



Oil Refineries Ltd.

**Consolidated Interim Financial Statements
as of September 30, 2008**

(Unaudited)

This translation of the financial statement is for convenience purposes only. The only binding version of the financial statement is the Hebrew version

Oil Refineries Ltd.

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Oil Refineries Ltd.

Directors' Report on the State of the Company's Affairs for the period ended September 30, 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 83% of the Company's consolidated revenues in the reporting period. 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 middle 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 are being expanded. The activities 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 and represent 5% of the Company's consolidated revenue in the reporting period.

Petrochemicals segment: This segment, which represents 12% of the Company's consolidated revenue in the reporting period, is made up of two operations: polymers, through Carmel Olefins Ltd. (hereinafter: Carmel Olefins) and aromatics, through Gadiv Petrochemical Industries Ltd. (hereinafter: Gadiv). Carmel Olefins, which represents 5% of the Company's consolidated revenue in the reporting period (the Company's share), is a private company that is proportionally consolidated with the Company and produces polyethylene and polypropylene, which are the principal raw materials in the plastics industry. Gadiv, which represents 7% of the Company's revenue, is a private company that is wholly-owned by the Company. Gadiv produces aromatic materials, mainly benzene, paraxylene, orthoxylene, and toluene, which are used as raw materials in the manufacture of other products

In the reporting period, the Company signed an agreement with Israel Petrochemical Enterprises Ltd. (hereinafter: IPE) to purchase the remaining shares of Carmel Olefins (50%) held by IPE, such that if the transaction is completed, the Company will hold the full issued share capital of Carmel Olefins. For details see Note 12E to the financial statements.

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 all or part of the products of their facilities to the Company, as well as the feedstock not used in their operations. The Company's refinery operations are integrated with its polymer and aromatics operations.

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In the Company's opinion, the integration and synergy between the various fields of operation leads to an increase in 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 Gadiv streamlines the activity of the companies and reduces expenses.

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

Production volumes

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

	<u>1-9.2008</u>	<u>1-9.2007</u>	<u>7-9.2008</u>	<u>7-9.2007</u>	<u>2007</u>
Refineries	6,150	5,677	2,098	1,856	7,759
Gadiv Petrochemical Industries Ltd.	352	347	113	121	474
Carmel Olefins Ltd.	275	290	99	149	323

The table below presents the breakdown of the Company's output (refineries) by the main product groups in the refinery segment (in thousands of tons)

	<u>1-9.2008</u>	<u>1-9.2007</u>	<u>7-9.2008</u>	<u>7-9.2007</u>	<u>2007</u>
Diesel fuel	1,715	1,444	566	465	1,996
Gasoline	1,242	1,205	410	369	1,627
Kerosene	645	560	265	192	751
Fuel oil	1,003	994	334	322	1,392
Vacuum diesel	549	522	198	188	706
Others	483	447	169	152	642
Total	<u>5,637</u>	<u>5,172</u>	<u>1,942</u>	<u>1,688</u>	<u>7,114</u>

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 \$600 million is for expansion of the cracking capacity of fuel products having a high added value. Subsequent to the balance sheet date, the board of directors of the Company approved the establishment of the hydrocracker (see section 9.9 below). 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.

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Expand commercial and logistics activity of oil products; and invest \$270 million in environmental quality, safety and security and in enhancing operational reliability.

Alongside the comprehensive investment plan for environmental quality, reliability and safety, the Company invested effort to raise public awareness of its contribution in these areas. In the reporting period, the Company launched a media campaign regarding the use of environmentally-friendly fuels in compliance with the Euro-5 standard, while emphasizing the slogan: "ORL – Energy of Change". This is in addition to the great effort invested in hosting the media at the Company's plants, presentation of environmental activities and planned investments on the subject, and an environmental exhibition held in Haifa during the week of the Succoth holidays in October.

Furthermore, 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. An internal enforcement plan was adopted for environmental quality and health and safety.

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: in the framework of advancing the project approved by the board of directors when adopting the strategic plan – reactors were ordered and planning is underway. On October 12, 2008 the Company's board of directors approved the establishment of the hydrocracker. See section 9.9 below.
 - 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.
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. In June 2008 the board of directors approved a transaction for the acquisition of the remaining 50% of Carmel Olefins shares from Israel Petrochemicals Ltd. (IPE). In return IPE will receive 20.53% of the Company's shares (after the allotment). This transaction is part of the Company's business strategy and aims to realize the full synergy potential in the refinery, polymers and aromatics segments. The general meeting approved the transaction on August 13, 2008. On September 28, 2008 the Company and IPE signed an addendum to the agreement as described in section 1.2.2 below.
- B. Increased production capacity of paraxylene and benzene – in process
- C. Increased production capacity of phthalic anhydride – in process
- D. Mergers and acquisitions in production and logistics: Acquisition by Carmel Olefins of a share in Domo, a company producing polypropylene in the Netherlands. There are advanced examinations for investments in other fields in Europe, the Mediterranean Basin and the Far East.

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4. 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, primarily in Mediterranean countries.
- C. A team for business development and capital market was established.
- D. Internal enforcement plans for antitrust issues, securities laws and environmental quality and safety were adopted and assimilated.

1.2.2 Developments in petrochemicals

Agreement for the purchase of the remaining Carmel Olefins shares

On June 24, 2008 the Company signed an agreement with IPE. The general meeting of the company's shareholders approved the agreement on August 13, 2008. The main points of the agreement are as follows:

- A. On completion of the transaction, IPE will sell the Company all the shares it owns in Carmel Olefins, comprising 50% of the issued share capital of Carmel Olefins (hereinafter: "the acquired Carmel Olefins shares") such that following the acquisition, the Company will hold the full issued share capital of Carmel Olefins. In consideration for the acquired Carmel Olefins shares, the Company will allot 516,672,961 ordinary shares to IPE, comprising (after the allotment and without dilution) 20.53% of the company's issued share capital and its voting rights (hereinafter: "the allotted shares").
- B. On completion of the transaction, the Company will sell IPE 3,741,680 of the shares it owns in IPE (hereinafter: "the acquired IPE shares"), comprising 12.29% of the share capital of IPE, in consideration for \$40 million.
- C. As a precondition for closing the transaction after complying with all the other preconditions and prior to allocation of the allotted shares to IPE, the Company will distribute to its shareholders a dividend of \$60 million (hereinafter: "the first dividend"). In addition, on the date of closing the transaction, the Company's board of directors will resolve to distribute an additional dividend of \$100 million (hereinafter: "the second dividend") and the allotted shares will participate in such distribution.
- D. Completion of the transaction is subject to meeting a number of preconditions by December 31, 2008, including, inter alia, the receipt of regulatory approvals, including approval of the Antitrust Commissioner and a permit from IPE pursuant to the Government Companies (Declaration of the State's Vital Interests in Oil Refineries Ltd) Order, 2007 ("the Interests Order") to purchase and hold the allotted shares (as required by the Law); approvals for the transaction and the operations involved therein by the organs required by law in each of the companies; approvals from third parties according to agreements, undertakings, licenses and approvals of Carmel Olefins detailed in the agreement; approval from the debenture holders of IPE or their trustee; and payment of the first dividend. Another precondition is that during the period from the date the agreement is signed and until the closing date, no events occurred as a result of which representations of the Company or representations of IPE, as relevant, were incorrect and which cause in the aggregate to the reduction of the value of the acquired Carmel Olefins shares or the value of the allotted shares, as relevant, in an amount exceeding \$50 million, and payment of the first dividend. As of the date of the financial statement, IPE has not yet received a permit pursuant to the Interests Order and approval from the Tax Authorities pursuant to section 103 of the Income Tax Order and has not yet received approval from all of the third parties.

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- E. If all the preconditions are not met by December 31, 2008, the agreement will terminate. If all the preconditions are met and on the same date an application for approving a distribution pursuant to the agreement by one of the parties is pending before the court, the last date for complying with the preconditions will be postponed to March 31, 2009. Each of the dates stated above can be extended with the agreement of the parties, by a resolution adopted by their boards of directors.

On August 4, 2008, the Israel Corporation announced that it signed another (third) letter of undertaking in favor of IPE and Petroleum Capital Holdings Ltd. (hereinafter: PCH) in respect of an agreement for joint control in the Company, which replaced its previous letter of undertaking, on the same subject.

On September 28, 2008 the Company and IPE signed an addendum to the agreement enabling the completion of the agreement, even without receiving a control permit by IPE in accordance with the interests ordinance (the control permit).

Main points in the addendum to the agreement:

- a. The Company will declare the first dividend within three business days from the date on which all the preconditions are met, with the exception of receiving the control permit.
- b. The completion date will fall on December 31, 2008 or an earlier date as agreed between the parties, subject to meeting, up to that date, all the preconditions, with the exception of receiving the control permit, subject to the option for extending the dates as set forth in section E above.
- c. On the completion date, the Company will allot 216,445,781 shares to IPE. Together with the shares held directly or indirectly, by IPE on that date this will comprise 23.99% of the Company's issued capital (hereinafter: "the immediately allotted shares").
- d. IPE is entitled to an allotment of 300,227,180 shares, comprising the balance of the allotted shares (hereinafter: "the deferred allotted shares") subject to receiving the control permit, renewing the validity of the approval of the Antitrust Authority, and receiving the approval of the Tel Aviv Stock Exchange to list the deferred allotted shares for trading, should their validity expire, and subject to the agreement of the parties to which the rights of IPE were pledged pursuant to the agreement, to the extent required.
- e. At the time of the allotment of the deferred allotted shares, IPE will be entitled to receive payment from the Company equal to the amount which IPE would have received as a dividend for that deferred allotted share, had it been allotted to IPE on the completion date, and the income from them as accrued ("the amounts of the adjustment of the dividend"). Company will deposit these amounts, when distributing each dividend, in a special deposit managed by the attorneys of IPE and the Company (hereinafter: "the earmarked deposit"). The earmarked deposit will not be considered as the property of ORL. ORL will not have any right to the deposited funds and will not be responsible in any way for its management, investment, balance or value. Protection provisions will apply to the deferred allotted shares in the event of any capital transaction with the Company's shares.
- f. The amount of the second dividend will be determined in such a way that the amount which will be distributed as a dividend together with the amount deposited for it in an earmarked deposit, will be equal to \$100 million.

