presented in the balance sheet and recognized in the statement of income over the lease period.

I. Capitalization of credit costs

Specific and non-specific credit costs were capitalized to qualifying assets as defined in IAS 23, *Borrowing Costs*, throughout the period required for completion and construction until they are ready for their intended use. Non-specific credit costs are capitalized in the same manner to the same investment in qualifying assets, or portion thereof, which was not financed with specific credit by means of a rate which is the weighted-average cost of the credit sources which were not specifically capitalized. Other credit costs are expensed as incurred.

J. Impairment

(1) Financial assets

A financial asset is tested for impairment when objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate.

Note 3 - Significant Accounting Policies (cont'd)

J. Impairment (cont'd)

(1) Financial assets (cont'd)

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics. All impairment losses are recognized in profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost, the reversal is recognized in profit or loss.

(2) Non-financial assets

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its net selling price (fair value less costs to sell). In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit").

An impairment loss is recognized if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

K. Employee benefits

The Group has a number of post-employment benefit plans. The plans are usually financed by deposits with insurance companies or with pension funds, and they are classified as defined contribution plans and defined benefit plans.

(1) Defined contribution plans

The Group's obligations for contributions to defined contribution pension plans are recognized as an expense in profit or loss as incurred.

Note 3 - Significant Accounting Policies (cont'd)

K. Employee benefits (cont'd)

(2) Defined benefit plans

The Group's net obligation in respect of defined benefit post-employment plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods. That benefit is discounted to determine its present value, and the fair value of any plan assets is deducted. The discount rate is the yield at the balance sheet date on Government debentures denominated in the same currency and having maturity dates approximating the terms of the Group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

Regarding the use of a discount rate deriving from Government debentures, to the best of the Company's knowledge the matter of the discount rate in actuarial calculations is under examination and it may ultimately be decided that in Israel the appropriate discount rate is one based on corporate debentures. In this case, the data included in these financial statements will change, the actuarial liability will decrease and the current financing expenses in respect of the liability will increase.

When the calculation results in an asset for the Group, an asset is recognized up to the net present value of economic benefits available in the form of a refund from the plan or a reduction in future contributions to the plan. An economic benefit in the form of refunds or reductions in future contributions is considered available when it can be realized over the life of the plan or after settlement of the obligation.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognized as an expense in profit or loss on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognized immediately in profit or loss.

The Group immediately recognizes all actuarial gains and losses arising from defined benefit plans directly in equity.

(3) Other long-term employee benefits

The Group's net obligation in respect of long-term employee benefits, other than post-employment plans, is the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value, and the fair value of any related assets is deducted. The discount rate is the yield at the reporting date on Government debentures denominated in the same currency and having maturity dates approximating the terms of the Group's obligations. The calculation is performed using the projected unit credit method. Any actuarial gains or losses are recognized in profit or loss in the period in which they arise.

Regarding the use of a discount rate deriving from Government debentures, to the best of the Company's knowledge the matter of the discount rate in actuarial calculations is under examination and it may ultimately be decided that in Israel the appropriate discount rate is one based on corporate debentures. In this case, the data included in these financial statements will change, the actuarial liability will decrease and the current financing expenses in respect of the liability will increase.

Note 3 - Significant Accounting Policies (cont'd)

K. Employee benefits (cont'd)

(4) Termination benefits

Termination benefits are recognized as an expense when the Group is demonstrably committed, without realistic possibility of withdrawal, to a formal detailed plan regarding termination of employment before the normal retirement date. Termination benefits for voluntary redundancies are recognized as an expense if the Group has made an offer encouraging voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

(5) Short-term benefits

Short-term employee benefit obligations are measured on an actuarial basis and are expensed as the related service is provided.

A liability is recognized for the amount expected to be paid under short-term cash bonus plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

(6) Share-based payment transactions

The fair value on the grant date of options granted to employees is recognized as an employee expense with a corresponding increase in equity (capital reserve) over the period during which the employees become unconditionally entitled to the options. The amount recognized as an expense is adjusted to reflect the actual number of share options that vest.

L. Provisions

A provision is recognized if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

(1) Warranties

A provision for warranties is recognized when the underlying products or services are sold. The provision is based on historical warranty data and a weighting of all possible outcomes against their associated probabilities.

(2) Early retirement

A provision for early retirement is recognized when the Group has approved a detailed and formal retirement plan, and the restructuring either has commenced or has been announced publicly. Future operating costs are not provided for.

Note 3 - Significant Accounting Policies (cont'd)

L. Provisions (cont'd)

(3) Contingencies

A provision for contingencies is recognized when the Company believes, on the basis of the opinion of its legal counsel, that it is more probable that the monetary claim against the Company shall be accepted than denied. The provision is made on the basis of the estimate of the amounts expected in order to settle the liability. Furthermore, in rare cases in which the outcome of the contingency cannot be assessed, no provision is included in the financial statements.

M. Revenue

Revenue from the sale of goods is measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates. The credit period is usually short and constitutes the accepted credit in the industry, so that accordingly the future consideration is not discounted. Revenue is recognized when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, there is no continuing management involvement with the goods, and the amount of revenue can be measured reliably.

Transfers of risks and rewards vary depending on the individual terms of the contract of sale. For sales of products in Israel, transfer usually occurs when the product is delivered to the customer; however, for some international shipments transfer occurs upon loading the goods onto the relevant carrier.

Revenue from services rendered is recognized in profit or loss upon rendering the service if it is certain that the economic benefits associated with the service will flow to the provider of the service.

N. Provision for doubtful debts

The provision for doubtful debts is determined on a specific basis for debts the collection of which Company Management believes to be doubtful.

O. Sale of customer debts

The sale of financial assets is recognized as a sale when the control over the financial asset was fully transferred to an independent third party and all of the risks and rewards involved in the asset were transferred to the independent third party.

P. Lease payments

Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease.

Note 3 - Significant Accounting Policies (cont'd)

P. Lease payments (cont'd)

Minimum lease payments made under finance leases are apportioned between the financing expense and the reduction of the outstanding liability. The financing expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Q. Financing income and expenses

Financing income comprises interest income on funds invested, dividend income, gains on the disposal of financial assets, changes in the fair value of financial assets at fair value through profit or loss, foreign currency gains and gains on hedging instruments that are recognized in profit or loss. Interest income is recognized as it accrues in profit or loss, using the effective interest method. Dividend income is recognized in profit or loss on the date that the Group's right to receive payment is established, which in the case of quoted securities is the ex-dividend date.

Financing expenses comprise interest expense on borrowings, unwinding of the discount on provisions, changes in the fair value of financial assets at fair value through profit or loss, impairment losses recognized on financial assets, and losses on hedging instruments that are recognized in profit or loss. All borrowing costs, which are not discounted, are recognized in profit or loss using the effective interest method. Foreign currency gains and losses are reported on a net basis.

R. Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries and jointly controlled entities and affiliated companies to the extent that it is probable that they will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

Note 3 - Significant Accounting Policies (cont'd)

R. Income tax (cont'd)

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each balance sheet date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

The Company may be liable for additional tax in the event of a distribution of a dividend from certain investee companies. This additional tax was not included in the accounts in view of the Company's policy not to initiate dividend distributions that generate additional tax liabilities in its subsidiaries and in view of the existence of agreements that stipulate that the profits of affiliated companies would not be distributed as dividends.

Additional income taxes that arise from the distribution of dividends are recognized at the same time as the liability to pay the related dividend is recognized.

S. Earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Group by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which include share options and share options granted to employees.

T. Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing related products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and returns that are different from those of other segments. Segment information is presented in respect of the Group's business segments and it is based on the Group's management and internal reporting structure. Inter-segment pricing is determined on an arm's length basis.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly investments and related revenue, loans and borrowings and related expenses, income tax assets and liabilities and tax expenses.

Segment capital expenditure is the total cost incurred during the period to acquire fixed assets, and intangible assets other than goodwill.

Note 3 - Significant Accounting Policies (cont'd)

U. Environmental costs

Current costs of operating and maintaining installations used in preventing environmental pollution and expected provisions for costs relating to existing conditions deriving from current operations are expensed in the current period. Costs of constructing installations used in preventing environmental pollution are recorded as fixed assets and are depreciated in accordance with the Company's depreciation policy pertaining to the fixed assets to which the costs relate.

V. Reclassification

Until July 1, 2007, according to the Supervisory Provisions, the Company was prohibited from selling its products directly to the companies of the Group. Commencing on that date, the Company sells its products directly to the companies of the Group, not through marketing companies. The Company reclassified these sales in the amount of \$ 124 million in the consolidated financial statements for the three months ended March 31, 2007, in order to adapt them to the current manner of presentation in the financial statements as of December 31, 2007.

W. New standards and interpretations not yet adopted

- IFRS 8 *Operating Segments* (hereinafter – the Standard) determines that the “management approach” should be used in segment reporting, meaning in accordance with the format of the internal reports provided to the decision makers of the entity. Currently the Company presents segment information in respect of its business segments. Under the management approach, the Group will present segment information in respect of the refining, petrochemicals and trade business segments. The Standard is effective for annual periods beginning on or after January 1, 2009. At this point, management of the Group is unable to evaluate the effect of implementation of the Standard on its financial position and results of operations.
- Revised IAS 23 *Borrowing Costs* (hereinafter – the Standard) removes the option to expense credit costs and requires that an entity capitalize credit costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. The Standard is effective for annual periods beginning on or after January 1, 2009 and will constitute a change in accounting policy for the Group. In accordance with the transitional provisions, the Group will apply the Standard to qualifying assets for which capitalization of credit costs commences on or after the effective date. Management of the Company evaluates that implementation of the Standard will not have an effect on the financial statements of the Group.

Note 3 - Significant Accounting Policies (cont'd)

W. New standards and interpretations not yet adopted (cont'd)

- Revised IAS 1 *Presentation of Financial Statements* (hereinafter – the Standard) requires the aggregation in the financial statements of information having common characteristics and the presentation of a statement of comprehensive income. The Standard allows the presentation of income and expense items and components of other comprehensive income either in a single statement of comprehensive income with subtotals, or in two separate statements (a separate income statement followed by a statement of comprehensive income). The titles of some of the financial statements were changed in order to reflect their function more clearly (for example, the balance sheet is renamed a statement of financial position). The Standard will come into effect for annual periods beginning on or after January 1, 2009. Early adoption is permitted. At this point, management of the Group is unable to evaluate the effect of implementation of the Standard on its financial position and results of operations.

- Revised IFRS 3 *Business Combinations* and Revised IAS 27 *Consolidated and Separate Financial Statements* (hereinafter – the Standards). The principal revisions in the new Standards are as follows: The inclusion of only business combinations involving mutual entities or executed by means of contract, a change in the definitions of a business and a business combination, a change in the method of measuring items transferred in a business combination, allowing two alternatives for the measurement of non-controlling interests, change in the method of accounting for transaction costs, the accounting treatment of a step acquisition, the attribution of comprehensive income to all the shareholders, accounting for acquisitions or sales of investments while retaining control as equity transactions, accounting for transactions resulting in loss of control or gain of control at full fair value, so that the remaining holding after the loss of control is remeasured through profit or loss whereas the original investment in obtaining control is also remeasured at fair value through profit or loss, and the expansion of disclosure requirements.

The new Standards shall apply to annual periods beginning on or after July 1, 2009, and early adoption is permitted (both Standards at the same time). IFRS 3 shall apply to business combinations that occurred as from the date it becomes effective. IAS 27 shall apply retroactively, other than the attribution of comprehensive income to the shareholders, the accounting treatment of interests in a subsidiary after obtaining control, and the accounting treatment of loss of control in a subsidiary, which will be applied as from the date it becomes effective. At this point, management of the Group is unable to evaluate the effect of implementation of the Standard on its financial position and results of operations.

- Revised IFRS 2 *Share-Based Payment* (hereinafter – the Standard) provides that vesting conditions are conditions that determine whether the company is receiving the services that entitle the other party to a share-based payment, and they are restricted to service and performance conditions. Non-vesting conditions will be reflected in the fair value of the share-based payment on the grant date, and after the grant date the company shall not adjust the fair value in respect of these conditions. Furthermore, the Standard specifies the accounting treatment of non-compliance with non-vesting conditions. The Standard shall apply retroactively to annual periods beginning after January 1, 2009 and permits early adoption along with disclosure. Management of the Company evaluates that implementation of the Standard will not have an effect on the financial statements of the Group.

Note 3 - Significant Accounting Policies (cont'd)

W. New standards and interpretations not yet adopted (cont'd)

- Revised IAS 32 *Financial Instruments: Presentation* and IAS 1 *Presentation of Financial Statements* (hereinafter – the Standards). The Standards require classifying as equity certain puttable financial instruments and obligations arising on liquidation, in certain circumstances. It also provides disclosure requirements regarding puttable financial instruments that were classified as equity. The new Standards shall apply to annual reporting periods beginning on or after January 1, 2009 and early adoption is permitted. At this point, management of the Group is unable to evaluate the effect of implementation of the Standard on its financial position and results of operations.
- IFRIC 13 *Customer Loyalty Programmes* provides that sales of goods and services in which the company grants to its customers award credits are to be accounted for as multiple element transactions, and the payment received from the customer shall be allocated between its various elements based on the fair value of the award credits. The proceeds attributed to the award shall be recognized as revenue when the award credits are redeemed and the Company's obligation to provide the awards is fulfilled.

The interpretation shall apply to annual periods beginning on January 1, 2009. Early adoption is permitted. Management of the Company evaluates that implementation of the Standard will not have an effect on the financial statements of the Group.

X. New standards and interpretations adopted in the reported period:

IFRIC 14 IAS 19 – *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* provides the meaning of “anticipated refunds and right to reductions in future contributions” when calculating the limit of the net asset recognized in respect of a defined benefit plan, and clarifies how an asset or liability in respect of a pension plan may be affected by a statutory or contractual minimum funding requirement. Implementation of the interpretation has no effect on the financial statements of the Group.

NOTE 4 – SEASONAL FLUCTUATIONS

The Company manufactures oil products based on standards that fluctuate according to the seasons. The standards are intended to ensure that the quality of the products complies with changing environmental conditions, in accordance with seasonal climates.

In addition, there are seasonal fluctuations in consumption of the Company's products which affect the relative prices of the various products.

The abovementioned effect of seasonal fluctuations is relatively small compared with the effect of other factors (such as the condition of the facilities, the Company's general refining capacity, and the viability of refining and competing imports) on the scope of product sales by the Company and on its product mix.

NOTE 5 – SEGMENT REPORTING

The Group operates in the following main business segments:

- Refining: refining of crude oil and production of fuel products
- Trade: trade in crude oil and its products and trade in derivatives on the prices of oil and its products
- Polymers: production of polymer raw materials in the plastics industry
- Aromatics: production of aromatics and solvents used as raw materials and production of other products

Most trade activities are combined vertically with operations in the refining segment. The foreign trade operations are presented as a separate segment from the first quarter in 2008. The operation of the trade segment in prior periods is not material.