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- g. IPE will be entitled to instruct the Company to allocate the deferred allotted shares to a trustee on behalf of IPE and to transfer to it the adjusted amounts of the dividend at any time prior to receiving the control permit, subject to submission of approval of the competent authorities to allocate the shares to a trustee and subject to the preconditions set forth in section D above, with the exception of receiving the control permit. IPE will also be entitled to instruct the Company to allocate the deferred allotted shares and to transfer the amounts of the adjusted dividend to a buyer as instructed by IPE.
- h. Up to the date of the allotment of the balance of the deferred allotted shares to IPE and/or to the trustee or buyer according to subsection (g) above, should IPE's shareholding in the Company drop below 23%, the Company will allot shares to IPE, subject to the valid approval of the private placement by the Tel Aviv Stock Exchange and subject to the agreement of the parties to which the rights of IPE are pledged under the agreement, to the extent required, such that after the allotment the shareholding of IPE in the Company, directly or indirectly, will represent 23.99% of the Company's issued capital. IPE will be entitled to exercise its right if its shareholding in the Company rises above 23%.
- i. With the exception of the amendments in the addendum to the agreement, all the provisions in the agreement will continue to apply to the parties without any change.

As on the date of approval of the financial statements, the Company is negotiating with IPE to change certain details in the transaction. These changes will not have a material effect on the transaction and its conditions for the Company, in accordance with the requirements and limitations that were presented by the competent authorities, with the aim of completing the transaction by the end of this year.

Acquisition of a company by Carmel Olefins

On April 25, 2008, Carmel Olefins acquired, through Colland Polymers B.V. (hereinafter: "Colland"), Domo Chemicals N.V. (hereinafter: "Domo") pursuant to an agreement entered into on January 23, 2008. Colland is a wholly-owned subsidiary of Carmel Olefins. Domo is a petrochemical company incorporated in the Netherlands that manufactures and markets polypropylene 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 purchased 49% of the shares of Domo for €20 million. In addition, commencing from 2013, Domo 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. Carmel Olefins, through Colland, has a call option from the purchase date 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, plus interest at a rate of 5% per annum. Domo has a put option, exercisable commencing on July 1, 2011 for the sale of the remaining 51% shares to Carmel Olefins at the same terms.

Commencing May 1, 2008 Carmel Olefins fully consolidates Domo results due to the options and the minority interests for the shareholders' balance in Domo are not included.

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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 owned company (WFOE) and which will manufacture Tri-Maleic-Anhydrid (TMA), a product 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 intent expired on November 25, 2007, and the negotiations conducted by the Company on the matter of the value of the joint company ended without the parties reaching the required agreements for consummation of a binding transaction.

1.2.3 Developments in the economic environment and in financial markets and their impact on the Company

In the third quarter of 2008, there was a dramatic fluctuation in the price of crude oil and its products, in the exchange rate and in the financial markets in Israel and the world. The board of directors of the Company, the board of the trade segment and the finance committee of the board of directors discussed these changes during the quarter and made decisions designed to adapt the operations in the Company to the changing marketing conditions.

The price of crude oil was \$97/barrel at the beginning of the year, rose to \$140/barrel at the beginning of the third quarter and dropped to \$94/barrel at the end of this quarter. The downward trend continued subsequent to the reporting period. On the date of the approval of the financial statements, the price of crude oil was \$50/barrel.

At the same time, there was a drop in the prices of fuel products produced by the Company from crude oil and sold by the Company.

A rise in the price of crude oil leads to an increase in the volume of working capital required by the Company to finance its purchases and to an increase in the inventory value in the Company's books. On the other hand, a drop in the price of crude oil leads to a reduction in the volume of working capital required by the Company to finance its operations and a reduction in the inventory value in the Company's books. The Company's exposure for changes in the price of crude oil is partially hedged in the futures and derivatives markets.

The drop in the price of crude oil and its products in the reporting period has a material impact on the third quarter results, as described in the section below describing the main factors for the decrease in gross profit.

In the reporting period there was an appreciation of 11% in the dollar exchange rate compared to the shekel. (See section 1.3 – Financing expenses). Although the Company's functional currency is the dollar, the Company has shekel expenses, (such as salaries and payments to suppliers and subcontractors in Israel as well as payments to institutions and authorities). The impact of the appreciation on the business results in the reporting period amounts to an expense of \$15 million.

The CPI rose by 4.4% in the reporting period. The Company took CPI-linked shekel loans, which are affected by the rise in the index. To reduce the Company's exposure to changes in the rate of inflation, the Company entered into a currency swap, converting most of its long-term shekel loans into dollar loans (see section 6.3 below). Parallel to the Company's CPI-linked liabilities that were not converted to dollars, the Company holds assets linked to this index.

As a result of the crisis in the financial markets in the third quarter, the fair value of the financial assets held by the Company decreased by \$12 million, which was recognized in the Company's financing expenses.

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In view of the crisis in the financial markets and in order to reduce the exposure to financial assets, at the end of the third quarter, the Company decided to update its investment policy to further reduce the risks in most of the components of the investment portfolio.

The crisis in the financial markets led to heavy losses incurred in pension and compensation funds in which the Company deposited funds to cover its severance liabilities. Under IFRS, losses from actuary changes net of tax in the amount of \$5 million were recognized in capital reserve.

For the effect of the continued drop in prices subsequent to the balance sheet date and the effect of the economic crisis on the Company's financial position, see section 9.1 below.

In accordance with the board of directors' approval for establishment of the hydrocracker, the Company is taking steps to complete arrangements for the credit facility through Export Credit Agency to finance the purchase of equipment from foreign suppliers, and to receive the additional long-term credit which is vital for completion of the project, from various sources. It is noted that part of the sum required to finance the strategic plan was raised by the Company in December 2007, pursuant to a prospectus published by the Company on November 28, 2007.

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 end products.

During the reporting period, refining margins dropped to \$45.6 per ton, compared to \$57 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 \$40.9 per ton in the reporting period compared to \$40.2 per ton in the corresponding period last year. In 2007 the Reuters margin amounted to \$38.7 per ton. For further details, see section 3.1.

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 distillates made from the crude oil. Accordingly, the comparison to Reuters' margin is likely to provide comprehension in relation to the trends of the development of company's margin, and does not constitute an exact criterion in estimation of company's margin in the short term.

The Company estimates, based on close estimates that take into account the Company's inventory in the gap between the refining margin and the Reuters' margin (hereinafter: the gap) in the reporting period, a total of \$14.4 per ton (\$10.2 per ton in the corresponding period last year and \$16.1 per ton in 2007) due to timing difference of purchasing and selling due to the price changes. In addition \$0.5 per ton was deducted from the gap, due to the accounting method for derivative transactions on prices of goods and margins (hereinafter: "the accounting method for derivatives") following application of IFRS (In the corresponding period last year, \$4 per ton was included in the gap and in 2007, \$2.6 was included in the gap). For further details see section 6.2.2.

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The following table summarizes the impact of recording derivatives according to IFRS and the estimated impact of timing difference of purchasing and selling due to the price changes on the margin:

	<u>1-9 2008</u>	<u>1-9 2007</u>	<u>7-9 2008</u>	<u>7-9 2007</u>	<u>4-6 2008</u>	<u>4-6 2007</u>	<u>1-3 2008</u>	<u>1-3 2007</u>	<u>2007</u>
Dollar per ton margin	45.6	57.0	43.6	37.3	66.8	82.4	27.1	49.5	57.7
Elimination of the impact of the accounting method for derivatives according to IFRS	<u>(0.5)</u>	<u>4.0</u>	<u>(23.9)</u>	<u>4.3</u>	<u>17.6</u>	<u>(9.4)</u>	<u>5.9</u>	<u>18.0</u>	<u>2.6</u>
	45.1	61.0	19.7	41.6	84.4	73.0	33.0	67.5	60.3
Net of the impact of purchasing and selling timing difference	<u>(14.4)</u>	<u>(10.2)</u>	<u>6.8</u>	<u>(12.0)</u>	<u>(35.5)</u>	<u>(25.0)</u>	<u>(15.3)</u>	<u>7.3</u>	<u>(16.1)</u>
Provision for impairment of inventory	<u>11.0</u>	<u>-</u>	<u>32.4</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Neutralized margin (dollar/ton)	<u>41.7</u>	<u>50.8</u>	<u>58.9</u>	<u>29.6</u>	<u>48.9</u>	<u>48.0</u>	<u>17.7</u>	<u>74.8</u>	<u>44.2</u>
Neutralized margin (dollar/barrel)	<u>5.7</u>	<u>7.0</u>	<u>8.1</u>	<u>4.1</u>	<u>6.7</u>	<u>6.6</u>	<u>2.4</u>	<u>10.2</u>	<u>6.1</u>
Ural margin in the Mediterranean (dollar/barrel)	<u>5.6</u>	<u>5.5</u>	<u>6.7</u>	<u>3.7</u>	<u>6.3</u>	<u>7.2</u>	<u>3.7</u>	<u>5.7</u>	<u>5.3</u>

Consolidated operating income amounted to \$165 million in the reporting period, compared to \$200 million in the corresponding period last year, a decrease of 18%.

Consolidated EBITDA amounted to \$208 million in the reporting period, compared to \$258 million in the corresponding period last year, a decrease of 19%.

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

The following table presents a description of the main reasons for the decrease in consolidated operating income (in USD million):

	1-9.2008 compared to 1-9.2007
Decrease in Group margins	(109)
Decrease in losses for derivative transactions – see section 6.2	27
Increase in volume of Group sales	44
Increase in other income in the refining and aromatics segments	19
Increase in Group production expenses, mainly energy	(48)
Earnings from the trade segment	8
	<u>(59)</u>
Increase in selling and administrative expenses	(19)
Decrease in other expenses	43
	<u>(35)</u>

Consolidated operating income amounted to \$54 million in the reporting period, compared to \$39 million in the corresponding period last year, an increase of 38%.