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008

NOTE 5 – SEGMENT REPORTING (CONT.)

Business segments

	Refining		Trade		Petrochemicals				Adjustments to consolidated		Consolidated	
					Polymers		Aromatics					
	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
For the three month period ended on March 31												
(unaudited)												
Total segment revenues	1,748,597	1,027,492	79,000	-	107,646	73,884	148,896	115,172	(198,443)	(135,547)	1,885,696	1,081,001
Gross profit in the segment	19,250	57,529	2,000	-	4,903	10,501	15,872	11,009	(990)	(1,096)	41,035	77,943
Sales, general and administrative expenses											25,200	26,814
Privatization grant											-	28,360
Operating profit											15,835	22,769

	Refining		Trade		Petrochemicals				Adjustments to consolidated		Consolidated	
					Polymers		Aromatics					
	For the year ended December 31, 2007											
Audited												
Total segment revenues	5,009,956					342,549	523,452		(639,012)		5,236,945	
Gross profit in the segment	306,784					48,586	62,067		(5,714)		411,723	
Sales, general and administrative expenses												101,545
Privatization grant												28,360
Operating profit												281,818

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
(in USD thousands)

NOTE 6 – TAXES ON INCOME

On February 26, 2008, the Israeli parliament passed the Income Tax Law (Inflationary Adjustments) (Amendment No, 20) (Restriction of Period of Applicability) 5768-2008 (the amendment). According to the amendment, the applicability of the Adjustments Law will end in the 2007 tax year, and in the 2008 tax year, the provisions of the law will no longer apply, except for the transition provisions, the goal of which is to prevent distorted tax calculations.

According to the Amendment, from the 2008 tax year and thereafter, income will no longer be adjusted to a real measurement basis for tax purposes. In addition, amounts of depreciation in respect of fixed assets and tax loss carryforwards will no longer be linked to the index, such that these amounts will be adjusted to the index at the end of 2007 and their linkage to the index will be discontinued from that date and henceforth.

NOTE 7 – FIXED ASSETS

Capital agreements

In the three-month period ended March 31, 2008 the Group signed agreements for the purchase of fixed assets in the amount of \$35.616 million. The fixed assets are expected to be transferred to the Group by the end of 2009.

NOTE 8 – CAPITAL AND FUNDS

Additional changes in shareholders' equity

	Share capital	Capital reserve for share- based payment	Capital reserve	Retained earnings	Total
For three month period ended March 31, 2008					
(unaudited)					
Balance as of January 1, 2008 (audited)	472,478	558	28,478	298,289	799,803
Share-based payments	-	747	-	-	747
Comprehensive income for the period	-	-	-	2,093	2,093
Balance as of March 31, 2008 (unaudited)	<u>472,478</u>	<u>1,305</u>	<u>28,478</u>	<u>300,382</u>	<u>802,643</u>
For three month period ended March 31, 2007					
(unaudited)					
Balance as of January 1, 2007 (audited)	239,819	-	-	454,504	694,323
Distribution of bonus shares	232,659	-	-	(232,659)	-
Company's share in capital reserves	-	-	867	-	867
Payment of issuance expenses for controlling shareholder	-	-	-	(890)	(890)
Payment of privatization grant to employees of the Company by the State	-	-	23,388	-	23,388
Payment of privatization grant to employees of investees	-	-	5,138	-	5,138
Comprehensive income for the period	-	-	-	11,338	11,338
Balance as of March 31, 2007 (unaudited)	<u>472,478</u>	<u>-</u>	<u>29,393</u>	<u>232,293</u>	<u>734,164</u>

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
(in USD thousands)

NOTE 8 – CAPITAL AND FUNDS (CONT.)

Additional changes in shareholders' equity (cont.)

For the year ended December 31, 2007					
(audited)					
	Share capital	Capital reserve for share- based payment	Capital reserve	Retained earnings	Total
Balance as of January 1, 2007	239,819	-	-	454,504	694,323
(audited)					
Distribution of bonus shares	232,659	-	-	(232,659)	-
Company's share in capital reserves	-	-	(48)	-	(48)
Payment of issuance expenses to controlling shareholders	-	-	-	(1,046)	(1,046)
Payment of privatization grant to employees of the Company by the State	-	-	23,388	-	23,388
Payment of privatization grant to employees of investees	-	-	5,138	-	5,138
Share-based payments	-	558	-	-	558
Dividend declared and paid	-	-	-	(69,410)	(69,410)
Comprehensive income for the period	-	-	-	146,900	146,900
Balance as of January 1, 2007	472,478	558	28,478	298,289	799,803
(audited)					

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
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NOTE 9 – CHANGES IN CONTINGENT LIABILITIES AND AGREEMENTS

A. Litigation

1. A civil suit was 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. In the reporting period there was no material change in the status of this lawsuit. See also Note 19.B.(1) to the annual financial statements as of December 31, 2007.
2. Suits were filed against the Company and certain investees, alleging 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. In the reporting period there was no material change in the status of these suits. Based on the opinion of the legal counsels of the Company and its investee companies, the Company management is unable to assess the extent of the exposure, if any exists, and therefore, no provision regarding this matter was included in their financial statements. See also Note 19.B.(2) to the annual financial statements as of December 31, 2007.
3. A claim was filed by Israel Shipyards Ltd. against the Company and 11 other parties, including Gadiv, Carmel Olefins and an affiliate, alleging that the defendants polluted the Kishon River, causing damage to the plaintiff's facilities at the river mouth. The lawsuit amounts to NIS 21 million (as of the date of filing - January 2004) and an undefined amount is claimed for future damages and compensation. On the date of the financial statements, the lawsuit is in the stage of pretrial and hearing of evidence in a case that is expected to commence in 2009.

On March 18, 2008 the plaintiff and Carmel Olefins signed a compromise agreement according to which the lawsuit against Carmel Olefins will be dismissed and all procedures relating exclusively to Carmel Olefins will be deleted from the expert opinion on behalf of the plaintiff. In the compromise agreement, Carmel Olefins undertook that if a compromise is achieved with the consent of most of the defendants and third parties, which will end all proceedings in the lawsuit, it will participate in 2.8% of the amount paid to the plaintiff under the compromise agreement.

On March 26, 2008 this compromise agreement was given the validity of judgment. Carmel Olefins is negotiating with the plaintiffs to prevent it from being served a third-party notice therefore its final status in the case has yet to be clarified. In the current situation, the legal counsels of Carmel Olefins estimate that Carmel Olefins will not be charged a material amount for this suit, if at all.

4. The Company received property tax notices from the Haifa Municipality for part of 2005 and for 2006 - 2008 (inclusive). For part of 2005, the Company was billed for NIS 8 million, for 2006 it was billed for NIS 48 million, for 2007 it was billed for similar amount to that of 2006, and for 2008 it was billed for NIS 51 million. The Company filed reservations and appeals on these charges and concurrently, filed an appeal with the High Court of Justice against the Ministers of Finance and the Interior and against the relevant municipal entities, in connection with the legality of the property tax demands. The Company paid advances - without admitting the legality of the charges - in a total amount of NIS 53.3 million, on account of the property taxes due (and/or to be due in the future) from it by law.

At the beginning of April 2008, the Haifa Municipality sent the Company an amended assessor notice for the period from October 26, 2005 to the end of 2008. Pursuant to this notice, the expected balance of the Company's debt, less the abovementioned advanced payment, after the municipality's planned measuring of the Company's grounds, the amount will increase to NIS 94.5 million for the period until the end of February 2008.

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
(in USD thousands)

NOTE 9 – CHANGES IN CONTINGENT LIABILITIES AND AGREEMENTS (CONT.)