Consolidated EBITDA amounted to \$74 million in the reporting period, compared to \$58 million in the corresponding period last year, an increase of 28%.

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The following table presents the main reasons for the increase in the consolidated operating income in the third quarter compared to the third quarter last year (USD millions):

	7-9.2008 compared to 7-9.2007
Decrease in Group margins	(56)
Decrease in losses for derivative transactions – see section 6.2	58
Increase in volume of Group sales	18
Increase in other income in the refining and aromatics segments	6
Increase in Group production expenses	(13)
Earnings from the trade segment	7
	20
Increase in selling and administrative expenses	(6)
Decrease in other expenses	1
	15

Financing expenses

In the reporting period, net consolidated financing expenses amounted to \$89 million, compared to \$43 million in the corresponding period last year.

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

	1-9.2008 compared to 1-9.2007
Impact of the appreciation on shekel and linked debentures	124
Impact of debenture derivatives following the appreciation	(100)
Increase in the cost of short-term credit mainly due to the increase in volume offset by a decrease in the interest rate including the impact of appreciation	39
Increase in interest expenses on long-term debentures and loans mainly due to an increase in the volume of debentures offset by a decrease in the interest rate	13
Decrease of discounting financing expenses	3
Increase in value of securities and loan to Haifa Early Pensions Ltd including the impact of appreciation	(33)
	46

2. Financial position

2.1 Current assets

On September 30, 2008, consolidated current assets amounted to \$1,981 million, representing 60% of the assets, compared to \$1,910 million, representing 62% of the assets on December 31, 2007. The increase in current assets is mainly due to the increase in inventories in the Group resulting mainly from the price increase of \$108 million, the increase in trade receivables (after offsetting the discounting amount of \$205 million) of \$123 million, resulting mainly from the price increase and impact of the appreciation on trade receivables denominated in shekels, and the increase of \$58 million in other receivables resulting from the balance of institutions, derivatives and advance expenses, offset by the decrease in cash flow of \$233 million as well as consolidation for the first time of Domo results in the financial statements of Carmel Olefins.

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2.2 Investments and long-term loans

On September 30, 2008 consolidated investments and long-term loans amounted to \$249 million, representing 7% of the assets, compared to \$148 million, representing 5% of the assets on December 31, 2007.

The increase is mainly due to an increase of \$102 million in financial derivatives in the reporting period and an increase of \$14 million in the value of the loan to Haifa Early Pensions Ltd, resulting mainly from the appreciation in the shekel exchange rate and offset by a decrease in the balance sheet value of investments in subsidiaries of \$13 million.

2.3 Current liabilities

Consolidated current liabilities on September 30, 2008 amounted to \$1,117 million, representing 44% of total liabilities, compared to \$889 million, representing 39% of total liabilities as of December 31, 2007. The increase is mainly due to the increase in short-term dollar bank credit of \$171 million, and the increase in customer deposits of \$50 million as well as consolidation for the first time of Domo results in the financial statements of Carmel Olefins.

2.4 Long-term financial liabilities

Consolidated long-term financial liabilities amounted to \$1,199 million on September 30, 2008 (the Company - \$937 million, Gadiv - \$2 million, and Carmel Olefins - \$ 260 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 \$30 million was mainly 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

The shareholders equity totaled \$ 789 million representing 24% of the balance sheet, compared to \$ 800 million which represents 26% of the balance sheet dated 31.12.2007. The change in shareholders equity is due to an increase in net income totaling \$73 million during the period and from an increase in the capital reserve for share based payment totaling \$3 million, which were set off by the following clauses: dividend distribution totaling \$ 72 million, actuarial losses from defined benefit plan totaling \$ 5 million, capital reserve to acquire minority rights in the parent company totaling \$ 5 million and capital reserve for financial assets available for sale in an investee totaling \$ 5 million. The investee company presents in its balance sheet liquid financial assets based on market value, and any change in them is credited to the equity fund. The parent company examines the classification of crediting the change in asset value when there is a significant and continuous decrease in the market value as compared to the cost of investment and in accordance to the specific circumstances. In current circumstances, the parent company deems the registration of the capital reserve is the appropriate accounting treatment

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3. Results of operations

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

	For the nine months ended (*)		For the three months ended(*)	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
in USD millions				
Revenues				
Refining	6,397	3,504	2,496	1,232
Trade	369	-	58	-
Polymers	383	233	142	83
Aromatics	474	392	164	146
Cancellation of inter-company transactions	(642)	(461)	(235)	(172)
Total	6,981	3,668	2,625	1,289
Cost of sales, refinery and services				
Refining	6,227	3,281	2,442	1,197
Trade	360	-	53	-
Polymers	362	199	129	71
Aromatics	429	346	154	130
Cancellation of inter-company transactions	(638)	(458)	(235)	(171)
Total	6,740	3,368	2,543	1,227
Gross profit				
Refining	170	223	54	35
Trade	9	-	5	-
Polymers	21	34	13	12
Aromatics	45	46	10	16
Cancellation of inter-company transactions	(4)	(3)	-	(1)
Total	241	300	82	62
Selling, general and administrative expenses				
Refining	51	41	16	11
Trade	1	-	1	-
Polymers	21	14	7	6
Aromatics	21	19	6	7
Cancellation of inter-company transactions	(3)	(2)	(1)	(1)
Total	91	72	29	23
Other (income) expenses				
Refining	-	23	-	-
Polymers	(15)	-	(1)	-
Aromatics	-	2	-	-
Cancellation of inter-company transactions	-	3	-	-
Total	(15)	28	(1)	-

(*) See Note 5 to the financial statements.

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	For the nine months ended (*)		For the three months ended(*)	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
	in USD millions			
Operating income				
Refining	119	159	38	24
Trade	8	-	4	-
Polymers	15	20	7	6
Aromatics	24	25	4	9
Cancellation of inter-company transactions	(1)	(4)	1	-
Total	165	200	54	39
Financing expenses, net	(89)	(43)	(51)	(21)
Profit before taxes on income	76	157	3	18
Income tax	(3)	(34)	1	6
	73	123	4	24
Company's share in earnings of investees	-	1	(4)	(6)
	-	1	(4)	(6)
Net income for the period	73	124	-	18

(*) See Note 5 to the financial statements

3.1.1 Sales turnover

The sales turnover of the refining segment (carried out through the Company) amounted to \$6,397 million in the reporting period, compared to \$3,504 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 (hereinafter: the Company's basket of products) amounted to \$936 in the reporting period, compared to \$573 in the corresponding period last year.

The sales turnover of the trade segment (which commenced operations this year and is carried out through the Company) amounted to \$369 million.

In the reporting period, there was an increase of 4% in fuel consumption in the local market compared to the corresponding period last year. There was an increase of 3% in the consumption of distillates in the relevant periods, offset by a decrease of 2% 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 64% compared to the turnover in the corresponding period last year. The increase is mainly due to the increase in sales volumes following the operation of the new facilities in July 2007, the increase in product prices and the consolidation of Domo results for the first time.

Sales turnover in the aromatics segment (carried out through Gadiv) increased by 21% in the reporting period compared to 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.

Revenues from the sale of products with a volume of over \$500 million in the first nine months of the year were as follows (in USD millions): gasoline - 1,151, diesel fuel - 1,727 and naphtha - 765.

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3.1.2 Gross profit

The following table presents a description of the main reasons for 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):

	1-9.2008 compared to 1-9.2007
Decrease in margin from refining operations	(91)
Decrease in losses for derivative transactions – see section 6.2	26
Increase in volume of refining and sales	22
Earnings from the trade segment	9
Increase in other income	7
Increase in production expenses	(17)
	(44)

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 products, as described below, in the chapter addressing risk management.

	Q1	Q2	Q3	Nine months	Year
2008	27.1	66.8	43.6	45.6	-
2007 *	49.5	82.4	37.3	57.0	57.7

* In the financial statements as of December 31, 2007, which were prepared according to Israeli GAAP (prior to implementation of IFRS). The margin for the first nine months of 2007 was \$61 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 (section 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 mainly due to speculator demands in the crude oil market following the crisis in financial markets. This resulted in an increase in oil prices 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 services in the reporting period compared to the corresponding period last year, mainly due to the increase in sales volume.

The increase of \$17 million in production expenses in the reporting period compared to the corresponding period last year was mainly due to an increase in payroll expenses of \$14 million, mainly as a result of the increase in payroll costs and the impact of the appreciation on payroll expenses. The increase was also due to an increases in expenses for energy and water services, offset by a decrease in maintenance expenses and in depreciation and amortization.

Gross profit in the reporting period in the polymers segment amounted to \$21 million, compared to \$34 million in the corresponding period last year.

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The following table presents a description of the main reasons for the decrease (in USD millions):

	1-9.2008 compared to 1-9.2007
Decrease in margin from the basket of products	(24)
Increase in sales quantities	22
Increase in production expenses	(11)
	(13)

Gross profit in the reporting period in the aromatics segment amounted to \$45 million, compared to \$46 million in the corresponding period last year.

The following table presents a description of the main reasons for the decrease (in USD millions):

	1-9.2008 compared to 1-9.2007
Increase in margin from the basket of products	7
Increase in processing fees	12
Increase in production costs, mainly energy	(20)
	(1)

3.1.3 Selling, general and administrative expenses

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

In the reporting period, consolidated selling expenses, general and administrative expenses amounted to \$91 million, compared to \$72 million in the corresponding period last year. The increase in expenses was mainly due to an increase in payroll expenses as a result of an increase in payroll costs and the impact of the appreciation on payroll expenses. The increase was also due to an increase in the selling costs of Carmel Olefins as a result of the increase in quantities exported produced at Carmel Olefins and expenses for the acquisition of Domo.

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

Operating income in the refining and trade segments amounted to \$127 million in the reporting period, compared to \$159 million in the corresponding period last year, representing a decrease of 20%. The decrease of \$32 million in operating income was due to the decrease in gross profit of \$44 million as explained above, an increase of \$11 million in selling, general and administrative expenses and a decrease in other expenses of \$23 million, due to the privatization grant for employees in the corresponding period last year. EBITDA for the refinery segment amounted to \$160 million in the reporting period, compared to \$192 million in the corresponding period last year, a decrease of 17%.

Operating income in the polymers segment amounted to \$15 million in the reporting period, compared to operating income of \$20 million in the corresponding period last year. The decrease was due to a decrease in gross profit of \$13 million, as described above, an increase in general and administrative expenses of \$7 million and from other income in the period of \$ 15 million mainly due to the earnings for negative goodwill created by the acquisition of Domo.

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EBITDA in the polymer segment amounted to \$19 million in the reporting period, compared to \$36 million in the corresponding period last year.

Operating income in the aromatics segment amounted to \$24 million in the reporting period, compared to \$25 million in the corresponding period last year, a decrease of 4%. EBITDA in the aromatics segment amounted to \$29 million in the reporting period, compared to \$ 30 million in the corresponding period last year.

Consolidated operating income amounted to \$165 million in the reporting period, compared to \$200 million in the corresponding period last year, a decrease of 18%.

Consolidated EBITDA amounted to \$208 million in the reporting period, compared to \$258 million in the corresponding period last year, a decrease of 19%.

3.1.5 Income tax

In the reporting period, the Group recorded tax expenses of \$3 million, compared to tax expenses of \$34 million in the corresponding period last year. The decrease of \$31 million in tax expenses is due to the differences in revenues for tax purposes in the reporting period compared to the corresponding period last year, 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, as well as the impact of the appreciation in the exchange rate on current tax and tax reserves..

3.1.6 Company's share in earnings of investees

The Company's share in the earnings of investees amounted to \$0.4 million in the reporting period, compared to earnings of \$0.9 million in the corresponding period last year. The change in the earnings of the companies is as follows: a decrease of \$0.2 million in IPE; a decrease of \$1.5 million in Gadot Biochemical Industries Ltd; an increase of \$0.6 million in Haifa Basic Oils Ltd.; and an increase of \$0.7 million in Ionex.

3.2 Third quarter results compared to the corresponding quarter last year

3.2.1 Sales turnover

The dollar sales turnover in the refining segment in the third quarter increased by 103% compared to the corresponding quarter last year, mainly due to an increase in the prices of products.

The sales turnover in the trade segment (which commenced operations this year and is carried out through the Company) amounted to \$58 million in the third quarter.

The sales turnover in the polymer segment increased by 71% in the third quarter due to an increase in sales volume and an increase selling prices. The increase in volume is mainly due to consolidation of Domo results for the first time.

The sales turnover in the aromatics segment increased by 12% in the third quarter compared to the corresponding quarter last year. The increase is due to the selling prices and an increase in sales volume.

Sales of products amounted to over \$250 million in the third quarter (in USD millions): gasoline - 532, diesel fuel - 727, crude oil - 293 and kerosene - 307.

3.2.2 Gross profit

Gross profit in the refining and trade segments amounted to \$59 million in the third quarter compared to \$35 million in the corresponding quarter last year.

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The following table presents a description of the main reasons for the increase in gross profit in the refining segment (in USD millions):

	7-9.2008 compared to 7-9.2007
Decrease in margin from refining operations	(48)
Decrease in losses for derivative transactions – see section 6.2	58
Increase in volume of refining and sales	12
Increase in production expenses	(2)
Earnings from the trade segment	4
	24

As a result of the dramatic fluctuations in the prices of crude oil and its products, the Company recognized a loss for impairment of inventory amounting to \$69 million on September 30, 2008, which was mainly offset by hedging transactions for inventory in the futures market in the amount of \$26 million. The loss reflects the difference between the cost of inventory and the net value of its realization. Impairment of the inventory is also reflected in the refinery margins in the third quarter, as described in section (3.1.2) above. The loss for impairment of inventory reflects Company's exposure policy to the changes in its inventory costs, under which the Company does not hedge basic operating inventory of 600 thousand tons.

Gross profit in the polymers segment amounted to \$13 million in the third quarter compared to \$12 million in the corresponding quarter last year.

The following table presents a description of the main reasons for the increase (in USD millions):

	7-9.2008 compared to 7-9.2007
Decrease in margin from the basket of products	(6)
Increase in sales quantities	7
	1

Gross profit in the aromatics segment amounted to \$10 million, compared to \$16 million in the corresponding quarter last year.

The following table presents a description of the main reasons for the influences on the gross profit in the aromatics segment (in USD millions):

	7-9.2008 compared to 7-9.2007
Decrease in margin from the basket of products	(1)
Decrease in sales quantities	(3)
Increase in production expenses, mainly energy	(8)
Increase in processing fees	6
	(6)

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3.2.3 Operating income and EBITDA

Operating income in the refining and trade segments amounted to \$42 million in the third quarter, compared to \$24 million in the corresponding period last year, an increase of 75%.

The increase in operating income of \$18 million in the refinery and trade section is due to an increase in gross profit of \$24 million as explained above, alongside an increase in administrative and selling expenses of \$6 million. EBITDA in the refining and trade segments amounted to \$53 million in the third quarter compared to \$34 million in the corresponding quarter last year.

Operating income in the polymers segment amounted to \$7 million in the third quarter compared to \$6 million in the corresponding period last year. The increase was due to an increase in gross profit of \$1 million, as described above, an increase in general and administrative expenses of \$1 million, and other income of \$1 million.

EBITDA amounted to \$12 million in the third quarter compared to \$14 million in the corresponding quarter last year.

Operating income in the aromatics segment amounted to \$4 million in the third quarter compared to \$9 million in the corresponding quarter last year. EBITDA amounted to \$7 million in the third quarter compared to \$10 million in the corresponding quarter last year.

Consolidated operating income amounted to \$54 million in the reporting period, compared to \$39 million in the corresponding period last year, an increase of 38%.

Consolidated EBITDA amounted to \$72 million in the third quarter compared to \$58 million in the corresponding quarter last year.

3.2.4 Financing

In the third quarter, net consolidated financing expenses amounted to \$51 million, compared to \$21 million in the corresponding period last year.

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

	7-9.2008 compared to 7-9.2007
Impact of the depreciation on shekel and linked debentures	(10)
Impact of debenture derivatives	16
Increase in the cost of short-term credit mainly due to the increase in volume offset by a decrease in the interest rate including the impact of depreciation	15
Increase in interest expenses on long-term debentures and loans mainly due to an increase in the volume of debentures offset by a decrease in the interest rate	3
Decrease of discounting financing expenses	(2)
Decrease in value of securities and loan to Haifa Early Pension Ltd. Including the impact of depreciation	8
	<u>30</u>

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3.2.5 Income tax

Tax revenues amounted to \$1 million in the third quarter compared to tax revenues of \$6 million in the corresponding quarter last year.

The decrease in tax benefit in the third quarter compared to the corresponding quarter last year is mainly to a decrease 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 as well as the impact of the appreciation in the exchange rate on current tax.

3.2.6 Company's share in earnings of investees

The Company's share of earnings in investees in the third quarter amounted to a loss of \$3 million compared to a loss of \$6 million in the corresponding quarter last year, mainly due to a decrease in the losses of IPE in the amount of \$3 million.

4. Liquidity

Working capital on September 30, 2008 amounted to \$864 million compared to \$1,021 million on December 31, 2007. The current ratio on September 30, 2008 is 1.7 compared to 2.1 on December 31, 2007.

Consolidated cash flows used in operating activities in the reporting period amounted to \$87 million. Due to an increase in working capital of \$280 million, including a payment to the tax authorities, investment in inventory, receivables and an increase in payables.

Cash flows used in investment activity amounted to \$128 million, used mainly to finance investments in fixed assets in the Company and Carmel Olefins and the acquisition of a subsidiary by Carmel Olefins.

The net cash flows from financing activity in the reporting period amounted to \$20 million. \$300 million was received in short-term credit offset by \$182 million used to repay debentures and long-term loans, \$66 million in interest paid and \$72 million in dividends paid.

The cash flows used for financing activity of investment in working capital and investment activity resulted in a decrease of \$235 million in cash in the reporting period.

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5. Sources of financing

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

	September 30, 2008	December 31, 2007
	in USD millions	
Sources		
Cash at the beginning of the period	259	124
Cash from operating activities (prior to changes in working capital)	129	273
Dividend from investees	-	11
Long-term loans and debentures	-	623
Receipt of short-term credit and deposits from customers	300	-
Privatization grant	-	28
	688	1,059
Uses		
Investments in fixed and other assets	113	100
Loan to Haifa Early Pensions Ltd.	-	72
Acquisition of a subsidiary consolidated for the first time by an investee	14	-
Investment in financial assets, net.	2	-
Acquisition of an investee	1	-
Repayment of long-term loans and debentures	182	157
Income tax for current tax	6	43
Repayment of short-term credit	-	55
Payment of dividend	72	74
Increase in working capital	298	558
	688	1,059

Long-term loans and debentures

The long term loans and debentures (after deduction of current maturities) amounted to \$1,199 million, representing 36% of the balance sheet compared to \$1,169 million, representing 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% compared to 59% in the balance sheet of December 31, 2007.

Total financial liabilities

The Current financial - Current financial liabilities plus long-term loans and debentures amounted to \$1,585 million, representing 47% of the balance sheet compared to \$1,385 million, representing 45% of the balance sheet on December 31, 2007. Financial leverage of total financial liabilities to banks and other credit providers is 67% compared to 63% on December 31, 2007.

Long-term financial debt, (long-term loans and debentures, including current maturities) amounted to \$1,340 million in the reporting period. In the Company \$1,061 million (including \$121 million in current maturities); in Carmel Olefins \$276 million (including \$15 million in current maturities); and in Gadiv \$3 million.

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

Long term loans (including current maturities) -1,359; short term credit -209; trade payables -624; trade receivables -515.

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 are measured 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 11 to the financial statements – Transition to 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 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 and monitoring 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 generally accepted accounting principles in Israel (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 meet 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 meet 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 transactions conducted by the Company 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 are measured at fair value, with the changes in the fair value immediately recognized in the income statement, as described below.

6.2.2 Transactions in derivatives on the prices of goods and margins

In reporting period, following the transition to IFRS accounting (compared to Israeli GAAP), the Company recorded net losses for derivative transactions on the prices of goods and refining margins of \$5 million, compared to a loss of \$21 million in the corresponding period last year (before tax).