A. Litigation (cont.)

5. On May 12, 2008 a hearing was held in the Haifa offices of the Ministry of Environmental Protection. The hearing was attended by Petroleum and Energy Infrastructure Company Ltd. (PEI), Eilat Ashkelon Pipeline Company Ltd. (EAPC) and the Company, after the Ministry of Environmental Protection alleged that it discovered findings that could indicate pollution near the fishing harbor in the PEI strip where Haifa Refinery and EAPC pipeline works are carried out, and that soil suspected as polluted was removed from the area to the Haifa Refinery. At the hearing, the Company stated that it patrols the strip, the pipeline has cathode protection and the pipeline is tested before any inflow. The test results indicate that there was no leakage from the pipeline. Notwithstanding the aforesaid, the Company cannot rule out the possibility that there is exposure on this matter, in amounts that it cannot estimate at this stage, inter alia, because the scope of the pollution, if it exists, is unknown. In addition, the Company does not know if there is any pollution, when it was created and who is responsible.

With the exception of the aforesaid, in the reporting period there were no material changes in the lawsuit filed against the Group companies.

The Group companies account for provisions for claims which, based on the opinion of legal counsel, are likely to materialize. The provisions are made according to the estimated amounts of payments to remove the liabilities. The amount of the additional exposure for which there is no provision amounts to \$ 169 million (not including the lawsuits in subsections 1 and 2 above).

B. Agreements

To maintain the operations of the Company, the Company is dependent upon receipt of services from the infrastructure companies, Oil and Energy Infrastructures Ltd. and Eilat Ashkelon Oil Pipeline Ltd. which own crucial infrastructure pertaining to the unloading, shipping, storage, and issuance of crude oil and distillates.

NOTE 10 – IMPACT OF TRANSITION TO IFRS

A. General

As noted in Note 2(A) above, these are the first condensed consolidated interim financial statements that the Group has prepared for part of the period included in the first consolidated financial statements prepared according to IFRS.

The accounting policy described in Note 3 was applied when preparing the condensed consolidated interim financial statements for the three months ended March 31, 2008, the comparative data for the three months ended March 31, 2007, the comparative data for the year ended December 31, 2007 and the opening balance sheet according to IFRS on January 1, 2007 (hereinafter: the transition date)..

This note was presented on the basis of IFRS principles as currently known, which were issued and will come into effect or that are subject to early adoption as of the first annual reporting date of the Group in accordance with IFRS, December 31, 2008, on the basis of which the Company's accounting policies were determined. IFRS principles which will be in effect or which are subject to early adoption in the annual financial statements for the year ended December 31, 2008 are subject to changes and to the publication of additional clarifications. Therefore, they cannot be determined with certainty. Accordingly, the accounting policies that were applied in respect of the reported periods will be determined finally only at the time of the preparation of the first financial statements in accordance with IFRS as of December 31, 2008.

An explanation of the effect of the transition from Israeli GAAP to IFRS on the financial position of the Group, the results of its operations and its cash flows is presented in the following tables and notes.

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
(in USD thousands)

NOTE 10 – IMPACT OF TRANSITION TO IFRS (CONT.)

B. Balance sheet

		January 1, 2007			
		Israeli GAAP	Impact of change of functional currency to USD	Impact of transition	IFRS
Note G		NIS thousands	USD thousands *	USD thousands	USD thousands
Current assets					
	Cash and cash equivalents	523,570	123,921	-	123,921
	Investment in financial assets at fair value in profit and loss	414,749	98,165	-	98,165
	Trade receivables	2,175,459	514,902	-	514,902
8	Receivables and debit balances	437,319	104,716	5,813	110,529
	Income tax	17,382	2,057	-	2,057
4	Inventory	2,813,392	664,346	(9,658)	654,688
		<u>6,381,871</u>	<u>1,508,107</u>	<u>(3,845)</u>	<u>1,504,262</u>
Investments and long-term loans					
	Investees	191,002	52,864	4,826	57,690
2	Long term loans and debit balances	7,409	1,755	-	1,755
2	Excess of funded amounts over the liability for severance pay, net	45,458	10,759	(2,937)	7,822
		<u>243,869</u>	<u>65,378</u>	<u>1,889</u>	<u>67,267</u>
3,5,6,7	Fixed assets, net	<u>3,827,045</u>	<u>883,519</u>	<u>75,003</u>	<u>958,522</u>
7	Intangible assets and deferred expenses, net	<u>48,100</u>	<u>10,678</u>	<u>1,998</u>	<u>12,676</u>
		<u>10,500,885</u>	<u>2,467,682</u>	<u>75,045</u>	<u>2,542,727</u>
Current liabilities					
	Credit from banking institutions and other credit providers	899,142	212,815	-	212,815
	Suppliers and service providers	2,214,883	524,233	-	524,233
2,4	Other payables	614,961	145,407	(12,570)	132,837
	Provisions	87,785	20,778	-	20,778
	Income tax	82,563	19,542	-	19,542
	Declared dividend	20,000	4,734	-	4,734
		<u>3,919,334</u>	<u>927,509</u>	<u>(12,570)</u>	<u>914,939</u>
Long term liabilities					
	Debentures	854,799	202,319	-	202,319
	Bank loans	2,205,647	522,047	-	522,047
	Deferred taxes	498,352	112,827	11,309	124,136
	Liabilities for financing lease	29,275	6,929	-	6,929
2	Liabilities for severance pay, net	278,801	65,988	12,046	78,034
		<u>3,866,874</u>	<u>910,110</u>	<u>23,355</u>	<u>933,465</u>
	Total liabilities	<u>7,786,208</u>	<u>1,837,619</u>	<u>10,785</u>	<u>1,848,404</u>

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
(in USD thousands)

NOTE 10 – IMPACT OF TRANSITION TO IFRS (CONT.)

B. Balance sheet (cont.)

		January 1, 2007			
	Israeli GAAP	Impact of change of functional currency to USD	Impact of transition	IFRS	
<u>Note G</u>	<u>NIS</u> <u>thousands</u>	<u>USD</u> <u>thousands *</u>	<u>USD</u> <u>thousands</u>	<u>USD</u> <u>thousands</u>	
Shareholders' equity					
Share capital	919,650	239,819	-	239,819	
Adjustments for translation of financial statements of autonomous units	(435)	(103)	103	-	
Retained earnings	1,795,462	390,347	64,157	454,504	
	2,714,677	630,063	64,260	694,323	
	10,500,885	2,467,682	75,045	2,542,727	

See Note G(1) below

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
(in USD thousands)

NOTE 10 – IMPACT OF TRANSITION TO IFRS (CONT.)