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The loss in the reporting period 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 refining 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.

In addition, according to IFRS, in the reporting period because of increase in crude oil prices, the Company recorded losses for realization of hedging positions on crude oil previously attributed to inventory based on accounting principles prior to full adoption of IFRS. Recognizing the loss in the income statement instead of in inventory does not create accounting parallelism when the incomes from sales of the inventory is expected to be recognized in the income statement subsequent to the reporting period.

6.2.3 Transactions in derivatives on foreign currency exchange rates and interest

In the reporting period, following the transition to accounting according to IFRS, the Company recorded net earnings of \$80 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 (hereinafter: " **the 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 \$83 million due to the impact of the appreciation on the value of the 2007 debentures.

6.2.4 Forward currency transactions

To hedge against exposure from the Company's credit sales to its customers in shekels, the Company purchases dollars in forward transactions for the expected dates of customer intake. The loss of \$3 million was recognized immediately in the income statement and offset the impact of the changes in the exchange rate against the shekel for these sales.

To hedge forecasted cash flows for the purchase of fixed assets in euro, the Company entered into forward transactions to purchase euro. The Company recognized a loss of approximately \$1 million in the income statement as a result of changes in the fair value of the derivative.

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 committee received reports from the management and held five meetings to discuss the Company's exposure to the impact of changes in foreign currency exchange rates.

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The resolutions of the finance committee on this subject are designed 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, reduction 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 operating and maintenance expenses denominated in shekels, 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 three meetings to discuss the Company's exposure to 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 committee as above.

6.4 Sensitivity analysis of exposure to market risks

The tables below describe sensitivity to the Company's 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

Change in exchange	Profit (loss)		Fair value	Profit (loss)	
	10%+	5%+	September	5%-	10%-
	3.7631	3.592	30, 2008	3.250	3.079
in USD thousands					
Long-term linked shekel debentures	48,942	25,636	(538,360)	(28,335)	(59,818)
Long-term shekel debentures	13,364	7,000	(147,000)	(7,737)	(16,333)
Accounts receivable(NIS)	(20,170)	(10,565)	221,872	11,677	24,652
Accounts payable (NIS)	10,764	5,638	(118,400)	(6,232)	(13,156)
Inventory balance (NIS) (*)	(9,409)	(4,929)	103,500	5,447	11,500
Securities (NIS)	(7,162)	(3,751)	78,780	4,146	8,753
Forward contract	13,909	7,286	(2,698)	(8,053)	(17,000)
Swapping principal and interest	(51,054)	(26,742)	82,643	29,557	62,399
	(816)	(427)	(319,663)	470	997

* Inventory denominated in NIS

6.4.2 Summary of the differences in fair value in view of the sensitivity analysis of the euro-dollar exchange rate

Change in exchange rate	Profit (loss)		Fair value	Profit (loss)	
	10%+	5%+	September	5%-	10%-
	2,567	1,284	30, 2008	(1,284)	(2,567)
in USD thousands					
Forward contracts	2,567	1,284	(732)	(1,284)	(2,567)

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

Change in Interest for dollar loans	Profit (loss)		Fair value	Profit (loss)	
	10%+	5%+	September	5%-	10%-
	7,777	4,141	30, 2008	(4,239)	(8,586)
in USD thousands					
Interest rate swaps (IRS)	96	231	417	(186)	(332)
Swap hedging	(42)	(21)	(755)	21	43
Dollar-linked securities	(5,567)	(2,784)	43,516	2,784	5,567
Forward contracts	106	53	(3,430)	(54)	(109)
Swapping principal and interest	13,184	6,662	82,643	(6,804)	(13,755)
	7,777	4,141	122,391	(4,239)	(8,586)

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

Change in price	Profit (loss)		Fair value	Profit (loss)	
	10%+	5%+	September 30, 2008	5%-	10%-
in USD thousands					
Inventory (*)	57,652	28,826	576,520	(28,826)	(57,652)
Futures	(7,103)	(3,529)	3,860	3,620	7,194
Swap hedging (**)	(4,947)	(2,474)	(755)	2,474	4,947
	<u>45,602</u>	<u>22,823</u>	<u>579,625</u>	<u>(22,732)</u>	<u>(45,511)</u>

(*) Excluding inventory with a fixed price

(**) Assuming product basket prices are unchanged

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

Change in interest	Profit (loss)		Fair value	Profit (loss)	
	10%+	5%+	September 30, 2008	5%-	10%-
in USD thousands					
CPI-linked securities	(1,115)	(557)	54,072	557	1,115
Long-term CPI-linked shekel debentures	14,172	7,163	(538,360)	(7,322)	(14,808)
Swapping principal and CPI-linked interest	(10,030)	(5,059)	68,650	5,150	10,392
	<u>3,027</u>	<u>1,547</u>	<u>(415,638)</u>	<u>(1,615)</u>	<u>(3,301)</u>

6.4.6 Summary of the differences in fair value in view of the sensitivity analysis of nominal shekel interest:

Change in interest	Profit (loss)		Fair value	Profit (loss)	
	10%+	5%+	September 30, 2008	5%-	10%-
in USD thousands					
Securities (NIS)	(607)	(304)	22,445	304	607
Forward contracts	45	23	(2,698)	(23)	(45)
Unlinked shekel debentures	3,597	1,815	(147,000)	(1,847)	(3,728)
Swapping principle and non-linked interest	(3,406)	(1,717)	13,994	1,746	3,520
	<u>(371)</u>	<u>(183)</u>	<u>(113,259)</u>	<u>180</u>	<u>354</u>

6.4.7 Summary of the differences in fair value in view of the sensitivity analysis of euro interest

Change in interest	Profit (loss)		Fair value	Profit (loss)	
	10%+	5%+	September 30, 2008	5%-	10%-
in USD thousands					
Forward contracts	(169)	(84)	(732)	84	167

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6.4.8 Summary of the differences in fair value in view of the sensitivity analysis of the CPI

<u>Change in CPI</u>	<u>Profit (loss)</u>		<u>Fair value</u>	<u>Profit (loss)</u>	
	<u>10%+</u>	<u>5%+</u>	<u>September 30, 2008</u>	<u>5%-</u>	<u>10%-</u>
in USD thousands					
CPI-linked securities	5,407	2,704	54,072	(5,407)	(2,704)
Long-term CPI-linked debentures (NIS)	(37,841)	(28,216)	(538,360)	28,216	37,841
Swapping principal and interest	21,414	20,251	68,650	(21,414)	(20,251)
	<u>(11,020)</u>	<u>(5,261)</u>	<u>(415,638)</u>	<u>1,395</u>	<u>14,886</u>

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

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

<u>Change in exchange rates</u>	<u>Profit (loss)</u>		<u>Fair value</u>	<u>Profit (loss)</u>	
	<u>10%+</u>	<u>5%+</u>	<u>September 30, 2008</u>	<u>5%-</u>	<u>10%-</u>
in USD thousands					
Long-term shekel linked debentures	11,229	5,882	(123,518)	(6,501)	(13,724)
Accounts receivable(NIS)	(1,451)	(725)	14,501	725	1,451
Accounts payable (NIS)	1,960	981	(19,593)	(981)	(1,960)
Forward contracts	952	499	(427)	(552)	(1,164)
Swapping principal and interest	(9,898)	(5,184)	20,646	5,731	12,097
	<u>2,792</u>	<u>1,453</u>	<u>(108,391)</u>	<u>(1,578)</u>	<u>(3,300)</u>

6.5.2 Summary of the differences in fair value in view of the sensitivity analysis of the euro-dollar exchange rate

<u>Change in exchange rates</u>	<u>Profit (loss)</u>		<u>Fair value</u>	<u>Profit (loss)</u>	
	<u>10%+</u>	<u>5%+</u>	<u>September 30, 2008</u>	<u>5%-</u>	<u>10%-</u>
in USD thousands					
Accounts receivable (euro)	(1,312)	(656)	13,116	656	1,312
Accounts payable (euro)	1,412	706	(14,118)	(706)	(1,412)
Other long-term liabilities (euro)	897	448	(8,964)	(448)	(897)
Long-term loans (euro)	3,883	1,941	(38,824)	(1,941)	(3,883)
Forward contracts	(2,464)	(1,232)	(1,098)	1,232	2,465
	<u>2,416</u>	<u>1,207</u>	<u>(49,888)</u>	<u>(1,207)</u>	<u>(2,415)</u>

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6.5.3 Summary of the differences in fair value in view of the sensitivity analysis of the GBP-dollar exchange rate

<u>Change in exchange rates</u>	<u>Profit (loss)</u>		<u>Fair value</u>	<u>Profit (loss)</u>	
	<u>10%+</u>	<u>5%+</u>	<u>September 30, 2008</u>	<u>5%-</u>	<u>10%-</u>
in USD thousands					
Trade receivables - GBP	(332)	(166)	3,321	166	332
Forward contracts	334	167	167	(167)	(334)
	<u>2</u>	<u>1</u>	<u>3,488</u>	<u>(1)</u>	<u>(2)</u>

6.5.4 Summary of the differences in fair value in view of the sensitivity analysis of euro interest

<u>Change in exchange rates</u>	<u>Profit (loss)</u>		<u>Fair value</u>	<u>Profit (loss)</u>	
	<u>10%+</u>	<u>5%+</u>	<u>September 30, 2008</u>	<u>5%-</u>	<u>10%-</u>
in USD thousands					
Fixed interest euro loan	969	485	29,992	(485)	(969)

6.5.5 Summary of the differences in fair value in view of the sensitivity analysis of dollar interest

<u>Change in interest rate</u>	<u>Profit (loss)</u>		<u>Fair value</u>	<u>Profit (loss)</u>	
	<u>10%+</u>	<u>5%+</u>	<u>September 30, 2008</u>	<u>5%-</u>	<u>10%-</u>
in USD thousands					
Swapping principal and interest	<u>3,256</u>	<u>1,650</u>	<u>20,646</u>	<u>(1,697)</u>	<u>(3,442)</u>

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

<u>Change in interest rate</u>	<u>Profit (loss)</u>		<u>Fair value</u>	<u>Profit (loss)</u>	
	<u>10%+</u>	<u>5%+</u>	<u>September 30, 2008</u>	<u>5%-</u>	<u>10%-</u>
in USD thousands					
Swapping principal and CPI-linked interest	(3,219)	(1,627)	20,646	1,661	3,359
Long-term CPI-linked shekel debentures	4,632	2,348	(123,518)	(2,414)	(4,895)
	<u>1,413</u>	<u>721</u>	<u>(102,872)</u>	<u>(753)</u>	<u>(1,536)</u>

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6.6 Consolidated linkage-based report

As of September 30, 2008 (USD thousands)

	Shekel Index- linked	Foreign currency- linked *	Shekel Unlinked	Non- monetary	Total
Assets					
Cash	-	15,548	10,785	-	26,333
Derivatives at fair value through profit and loss	-	3,106	-	-	3,106
Investment in financial assets at fair value through profit and loss	54,088	52,073	25,159	-	131,320
Future purchase	-	157,416	7,237	-	164,653
Long-term future purchase	-	25,665	-	-	25,665
Trade and other accounts receivable and debit balances	56,471	410,771	184,422	17,580	669,244
Inventory of fuel products	-	960,896	105,275	84,258	1,150,429
Affiliates	-	-	-	40,197	40,197
Long-term derivatives at fair value through profit and loss	519,138	417	150,061	-	669,616
Deposits and loans (**)	-	-	5,453	-	5,453
Loan to Haifa Early Pensions Ltd.	93,864	-	-	-	93,864
Fixed assets	-	-	-	1,066,178	1,066,178
Other assets	-	-	-	24,816	24,816
Total assets	723,561	1,625,892	488,392	1,233,029	4,070,874
Liabilities					
Short-term credit and loans	-	(107,314)	(143,644)	-	(250,958)
Trade and other accounts payable and credit balances	(38,105)	(586,498)	(110,681)	-	(735,284)
Derivatives at fair value through profit and loss	-	-	(700)	-	(700)
Future sales	-	(7,002)	(160,349)	-	(167,351)
Long term financial liabilities – fair value through profit and loss	-	(565,910)	-	-	(565,910)
Deferred taxes	-	-	-	(125,600)	(125,600)
Long-term future sale	-	(26,397)	-	-	(26,397)
Employee benefits	-	(732)	(64,896)	-	(65,628)
Other liabilities (Domo)	-	(8,964)	-	-	(8,964)
Long-term loans(**)	(698,999)	(495,673)	(146,156)	5,398	(1,335,430)
Total liabilities	(737,104)	(1,798,490)	(626,426)	(120,202)	(3,282,222)
Net balance	(13,543)	(172,598)	(138,034)	1,112,827	788,652

(*) Primarily dollar

(**) 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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6.7 Consolidated linkage-based report

As of December 31, 2007 (in USD thousands)

	<u>Shekel Index- linked</u>	<u>Foreign currency linked (*)</u>	<u>Shekel Non-linked</u>	<u>Non- financial</u>	<u>Total</u>
Assets					
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
Total assets	454,832	1,070,729	807,457	1,118,237	3,451,255
Liabilities					
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)
Total liabilities	(698,621)	(1,469,745)	(297,869)	(185,217)	(2,651,452)
Net balance	(243,789)	(399,016)	509,588	933,020	799,803

(*) Primarily dollar

(**) 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.

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 10A(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 bears 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.
2. The contents of Note 10B regarding the dependency of the Company on receipt of services from infrastructure companies.
3. The contents of Note 10A(9) regarding the application for certification of a class action filed against a proportionally consolidated subsidiary, subsequent to the date of the balance sheet.

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. Ori Slonim, 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 CFO. 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 affecting 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 investigates the material issues included in the financial statements, including material transactions not conducted in the normal course of business (if any), the significant assessments and critical estimates applied in the financial statements, the accounting policy applied and changes thereto (if any), and the implementation of the fair disclosure principle in the financial statements and accompanying information. The 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 affecting 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.

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During the course of the deliberations of the board of directors, questions are raised by the members of the board on various issues, including issues that arose during the audit. The goal of the entire process is to ensure that the financial statements faithfully present the financial position of the Company.

The questions and issues raised are addressed when necessary by both Company management through the CEO or CFO 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.

The financial reports as at September 30, 2008, were discussed by the B.O.D financial committee in the attendance of B.O.D members – Yossi Rosen, Yachin Cohen, Ori Slonim, Avisar Paz, Nehama Ronen, Dafna Schwartz,, and were discussed and approved by the B.O.D of the company on November 23, 2008 in the attendance of all B.O.D members.

9. Significant events during and subsequent to the reporting period

- 9.1** Exchange rate: There was a devaluation of 16% in the shekel-dollar exchange rate from the end of the reporting period and until the date of the approval of the balance sheet. The effect of the depreciation on the Group's business results, based on the linkage balance on September 30, 2008 is estimated as \$21 million in net financing income.

Price of crude oil and its products – Subsequent to the balance sheet date and until the date of the approval of the financial statements the price of crude oil and its products dropped by 40%. At the end of the third quarter the price of crude oil was \$94/barrel. The price continued to drop subsequent to the reporting period. On the date of approval of the financial statements, the price of crude oil was \$50/barrel. . Based on the Company's exposure policy to the changes in its inventory costs, under which the Company does not hedge basic operating inventory of 600 thousand tons. The Company estimates, based on exposure management policy and hedging transactions for inventory prices and since the inventory balance on September 30, 2008 is realized in October and November, the impact of this decrease on the inventory balance amounted to \$106 million, which was partially offset by hedging transactions for inventory in the amount of \$32 million, therefore amounting to \$74 million.

Prices of naphtha and LPG: From the end of the reporting period and up to the approval of the financial statements of Carmel Olefins, there was a dramatic decrease in the prices of naphtha and LPG (hereinafter: "feedstock products") and in the price of the polymers sold by Carmel Olefins. As the feedstocks are a material part of the finished goods inventory at Carmel Olefins, Carmel Olefins estimates that the changes in feedstock and polymers prices on the reporting date will affect the value of inventory in the balance sheet of Carmel Olefins in the amount of \$32 million (the affect on the value of inventory in the consolidated balance sheet in amount of \$ 16 million).

- 9.2** On September 28, 2008 the Company and Carmel Olefins signed an addendum to Carmel Olefins merger agreement, enabling the completion of the agreement, also in the instance whereby IPE does not receive a control permit (see expansion in section 1.2.2 above).
- 9.3** On August 13, 2008 the general meeting of the Company approved an increase in the Company's authorized capital by NIS 1,000,000,000 divided into 1,000,000,000 ordinary shares of NIS 1 par value each, such that following the increase of the capital, the Company's authorized capital will be NIS 3,000,000,010 divided into 3,000,000,010 ordinary shares of NIS 1 par value each.
- 9,4** On August 13, 2008 the general meeting of the Company approved an amendment to the Company Articles such that the Company's board of directors will have the authority to resolve the distribution of a dividend (and not the general meeting, as was the case previously) and to approve the lifting of the prohibition for a subsidiary or company controlled by the Company to acquire the shares of the Company.

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- 9.5** On July 22, 2007 Israel's Knesset (parliament) passed the second and third reading of the Clean Air Law 2768-2008 (hereinafter: Clean Air Law). The Clean Air Law, which will come into effect on January 1, 2011 (the effective date) is expected to tighten the monitoring of emissions and require plants emitting substances into the air to receive an emission permit for their operation. In addition, the Clean Air Law will intensify the criminal and administrative sanctions that could be imposed on any party contravening the provisions of the Law and causing strong or unreasonable air pollution.

Pursuant to the interim provisions of the Clean Air Law, a plant operating in the Company's field of operations and which operated an emission source pursuant to the provisions of the Personal Order, before the Clean Air Law came into effect, may continue to operate without a permit under the Clean Air Law until September 30, 2016 or until a decision is made on its application for an emission permit, whichever earlier, provided it applies for an emission permit no later than March 1, 2014.

It is noted that the Company is in compliance with the provisions of the Personal Order. The secondary legislator was certified by law to formulate material and central provisions related to implementation of the Clean Air Law, including provisions defining strong or unreasonable air pollution and steps and means to prevent such pollution. These provisions have not yet been formulated.

- 9.6** 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.
- 9.7** 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 Carmel Olefins disagrees with the orders for emission in the event of a malfunction in the Personal Order (which includes a provision according to which the smoke emission will not exceed a cumulative period of six minutes an hour), as it alleges the provisions are not practical and Carmel Olefins is unable to comply with them

It is further 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 best available technique (BAT), including the backup required to prevent malfunctions, to the satisfaction of the Ministry and the Haifa District Municipal Association (hereinafter: the demand).

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On May 25, 2008 Carmel Olefins shut down the installations (hereinafter: the temporary shutdown). In the framework of the temporary shutdown, Carmel carried out various operations to ensure that BAT in Lapid will be operated in optimum processes, including backups required to prevent malfunctions. Carmel estimates that after the temporary shutdown, it is in compliance with all the requirements presented by the district manager regarding Lapid. However, Carmel emphasized to the district manager that this will not solve the matter of the orders for emission in the event of a malfunction and requested the appointment of a professional committee to study the matter.

On July 6, 2008, a hearing was held for Carmel at the district manager following the district manager's allegations of failure to comply with the provisions of the Personal Order and generation of unreasonable pollution regarding the smoke emission event from the Carmel Olefin plant on June 21, 2008. In the minutes of this hearing, the district manager ordered the company, inter alia, to shut down one of its polyethylene plants until tests are completed and conclusions drawn, and ordered a test by a German expert within two weeks from the date of the hearing. The district manager further ordered that the conclusions of the German expert's report will be applied within one month of the hearing. Carmel implemented the requirements set forth in the minutes of the hearing and shut down one of its polyethylene plants, which was reopened after the test on July 18, 2008.

- 9.8** On October 28, 2008 Carmel Olefins was presented with an application for the certification of a class action pursuant to the Class Actions Law 5766-2006, filed on October 5, 2008, with the Tel Aviv District Court (hereinafter: the application).