C. Balance sheet

		As of March 31, 2007			
		Israeli GAAP	Impact of change of functional currency to USD	Impact of transition	IFRS
Note G	NIS thousands	USD thousands *	USD thousands	USD thousands	
Current assets					
	197,393	47,507	-	47,507	
	-	-	794	794	
	421,910	101,543	-	101,543	
	1,818,937	437,771	-	437,771	
	500,589	107,101	(9,009)	98,092	
4	2,770,426	673,076	-	673,076	
	<u>5,709,255</u>	<u>1,366,998</u>	<u>(8,215)</u>	<u>1,358,783</u>	
Investments and long-term loans					
	179,841	54,741	1,276	56,017	
	299,592	72,104	-	72,104	
4	7,343	1,767	-	1,767	
2	39,641	9,541	(2,617)	6,924	
	<u>526,417</u>	<u>138,153</u>	<u>(1,341)</u>	<u>136,812</u>	
3,5,6,7	Fixed assets, net	3,922,314	908,865	58,363	967,228
7	Intangible assets and deferred expenses, net	47,175	10,574	1,998	12,572
	<u>10,205,161</u>	<u>2,424,590</u>	<u>50,805</u>	<u>2,475,395</u>	
Current liabilities					
	1,369,470	329,597	-	329,597	
	1,313,788	316,195	-	316,195	
2,4	374,762	90,195	(11,768)	78,427	
	-	-	9,677	9,677	
	62,682	15,086	-	15,086	
	109,626	26,384	-	26,384	
	<u>3,230,328</u>	<u>777,457</u>	<u>(2,091)</u>	<u>775,366</u>	
Long term liabilities					
	987,312	237,621	-	237,621	
	2,198,782	529,189	-	529,189	
	511,917	117,460	(3,355)	114,105	
	29,247	7,039	-	7,039	
2	268,659	64,659	13,252	77,911	
	<u>3,995,917</u>	<u>955,968</u>	<u>9,897</u>	<u>965,865</u>	
	<u>7,226,245</u>	<u>1,733,425</u>	<u>7,806</u>	<u>1,741,231</u>	
Total liabilities					

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
(in USD thousands)

NOTE 10 – IMPACT OF TRANSITION TO IFRS (CONT.)

C. Balance sheet (cont.)

		As of March 31, 2007			
	Israeli GAAP	Impact of change of functional currency to USD	Impact of transition	IFRS	
Note G	NIS thousands	USD thousands *	USD thousands	USD thousands	
Shareholders' equity					
Share capital	2,000,000	472,478	-	472,478	
Capital reserve for translation differentials	(752)	-	-	-	
Capital reserve	118,529	28,478	915	29,393	
Retained earnings	861,139	190,209	42,084	232,293	
	2,978,916	691,165	42,999	734,164	
	10,205,161	2,424,590	50,805	2,475,395	

See NOTE G (1) below

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
(in USD thousands)

NOTE 10 – IMPACT OF TRANSITION TO IFRS (cont)

D. Balance sheet

		As of December 31, 2007			
		Israeli GAAP	Impact of change of functional currency to USD	Impact of transition	IFRS
Note G	NIS thousands	USD thousands *	USD thousands	USD thousands	
Current assets					
	Cash and cash equivalents	997,363	259,325	-	259,325
	Derivatives at fair value in profit and loss	25,049	6,513	-	6,513
	Investment in financial assets at fair value through profit and loss	434,734	113,035	-	113,035
	Trade receivables	1,517,130	394,470	-	394,470
8	Receivables and debit balances	351,241	88,614	(4,585)	84,029
	Income tax	39,046	10,153	-	10,153
4	Inventory	4,148,554	1,054,976	(12,431)	1,042,545
		<u>7,513,117</u>	<u>1,927,086</u>	<u>(17,016)</u>	<u>1,910,070</u>
Investments and long-term loans					
	Investees	160,066	49,143	4,815	53,958
	Loan to Haifa Early Pensions Ltd.	307,827	80,038	-	80,038
4	Long term loans and debit balances	17,290	4,496	1,706	6,202
2	Excess of funded amounts over the liability for severance pay, net	37,089	9,644	(2,125)	7,519
		<u>522,272</u>	<u>143,321</u>	<u>4,396</u>	<u>147,717</u>
3,5,6,7	Fixed assets, net	<u>3,870,594</u>	<u>897,962</u>	<u>80,450</u>	<u>978,412</u>
7	Intangible assets and deferred expenses, net	<u>89,814</u>	<u>20,928</u>	<u>1,996</u>	<u>22,924</u>
		<u>11,995,797</u>	<u>2,989,297</u>	<u>69,826</u>	<u>3,059,123</u>
Current liabilities					
	Credit from banking institutions and other credit providers	830,818	216,021	-	216,021
	Suppliers and service providers	2,158,499	561,232	-	561,232
2,4	Other payables	377,705	98,208	(5,955)	92,253
	Provisions	76,727	19,950	-	19,950
		<u>3,443,749</u>	<u>895,411</u>	<u>(5,955)</u>	<u>889,456</u>

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
(in USD thousands)

NOTE 10 – IMPACT OF TRANSITION TO IFRS (cont)

D. Balance sheet (cont.)

		As of December 31, 2007			
		Israeli GAAP	Impact of change of functional currency to USD	Impact of transition	IFRS
Note G	NIS thousands	USD thousands *	USD thousands	USD thousands	
Long term liabilities					
	2,758,742	717,302	-	717,302	
	1,738,983	452,154	-	452,154	
	563,569	116,884	8,403	125,287	
	29,857	7,763	-	7,763	
2	222,703	57,905	9,453	67,358	
	<u>5,313,854</u>	<u>1,352,008</u>	<u>17,856</u>	<u>1,369,864</u>	
	8,757,603	2,247,419	11,901	2,259,320	
Shareholders' equity					
	2,000,000	472,478	-	472,478	
	(6,139)	-	-	-	
	118,529	28,478	-	28,478	
	2,174	558	-	558	
	240,000	62,402	(62,402)	-	
	883,630	177,962	120,327	298,289	
	<u>3,238,194</u>	<u>741,878</u>	<u>57,925</u>	<u>799,803</u>	
	<u>11,995,797</u>	<u>2,989,297</u>	<u>69,826</u>	<u>3,059,123</u>	

See NOTE G (1) below

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
(in USD thousands)

NOTE 10 – IMPACT OF TRANSITION TO IFRS (cont)

E. Statement of income

		For the three months ended March 31, 2007			
		Israeli GAAP	Impact of change of functional currency to USD	Impact of transition	IFRS
Note G		NIS thousands	USD thousands *	USD thousands	USD thousands
	Revenues	4,796,034	1,081,001	-	1,081,001
	Cost of sales, refinery and services	4,335,820	984,846	(14,916)	969,930
	Revaluation of open positions in derivatives on prices of goods and margins, net	-	-	33,128	33,128
	Total cost of sales	4,335,820	984,846	18,212	1,003,058
	Gross profit	460,214	96,155	(18,212)	77,943
	Selling expenses	30,579	7,650	-	7,650
	General and administrative expenses	82,901	19,164	-	19,164
	Privatization grant	-	-	28,360	28,360
	Operating Income	346,734	69,341	(46,572)	22,769
	Financing income	20,980	7,489	452	7,941
	Financing expenses	(18,772)	(13,254)	(1,422)	(14,676)
	Privatization grant	(118,529)	(28,360)	28,360	-
	Company's share in earnings of affiliates	-	-	1,971	1,971
	Profit before income tax	230,413	35,216	(17,211)	18,005
	Taxes on income	(90,044)	(14,531)	7,864	(6,667)
	Earnings after taxes on income	140,369	20,685	(9,347)	11,338
	Company's share in earnings of affiliates	9,156	5,521	(5,521)	-
	Net profit for the year	149,525	26,206	(14,868)	11,338
	Earnings per ordinary share				
	Basic and diluted earnings, net, per ordinary share	0.075	0.013	(0.007)	0.006

See Note G(1) below

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
(in USD thousands)

NOTE 10 – IMPACT OF TRANSITION TO IFRS (cont)

F. Statement of income

		For the year ended December 31, 2007			
		Israeli GAAP	Israeli GAAP	Effect of the transition	IFRS
Note G		NIS thousands	USD thousands *	USD thousands	USD thousands
	Revenues	21,339,364	5,236,945	-	5,236,945
	Cost of sales, refinery and services	19,843,713	4,788,715	16,351	4,805,066
	Revaluation of open positions in derivatives on prices of goods and margins, net	-	20,156	-	20,156
	Total cost of sales	19,843,713	4,808,871	16,351	4,825,222
	Gross profit	1,495,651	428,074	(16,351)	411,723
	Selling expenses	137,077	33,518	-	33,518
	General and administrative expenses	276,802	67,907	120	68,027
	Privatization grant	-	-	28,360	28,360
	Operating income	1,081,772	326,649	(44,831)	281,818
	Financing income	25,537	32,919	1,706	34,625
	Financing expenses	(75,090)	(135,895)	(855)	(136,750)
	Privatization grant	(117,833)	(28,360)	28,360	-
	Company's share in earnings (losses) of affiliates	-	-	6,913	6,913
	Earnings (loss) before income tax	914,386	195,313	(8,707)	186,606
	Tax benefits (taxes on income)	(241,653)	(49,003)	4,066	(44,937)
	Earnings after taxes on income	672,733	146,310	(4,641)	141,669
	Company's share in earnings of affiliates	19,833	6,875	(6,875)	-
	Net profit for the year	692,566	153,185	(11,516)	141,669
	Earnings per ordinary share				
	Basic and diluted earnings per ordinary share	0.346	0.077	(0.006)	0.071

See NOTE G (1) below

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
(in USD thousands)

NOTE 10 – IMPACT OF TRANSITION TO IFRS (cont.)

G. Notes to IFRS reconciliation

1. According to Israeli GAAP, it was possible to determine a functional currency other than the new shekel only where most of the revenues received and most of the assets purchased are in that same currency. Under IFRS, in order to determine the functional currency, the entity has to take into consideration the following factors (among others):
 - a. The currency that affects mainly the sale price of goods and services (usually this will be the currency in which the sale prices are denominated and settled) and the currency of the country whose competitive and regulatory forces mainly determine the sale prices of goods and services.
 - b. The currency that affects mainly the costs of labor, materials, and other costs incurred in the supply of goods and services (usually, this will be the currency in which these costs are denominated and settled).
 - c. There are also other factors that can provide evidence of the functional currency of the entity, such as the currency in which monetary sources are generated from financing activities and the currency in which receipts from current operations are held.

According to Israeli GAAP, the functional currency of the Company is the shekel, whereas according to IFRS, the functional currency is the dollar.

2. According to Israeli GAAP, liabilities in respect of employee severance are recognized on the basis of the full indebtedness, under the assumption that all of the employees will be terminated under conditions that entitle them to full severance pay, ignoring discount rates, future increases in salaries and future terminations. In addition, the liabilities in respect of vacation pay, convalescence pay and unutilized sick pay were calculated on the basis of estimates regarding utilization and redemption, respectively. At the date of transition to IFRS, all of the net liabilities in respect of benefits to employees after termination and other long-term benefit plans are measured in accordance with the provisions of IAS 19 regarding employee benefits. Benefits after termination that are in respect of defined benefit plans are measured on the basis of actuarial estimates and discounted amounts. The discount rate used is based on the interest rate of government bonds since the Company believes that there is no high quality deep market for corporate bonds in Israel. This issue will be subjected to an in-depth study by a task force of the Israel Securities Authority, so it is possible that a decision on the issue will be made that is different than the accounting in the financial statements.

The Company elected to recognize actuarial gains and losses directly to shareholders' equity (retained earnings), pursuant to the existing alternatives in IAS 19, since under this alternative, the balance sheet reflects the proper fair value of the net liability to employees as of the cutoff date and, in accordance with this alternative, the statement of income more fairly reflects the results of operations of the Company by avoiding volatility in respect of actuarial gains and losses.

3. According to Israeli GAAP, leasing buildings from the State was presented as a transaction with an interested party. The financial leasing transaction with a controlling shareholder was recorded as a long-term financial liability and, accordingly, the difference between the liability for minimum leasing fees and the cost of the buildings on the books was carried to a capital reserve.

According to IFRS, the leasing of the buildings was recognized as a financial lease. According to international standards, the liability in respect of a financial lease is recorded against an asset - buildings (and not as a capital reserve), in an amount equal to the present value attributed to the buildings. Therefore, the buildings were recorded in the books of the Company based on the minimum leasing fee.

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
(in USD thousands)

NOTE 10 – IMPACT OF TRANSITION TO IFRS (cont)

G. Notes to FRS reconciliation (cont.)

4. The Group companies use financial instruments, including derivative financial instruments, to reduce exposure to the risks of the prices of goods, currency risks and interest risks. According to GAAP, the conditions for implementing hedge accounting are based mainly on economic criteria. In addition, under certain circumstances, derivative financial instruments that qualify for accounting hedging are not measured at fair value and sometimes are not even recognized in the balance sheet. According to IFRS, in order for a transaction in financial instruments to be recognized as an accounting hedging transaction, it has to fulfill certain conditions, including conditions dealing with the designation of the instrument, compliance with strict documentation requirements, and high hedging effectiveness at the beginning of and during the course of the entire hedge. The changes in the fair value of the financial instrument designated for hedging of the asset or liability will be charged in the statement of income with a corresponding charge of the changes in the fair value of the defined asset or liability relating to the hedged risk. In addition, under IFRS, changes in the fair value of derivative financial instruments that do not fulfill the conditions required for hedge accounting are immediately charged to the statement of income in each period.

The transactions conducted by the Company in financial instruments to reduce this exposure do not comply with the hedge conditions set out in international standards and, therefore, in the transition to IFRS, these financial instruments are measured at fair value, with the changes in the fair value immediately carried to the statement of income.

The changes in the fair value of the derivatives on prices of goods and refining margins are classified in a separate item as part of cost of sales, whereas changes in the fair value of derivatives on exchange rates and interest rates are classified to financing expenses.

5. In accordance with the leniency permitted by the provisions of IFRS 1, Carmel Olefins elected to measure fixed asset items (property, buildings, machinery and equipment) at their fair value as of January 1, 2007 and to use the same fair value as deemed cost as of the transition date. The deemed cost was based on the opinion of an external expert. In addition, the useful lifespan of some of the assets was changed (see paragraph 6 below).

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NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
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NOTE 10 – IMPACT OF TRANSITION TO IFRS (cont)

G. Notes to IFRS reconciliation (cont.)

6. Change in the estimate of the useful lifespan of fixed assets.

International Accounting Standard IAS 16 – Fixed Assets stipulates that the useful lifespan of an asset be reviewed at least at the end of each fiscal year and if the expectations are different from the previous estimates, the change should be handled as a change in accounting estimate in accordance with IAS 8 – Accounting Policy, Changes in Accounting Estimates and Errors.

In October 2007, the Israel Securities Authority issued decision 3-17 regarding a change in the estimate of the useful lifespan of fixed assets (hereinafter - the “authority's decision”). The authority's decision applies to financial statements presented in accordance with IFRS. According to the authority's decision, a change in estimate of the useful lifespan of an asset may be based on the accumulated experience of the company regarding the same asset, if the company has concrete and reliable evidence in support of making such a change.

In 2007, the companies of the Group, through an external appraiser of industrial matters, assessed the useful lifespan of certain production facilities. According to the opinion of the appraiser, further to renovations and steps taken for purposes of extending the lifespan of the facilities, there was a change in the estimate of the economic lifespan of those production facilities, and their average lifespan was extended by 10 to 20 years.