The application was filed for non-monetary damages caused, according to the applicant, by two smoke emission events which occurred on September 15, 2003 and October 5, 2003 (hereinafter: the events). In a prior class action that was filed against the Company and Carmel Olefins, the plaintiffs agreed to strike out Carmel Olefins from the claim.

In the application, the applicant asks to represent the residents of the Haifa Bay area and those who were present in the area (hereinafter: the group) and were exposed to the smoke emissions on the said dates. The applicant claims that each of the members of the group is to be compensated NIS 1,000 for the damage allegedly caused. The application does not quote the estimated number of the group's members and does not quote the total amount that the application claims should compensate the group. The applicant claimed that he filed the application following the results of the criminal procedure against Carmel Olefins, under which Carmel Olefins was convicted, at its own admission, in a revised indictment relating to the events, by the Supreme Court.

Based on the opinion of the legal advisors of Carmel Olefins, in view of the early stage of the claim, the complexity of the process and the fact that no amount was quoted in the application, the Company is unable to evaluate the amount of the exposure, if any exists.

- 9.9** On October 12, 2008 the Company's board of directors approved the establishment of a hydrocracker at the Haifa refinery for a total investment of \$670 million, (including an investment of \$37 million approved by the board of directors in November 2007 in order to advance the project), as part of the strategic plan adopted in November 2007. The hydrocracker will produce middle distillates (diesel oil and kerosene) and is expected to be operational in 2011.

The board of directors instructed the Company's management to complete the organization of the credit facility through Export Credit Agency to finance the purchase of the main equipment from foreign suppliers, and to act to receive additional long-term credit required for the project, from various sources.

It is noted that the Company has raised part of the required financing for the strategic plan in December 2007, under the Company's prospectus published on November 28, 2007.

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Upon activation, the hydrocracker will allow production of higher added-value products with each barrel of oil, substantially increasing the complexity of the Haifa refinery. Additionally, the plant will increase the flexibility of the refinery in terms of ability to choose raw materials and product mix, in order to adapt them to the changing markets.

As of the date of approval of the financial statements, the Company has no financial liabilities for the purchase of fixed assets that are not covered by secured financial financing.

- 9.10** On November 12, 2008 Standard & Poor's Maalot announced that it has downgraded the Company's debentures (Series A, B and C as well as untraded debentures) from AA/Stable to A/Negative.

The immediate report published by the Company emphasizes that when the debentures (Series A-C) were issued in December 2007, and were rated AA/Stable by Maalot, the Company, as well as Maalot, took into account the Company's investment forecast for the coming years for the implementation of its strategic plan, and accordingly, the terms of the debentures (Series A-C), whereby the majority of the payments will start from 2012 onwards, during which time the Company expects to generate large cash inflows on these investments.

The Company also wishes to note that from the time credit rating was granted in November 2007, and to date, there have been several positive developments, as outlined below:

1. Improved operational availability of the facilities and increased production and sales capacities
2. Improved liquidity and free cash flow, following the sharp decline in crude oil prices
3. Substantial increase in the forecasted future margins for the products produced by the hydrocracker (mainly diesel oil and kerosene) since the strategic plan was approved
4. Continued investment in strengthening of the Company's core businesses, while increasing the refining complexity and flexibility of the facilities as well as adding other margin components, in order to increase its profits and reduce risk over time

The Company announced that it examined its steps in detail when preparing the strategic plan and re-evaluation of the chosen directions shows that the changes in the market strengthens these directions. This plan further emphasizes the Company's strengths, including its human resources, which are among the highest in terms of technological aptitude worldwide, integration of the petrochemical and refining industries, excellent strategic location with good accessibility to a wide selection of crude oils, close proximity to growing markets, and strong modern infrastructure in its main Haifa facility.

The Company estimates that its strategic plan, the ensuing investments, as well as the organizational changes and efficiency measures adopted, strengthen the Company as compared to its position at the time of the rating issuance before the debenture offering in 2007.

- 9.11** On November 23, 2008 the Board of Directors of the Company approved the distribution of a cash dividend in the amount of NIS 200 million (hereinafter : "the dividend"), from the distributable profits according to the financial statements as of September 30, 2008. If the Company will distribute the "first dividend", as defined in the agreement for the purchase of the remaining shares of Carmel Olefins, between the Company and IPE from June 24, 2008, the dividend will be considered part of the "first dividend". (section 1.2.2. (c) above).

Yossi Rosen
Chairman of the board of directors

Yashar Ben Mordechai
CEO

November 23, 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

In May 29, 2008 the Company published a shelf prospectus on the basis of the Company's financial statements as of December 31, 2007, for the issuance of shares, debentures, convertible debentures, option warrants for ordinary shares and option warrants for debentures, as set forth in the 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 September 30, 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 11 to the Company's financial statements as of September 30, 2008.

3. Financial information concerning the Company's operations

See Note 5 to the financial statements.



The Board of Directors
Oil Refineries Limited
HAIFA

Re: Review of the unaudited consolidated interim financial statements for the nine- and three-month periods ended September 30, 2008

At your request, we have reviewed the interim balance sheet of Oil Refineries Limited as of September 30, 2008, and the consolidated interim statement of income, consolidated interim statement of comprehensive income and expenses, and consolidated interim statement of cash flows for the nine- and three-month periods then ended.

Our review was carried out in accordance with procedures established by the Institute of Certified Public Accountants in Israel. The procedures included, inter alia, reading the abovementioned financial statements, reading the minutes of meetings of the shareholders and the Board of Directors and its committees and making inquiries with certain officers responsible for financial and accounting matters.

We were furnished with reports of other auditors regarding the review of the interim financial statements of a proportionally consolidated subsidiary whose assets included in the consolidated balance sheet as of September 30, 2008 represent 19% of assets included in the consolidated interim balance sheet and whose revenues included in the consolidated statements represent 5% of the total income included in the consolidated interim statement of income for the nine- and three-month periods then ended,. In addition, we were furnished with reports of other auditors of affiliates in which the Company invested \$40,187 thousand as of September 30, 2008 and the Company's share in their profits is \$437 thousand and in their losses is \$3,289 thousand for the nine- and three-month periods then ended, respectively.

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 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), 1970.

We call attention to:

1. The contents of Note 10A(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 bears 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.
2. The contents of Note 10B regarding the dependency of the Company on receipt of services from infrastructure companies.
3. The content of Note 10A(9) regarding the request to approve a class action filed against a proportionally consolidated subsidiary, subsequent to the balance sheet date.

Sincerely,

Somekh Chaikin
Certified Public Accountants

November 23, 2008

Tel Aviv
November 23, 2008

The Board of Directors
Oil Refineries Limited
HAIFA

Re: Review of the unaudited consolidated interim financial statements for the nine- and three-month periods ended September 30, 2007

At your request, we have reviewed the interim balance sheet of Oil Refineries Limited as of September 30, 2007, and the interim statement of income, consolidated interim statement of comprehensive income and expenses, and the consolidated interim statement of cash flows for the nine- and three-month periods then ended.

Our review was carried out in accordance with procedures established by the Institute of Certified Public Accountants in Israel. The procedures included, inter alia, reading the abovementioned financial statements, reading the minutes of meetings of the shareholders and the Board of Directors and its committees and making inquiries with certain officers responsible for financial and accounting matters.

We were furnished with reports of other auditors regarding the review of the interim financial statements of a proportionally consolidated subsidiary whose assets included in the consolidated balance sheet as of September 30, 2007 represent 13% of assets included in the consolidated interim balance sheet and whose revenues included in the consolidated statements represent 4% of the total income included in the consolidated interim statement of income for the nine- and three-month periods then ended. In addition, we were furnished with reports of other auditors of affiliates in which the Company invested \$54,026 thousand as of September 30, 2007 and the Company's share in their profits is \$857 thousand and in their losses for the three month periods then ended is \$6,268 thousand.

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 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 (hereinafter: IAS) 34, Interim Financial Reporting, and in accordance with Section D of the Securities Regulations (Periodic and Immediate Reports), 1970.

We call attention to:

1. The contents of Note 10A(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 bears the costs of removing polluted sludge from the Kishon River. Based on the opinion of the legal counsels of the Company and its investees, 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.
2. The contents of Note 10.B regarding the dependency of the Company on receipt of services from infrastructure companies.
3. The content of Note 10A(9) regarding the request to approve a class action filed against a proportionally consolidated subsidiary, subsequent to the balance sheet date.

Sincerely,
Fahn Kanne & Co.
Certified Public Accountants

Consolidated interim balance sheets
(in USD thousands)

	September 30, 2008	September 30, 2007	December 31, 2007
	(Unaudited)		(Audited)
Assets			
Cash and cash equivalents	26,333	19,523	259,325
Derivatives at fair value through profit and loss	3,106	4,485	6,513
Investment in other financial assets at fair value through profit and loss.	131,320	106,917	113,035
Trade receivables	517,815	396,693	394,470
Receivables and debit balances	121,868	75,508	84,029
Income tax	30,129	1,526	10,153
Inventory	1,150,429	770,893	1,042,545
Total current assets	1,981,000	1,375,545	1,910,070
Investments and long-term loans			
Investments in investees accounted by the equity method			
	40,197	54,026	53,958
Loan to Haifa Early Pensions Ltd.	93,864	75,670	80,038
Long term loans and debit balances	4,885	2,021	3,631
Derivatives at fair value through profit and loss	103,706	-	2,571
Employee benefit plan assets	6,689	6,681	7,519
	249,341	138,398	147,717
Fixed assets, net	1,066,178	972,218	978,412
Intangible assets and deferred expenses, net	24,816	22,418	22,924
Total non-current assets	1,340,335	1,133,034	1,149,053
Total assets	3,321,335	2,508,579	3,059,123

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

Consolidated interim balance sheet
(in USD thousands)