The reason for the change in estimate rests with a basic change in the treatment by the companies of the Group for maintenance of their facilities and their approach to the periodic maintenance. To the extent that this deals with maintenance, the companies made a transition from maintenance that is basically corrective maintenance (repair) to maintenance that is basically preventive maintenance. Contrary to the past, in recent years extensive maintenance work is carried out in advance, on the basis of examinations conducted at the facilities, all in order to reduce to a minimum the cases in which facilities will be shut down due to malfunction. As part of the maintenance work, tanks and major equipment are replaced when they appear to be "old" or may fail, or when the new equipment allows for significant technological improvement.

Regarding periodic maintenance - most of the facilities of the Company undergo periodic maintenance every four years. In recent years, as part of the periodic maintenance, major equipment items were replaced, entire tanks were replaced in the facility instead of partial repairs to a tank that appeared to be damaged or "tired", and backup systems were pressed into service in the event of damage to a main system at the facility, as well as to improve the utilization or consumption of energy.

The changes in the maintenance policy and in the manner in which the renovations are performed are material changes in the manner of operations of the companies of the Group, which improve the facilities and significantly change the estimate regarding the lifespan that was estimated by the Company in the past (in 1997), based on the manner of treatment of the facilities at that time.

7. According to Israeli GAAP, leased property is classified as fixed assets and is not depreciated. According to international standards, in cases in which such property is not considered to be owned by the Company, the leasing payments are classified as a deferred expense and are amortized over the leasing period, including an option to extend the leasing period, if at the date of the leasing transaction it is reasonably certain that the option will be exercised.

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NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
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NOTE 10 – IMPACT OF TRANSITION TO IFRS (cont)

G. Notes to IFRS reconciliation (cont.

8. According to Israeli GAAP, deferred tax assets are classified as current assets or non-current assets, depending upon the classification of the assets in respect of which the deferred taxes were generated. According to IFRS, deferred tax assets are classified as non-current assets even if the date of utilization is expected to be in the short term
9. According to Israeli GAAP, in the consolidated statement of income, earnings and losses on the sale of fixed assets, expenses in respect of reorganization, expenses in respect of early retirement of employees and revenues in respect of the privatization grant were not presented as part of operating income (as part of other income / expenses). Under IFRS these items will be included as part of operating income.
10. According to the leniency permitted by the provisions of IFRS 1, translation differentials generated prior to the date of transition to IFRS in respect of foreign operations are carried to retained earnings on the date of transition to IFRS.
11. In the absence of specific instructions in IFRS, the Company elected to carry the increase in shareholders' equity in respect of the recording of share-based payment expenses to capital reserve.
12. According to Israeli GAAP, a dividend that was declared subsequent to the balance sheet date and until the date of the approval of the financial statements is presented as part of shareholders' equity as a separate item entitled "Dividend proposed or declared subsequent to the balance sheet date", against a decrease in retained earnings. According to IFRS, the entity is required only to give disclosure to the dividend but not actually reclassify amounts in equity.
13. Accounting with index-linked financial instruments:

The Company has balances of index-linked financial instruments. In the opinion of the Company's management, based on the draft position paper of the Israel Accounting Standards Board (IASB), there are a number of possible alternatives for accounting of index-linked financial instruments. For purposes of preparing this note, the Company adopted accounting whereby the book value of the instrument and the payments deriving therefrom are revalued in each period on the basis of the actual increase in the index and therefore there is no need to reconcile the value of the instruments in accordance with Israeli standards and their value in accordance with international standard.

Measurement of index-linked financial instruments according to IFRS is under review, and as part of this study, the professional committee of the IASB and the professional committee of the Israel Accounting Standards Board will turn to the International Financial Reporting Interpretations Committee (IFRIC) for their position regarding the accounting of index-linked liabilities and assets under IFRS.

In view of the above, it could be determined that the abovementioned accounting is not possible under IFRS and that different accounting, whereby the expectations of inflation should be taken into consideration when measuring the financial instrument, would be more appropriate. In connection with this matter, see provisions AG7 and AG8 of IAS 39. If this is indeed the decision, the Company will be required to examine the implication, including transition provisions, if determined, on its financial statements and notes as published and as will be published until the decision is made according to international standards.

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
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NOTE 10 – IMPACT OF TRANSITION TO IFRS (cont)

G. Notes to IFRS reconciliation (cont.)

14. Accounting of the holding in a jointly-controlled company:

According to Israeli GAAP, companies in which the Company has joint control are presented in accordance with the proportionate consolidation method. According to IFRS, an entity has the choice of presenting the investment in such companies either under the proportionate consolidation method or the equity method. The Company elected to continue presenting its investments in jointly-controlled entities under the proportionate consolidation method, in order to fairly reflect the calculation of the assets and liabilities and the results of operations of the jointly-controlled company.

15. Accounting of business combinations:

The company did not retroactively apply IFRS 3 Business Combinations. Therefore, goodwill and surplus cost generated by business combinations that occurred prior to January 1, 2007, were not accounted on the basis of IAS 3, but in accordance with Israeli GAAP.

H. Material adjustments to the cash flow statement in 2007 and for the three month period ended March 31, 2007

1. According to Israeli GAAP, interests received are classified as cash flows from operating activities. According to IFRS and based on the accounting policy adopted by the Company, interests received are classified as cash flows from financing operations.
2. According to Israeli GAAP, the effect of exchange rate fluctuations on cash balances is entered as cash flow from operating activities. According to IFRS, the effect of exchange rate fluctuations on cash balances is classified under a different item.

There are no other material differences between the cash flow statement presented according to IFRS and the cash flow statement presented according to Israeli GAAP.

NOTE 11 – MATERIAL EVENTS IN THE REPORTING PERIOD

A. Trade receivables

In January 2008, the Company entered into an agreement with a banking institution (the bank). As part of the agreement, it was stipulated that the liabilities reflected in invoices to be received by the bank for discount are endorsed from the Company to the bank pursuant to the Law for the Endorsement of Charges 5729-1969. The endorsement is absolute, final, and complete, and unconditional, by way of a sale. The endorsement is independent and cannot be changed or cancelled without the prior written consent of the bank.

On March 31, 2008 the consolidated discount balance amounted to \$187 million.

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
(in USD thousands)

NOTE 11 – MATERIAL EVENTS IN THE REPORTING PERIOD (CONT.)

B. New financial covenants

In view of adoption of IFRS in the first quarter of 2008, in March 2008 Carmel Olefins and the banks and debenture holders agreed to amend some of the original financial covenants valid from January 1, 2008. The new financial covenants are described below.

New financial covenants with the banks:

1. The definition of the debt coverage ratio was changed as follows: The ratio between the operating profit in the period with the addition of depreciation and amortization and the amount of the fund payments for that period with the addition of payments of interests on long-term loans (less the difference for the funds and interest swap currency transactions for the period) and short term loans and the current taxes for that period.
2. Tangible shareholders' equity will not fall below \$138 million. Tangible shareholders' equity is defined as equity less deferred expenses and other intangible assets.
3. Tangible shareholders' equity as a percentage of the total balance sheet will not fall below 29%.
4. The ratio between all the liabilities to banks and financial institutions less moneys due from short- and long-term swap currency transactions and the tangible shareholders' equity on the last day of each quarter will not exceed 1.8.
5. The average debt coverage ratio in the last eight quarters will not fall below 1.1 in relation to the four consecutive quarters prior to the assessment date. The debt coverage ratio will not fall below 1, with the exception of a quarter in which there is periodic treatment of facilities, the debt coverage ratio in that quarter will not fall below 0.75.
6. Subject to the amendments in the new financial covenants, all other liabilities of Carmel Olefins towards banks, as set forth above, will continue to apply.

As of the date of the financial statements, Carmel Olefins is in compliance with these conditions.

New financial covenants for debentures

1. The shareholders' equity of Carmel Olefins (without minority interest) will not fall below \$170 million.
2. Up to and including the financial statements for the second quarter of 2008, the ratio of net debt of Carmel Olefins to its cumulative EBITDA for the last four quarters will not exceed 6 in each quarterly financial statement.
3. Commencing from the financial statements for the third quarter of 2008, the ratio of net debt of Carmel Olefins to its EBITDA for the last four quarters will not exceed 5 in each quarterly financial statement.
4. For the four consecutive quarters starting from the first quarter subsequent to completing the transaction for the acquisition of Domo shares by Carmel Olefins, the abovementioned conditions will be assessed without the accounting impact of acquisition of the said shares.
5. Carmel Olefins will not distribute a dividend in the first and second quarters of 2008.
6. Subject to revisions in the new financial covenants, all the other liabilities of Carmel Olefins towards the debenture holders will continue to apply.

As of the date of the financial statements, Carmel Olefins is in compliance with these covenants.

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NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
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NOTE 12 – MATERIAL EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

1. Acquisition of a company

On January 23, 2008, Carmel Olefins entered into an agreement through a wholly-owned subsidiary, Colland Polymers B.V., with Domo Chemicals N.V., a petrochemical company engaging in the manufacture and marketing of polypropylene, which is used as raw material in the plastics industry for a range of uses and products.

The main terms of the agreement are as follows: Carmel Olefins will purchase 49% of the shares of Domo Polypropylene B.V. for €20 million. In addition, commencing 2013, Domo Chemicals N.V. may be entitled to additional compensation, not to exceed an amount of €1 million a year for a five-year period, in accordance with the terms set out in the agreement. Under the agreement, on completion of the transaction, Colland will enter into a joint venture agreement with Domo Chemicals B.V. The terms of the agreement were formulated by the parties and are attached to the agreement as an appendix. Carmel, through Colland, will have a Call option until December 31, 2016, for the purchase of the balance of the shares for an additional €10 million, net of the dividends to be distributed to Domo Chemicals N.V., plus interest at a rate of 5% per annum, commencing from the date of completion and up to actual payment. Domo Chemicals N.V. will have a Put option, exercisable commencing on July 1, 2011 for the sale of the remaining 51% to Carmel Olefins at the same terms.

Consummation of the transaction as detailed in the share purchase agreement was subject to the approval of the relevant antitrust authorities and to receipt of an environmental report on the condition of the ground upon which the Domo Polypropylene plant is located (hereinafter: the pre-conditions). As of the date of the approval of the financial statements, the pre-conditions have not yet been fulfilled. In view of the above, the transaction is not reflected in the financial statements of Carmel Olefins.

The transaction was completed on May 6, 2008, after all the pre-conditions in the acquisition agreement were fulfilled.

2. On April 28, 2008 the general meeting approved distribution of a dividend in the amount of NIS 240 million, which will be paid on May 20, 2008.
3. Subsequent to the date of the balance sheet, the Company and Israel Petrochemical Enterprises Ltd. are examining the possibility of a merger between Carmel Olefins and the Company. If the transaction is completed, the Company will hold the full issued capital of Carmel Olefins.

On May 20, 2008 the board of directors approved negotiations for an agreement to purchase of the remaining 50% of Carmel Olefins shares held by Israel Petrochemical Enterprises Ltd. (hereinafter: Israel Petrochemicals), in addition to the 50% held by the Company (hereinafter: the transaction), under the following terms:

- a. The transaction will be carried out under a share swap agreement whereby in return for the sale of 50% of Carmel Olefin shares owned by Israel Petrochemicals the Company will allocate its shares to Israel Petrochemicals.
- b. Completion of the transaction will be based, inter alia, on the assessment of Carmel Olefins and the Company carried out by Prof. Yitzhak Suary & Co. for the Company and Israel Petrochemicals together.
- c. Israel Petrochemicals informed the Company that in consideration for the sale of Carmel Olefins it is requesting the Company's shares that will constitute, subsequent to the allocation, at least 20% of the Company's equity. The Company will examine this position and negotiate accordingly and subject to the principles described in this report.

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
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NOTE 12 – MATERIAL EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE (CONT.)

- d. Prior to the share swap, the Company will distribute a cash dividend in an amount agreed upon between the Company and Israel Petrochemicals. The amount of the dividend will not exceed NIS 200 million.
- e. In addition, as part of the transaction, Israel Petrochemicals will purchase its shares held by the Company (12.3% of Israel Petrochemical shares) at a price to be determined between the parties, inter alia, based on the assessed value prepared for the parties by Prof. Yitzhak Suary & Co. The proceeds received by the Company will be distributed as a cash dividend after completion of the share swap. The decision to distribute the dividend, if made, will be subject to the applicable law for distribution of a dividend.
- f. The transaction will be subject to various suspending conditions, including approval of the agreement by the audit committee, board of directors and general meeting, pursuant to Section 275 of the Companies Law 5759-1999 and subject to ministerial approval in accordance with the Government Companies (Declaration of the State's Vital Interests in Oil Refineries Ltd) Order, 5767-2007, and any other permits that may be required.
- g. In order to approve the transaction by the organs of the Company, the audit committee appointed Prof. Amir Barnea, who is unrelated to the Company and is not an interested party therein, to prepare and submit his opinion of the fairness of the transaction towards the Company (hereinafter: the fairness opinion) under the abovementioned terms.

The abovementioned principles of the transaction do not obligate the Company. The Company and/or Israel Petrochemicals have no obligation to engage in the transaction at all, and under the abovementioned terms in particular, and it is uncertain whether this transaction will materialize. The possibility that an agreement for executing the transaction is subject to the parties' agreement of the transaction terms and upon the receipt of all the permits required for the transaction and its terms as required by law.

- 4. On April 10, 2008 the Ministry of Environmental Protection sent a letter to Carmel Olefins claiming that on April 9, 2008 black smoke was emitted from the company's polypropylene plant for cumulative periods of over six minutes an hour, which, according to the Ministry, constitutes breach of the provisions of the Personal Order. Following the alleged event, Carmel Olefins was summoned to a hearing on May 1, 2008 at the offices of the district director of the Ministry of Environmental Protection.

It is noted that in the hearing held on August 19, 2007 following a similar incident of smoke emission, it was noted that further deviation from the provisions of the Personal Order will result in an investigation by the Ministry of Environmental Protection.

Carmel Olefins informed the Company that on May 19, 2008 it received the minutes of the hearing regarding the incident that led to a demand for the immediate shutdown of operations at the monomer plant until fulfillment of all the requirements according to the best available technique, including the backup required to prevent malfunctions, to the satisfaction of the Ministry and the Haifa District Municipal Association (hereinafter: the demand).

Carmel Olefins also stated that, to the best of its understanding, this refers to the cracking plant that produces, inter alia, ethylene and propylene at the monomer plant.

Carmel Olefins also informed the Company that it is studying the minutes and examining the options open for operations in view of the minutes received and the demand.

As of the date of the financial statements, the Company is unable to assess the implications of the incident.

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NOTES TO THE FINANCIAL STATEMENTS AS OF MARCH 31, 2008
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NOTE 12 – MATERIAL EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE (CONT.)

5. In May 2008 the Company submitted a draft shelf prospectus for the issuance of shares, debentures, convertible debentures, option warrants for ordinary shares and option warrants for debentures, as set forth in the prospectus.
6. In May 2008 Carmel Olefins submitted a draft prospectus to list for trade debentures issued in 2007.
7. Subsequent to the date of the balance sheet the shekel appreciated against the dollar by 5% and the CPI rose by 1.5%. As described in the financial statements as of December 31, 2007, the Company is exposed to changes in the index and the exchange rate.