	September 30, 2008	September 30, 2007	December 31, 2007
	(Unaudited)		(Audited)
Current liabilities			
Credit from banking institutions and other credit providers	387,307	278,650	216,021
Trade payables	536,240	372,706	561,232
Other payables	159,035	65,282	92,253
Derivatives at fair value through profit and loss	3,398	4,013	-
Provisions	30,994	16,523	19,950
Total current liabilities	1,116,974	737,174	889,456
Non-current liabilities			
Debentures	817,816	242,726	717,302
Bank loans	381,265	482,293	452,154
Derivatives in fair value through profit and loss	732	-	-
Deferred taxes	125,600	119,249	125,287
Liabilities for financing lease	9,452	7,273	7,763
Other long-term liabilities	8,964	-	-
Employee benefits	71,880	73,509	67,358
Total non-current liabilities	1,415,709	925,050	1,369,864
Total liabilities	2,532,683	1,662,224	2,259,320
Shareholders' equity			
Share capital	472,478	472,478	472,478
Capital reserves	21,015	28,501	29,036
Retained earnings	295,159	345,376	298,289
Total equity attributed to equity holders of the Company	788,652	846,355	799,803
Total liabilities and capital	3,321,335	2,508,579	3,059,123
Yossi Rosen Chairman of the Board	Yashar Ben Mordechai CEO	Jacob Hirsh CFO	

Date of approval: November 23, 2008

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

Consolidated interim statement of income (in USD thousands)

	For the nine months ended September 30		For the three months ended September 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)		(Unaudited)		(Audited)
Revenues	6,981,424	3,667,916	2,624,665	1,288,632	5,236,945
Cost of sales, refinery and services	6,738,068	3,346,340	2,574,325	1,192,300	4,805,066
Revaluation of open positions in derivatives on prices of goods and margins, net	2,087	21,135	(31,456)	33,557	20,156
Total cost of revenues	6,740,155	3,367,475	2,542,869	1,225,857	4,825,222
Gross profit	241,269	300,441	81,796	62,775	411,723
Selling expenses	32,215	24,138	11,029	9,086	33,518
General and administrative expenses	58,610	47,748	17,959	14,238	68,027
Reduction of negative goodwill created upon acquisition (*)	(14,535)	-	(692)	-	-
Privatization grant	-	28,360	-	-	28,360
Operating profit	164,979	200,195	53,500	39,451	281,818
Financing income	67,953	34,123	15,579	16,004	34,625
Financing expenses	(157,096)	(76,484)	(67,144)	(36,762)	(136,750)
Company's share in gains (losses) of investees (net of tax)	437	857	(3,289)	(6,268)	6,913
Income (loss) before taxes on income	76,273	158,691	(1,354)	12,425	186,606
Tax benefits (taxes on income)	(2,754)	(34,237)	1,396	5,629	(44,937)
Net Income for the period	73,519	124,454	42	18,054	141,669
Earnings per ordinary share					
Net basic and diluted earnings per ordinary share (in USD)	0.037	0.062	(**)	0.009	0.071

(*) See Note 8 G

(**) Less than \$0.001

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

Consolidated interim statement of comprehensive income and expenses
(in USD thousands)

	For the nine months ended September 30		For the three months ended September 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)		(Unaudited)		(Audited)
Actuarial gains (losses) from a defined benefit plan	(5,050)	-	(4,885)	-	5,231
Capital reserve for translation differentials	(867)	(25)	(1,086)	(25)	-
Capital reserve for financial assets available for sale	(10,339)	-	751	-	-
Other total income for the period, net of tax	(16,256)	(25)	(5,220)	(25)	5,231
Income for the period	73,519	124,454	42	18,054	141,669
Total income for the period attributed to the equity holders of the Company	<u>57,263</u>	<u>124,429</u>	<u>(5,178)</u>	<u>18,029</u>	<u>146,900</u>

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

Consolidated interim statement of cash flows
(in USD thousands)

	For the nine months ended September 30		For the three months ended September 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)		(Unaudited)		(Audited)
Cash flows for operating activities					
Net Income for the period	73,519	124,454	42	18,054	141,669
Adjustments:					
Depreciation and amortization	57,338	53,572	20,071	18,624	72,258
Reduction of negative goodwill created upon acquisition	(14,535)	-	(692)	-	-
Financing costs, net	100,593	71,625	23,652	40,278	103,923
Changes in fair value of derivatives	3,245	18,797	(31,186)	9,940	11,151
Change in fair value of the loan to Haifa Early Pensions Ltd	(13,826)	(4,049)	5,384	(5,161)	(8,408)
Share in the (profits) losses of investees accounted by the equity method	(437)	(857)	3,289	6,268	(6,913)
Dividends received from investees	(298)	4,772	-	-	10,920
Earnings (loss) from securities held for trading	(16,647)	(8,752)	4,016	(5,140)	(14,870)
Proceeds from sale of property, plant and equipment	-	(10)	-	(10)	(10)
Employee benefits, net	(2,606)	(3,921)	(5,719)	1,246	(4,837)
Share-based payment expenses	3,131	-	1,029	-	558
Income tax benefit expenses (revenues)	2,754	34,237	(1,396)	(5,629)	44,937
	119,308	165,414	18,448	60,416	208,709
Change in inventory	(94,858)	(116,227)	194,818	50,525	(387,889)
Change in trade receivables and other receivables	(149,080)	134,521	116,884	60,392	115,914
Change in trade payables and other payables	(10,981)	(165,829)	(131,032)	(77,353)	58,029
	(254,919)	(147,535)	180,670	33,564	(213,946)
Income tax paid, net	(24,743)	(116,476)	(12,314)	(31,423)	(128,833)
Net cash provided by (used for) operating activities	(86,835)	25,857	186,846	80,611	7,599
Cash flow for investing operations					
Interest received	2,299	2,587	486	614	2,062
Proceeds from sale of property, plant and equipment	-	28	-	28	28
Acquisition of a subsidiary consolidated for the first time	(14,462)	-	-	-	-
Loan to Haifa Early Pensions Ltd.		(71,621)	-	-	(71,621)
Investment in investees	(796)	-	(763)	-	-
Repayment (granting) of long-term loans from others, net	(333)	(188)	182	(262)	(472)
Purchase of securities held for trading	(150,000)	-	-	-	-
Sale of securities held for trading	148,362	-	88,352	-	-
Purchase of property, plant & equipment	(112,431)	(63,497)	(39,036)	(15,306)	(89,021)
Purchase of intangible assets and deferred expenses	(789)	(10,714)	(180)	(9,719)	(11,458)
Net cash provided by (used in) investing activities	(128,150)	(143,405)	49,041	(24,645)	(170,482)

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

Consolidated interim statement of cash flows as of September 30, 2008 (cont'd)
(in USD thousands)

	For the nine months ended September 30		For the three months ended September 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)		(Unaudited)		(Audited)
Cash flow from financing activities					
Receipt (repayment) of short-term credit	248,070	1,650	(184,080)	(11,406)	(62,850)
Receipt of deposits from customers	51,930	2,563	833	2,089	8,032
Interest paid in cash less proceeds from transactions in derivatives	(66,166)	(48,546)	(3,420)	(15,219)	(67,178)
Proceeds from issuing debentures	-	100,903	-	-	573,697
Repayment of debentures	(97,760)	(13,905)	(7,251)	(5,094)	(22,529)
Payment of issuance expenses for interested parties	-	(923)	-	-	(1,046)
Bank loans received	-	48,684	-	10,177	48,684
Repayment of bank loans	(84,491)	(99,808)	(24,854)	(30,465)	(134,090)
Privatization grant	-	28,360	-	-	28,360
Dividends paid	(71,599)	(4,734)	-	-	(74,144)
Net cash flows provided by (used for) financing operations	(20,016)	14,244	(218,772)	(49,918)	296,936
Net increase (decrease) in cash and cash equivalents	(235,001)	(103,304)	17,115	6,048	134,053
Effect of fluctuations in the rate of exchange on cash and cash equivalents	2,009	(1,094)	126	2,044	1,351
Cash and cash equivalents at the beginning of the period	259,325	123,921	9,092	11,431	123,921
Cash and cash equivalents at the end of the period	26,333	19,523	26,333	19,523	259,325

The accompanying notes are an integral part of the consolidated interim financial statements

NOTE 1 – GENERAL

Oil Refineries Ltd. (hereinafter: the Company or ORL) is a company domiciled and incorporated in Israel. The Company is located in the Haifa Bay and its official address is PO Box 4, Haifa 31000, 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 September 30, 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. (hereinafter: PCH) hold 45.08% and 15.76% of the Company's shares, respectively.

NOTE 2 – BASIS OF PREPARATION**A. Statement of compliance**

The consolidated interim financial statements have been prepared by the Group in accordance with International Financial Reporting Standards (IFRS). The statements are 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 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. Additionally, these statements were prepared in accordance with Chapter D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

An explanation of how the transition to IFRS has affected the reported financial position, financial performance and cash flows of the Company is provided in Note 11.

The consolidated interim financial statements were approved by the Company's Board of Directors on November 23, 2008.

B. Functional and presentation currency

The 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 most of the Group companies operate.

C. Basis of measurement

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

NOTE 2 – BASIS OF PREPARATION (CONT'D)**D. Use of estimates and judgments**

The preparation of the financial statements in conformity with IFRS 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.

When preparing the accounting estimates used to prepare the Company's financial statements, management was required to make assumptions regarding the circumstances and events involving substantial uncertainty and relied on past experience, various facts, external factors and reasonable assumptions according to the circumstances appropriate for each estimate. Management reviews the estimates and judgments routinely. Adjustments in the accounting estimates are recognized in the period in which they are made and in any other affected period in the future.

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 consolidated interim financial statements is as follows:

	Balance before change in estimate	Effect of change in estimate	Balance in the financial statements (after change in estimate)
	(in USD thousands)		
For the nine-month period ended September 30, 2008 (Unaudited)			
Depreciation and amortization expenses	64,620	(7,282)	57,338
Income before taxes on income	68,991	7,282	76,273
Net income	68,057	5,462	73,519
Earnings per share (dollar)	0.034	0.003	0.037
For the nine-month period ended September 30, 2007 (Unaudited)			
Depreciation and amortization expenses	60,854	(7,282)	53,572
Income before taxes on income	151,409	7,282	158,691
Net income	118,992	5,462	124,454
Earnings per share (dollar)	0.059	0.003	0.062
For the three-month period ended September 30, 2008 (Unaudited)			
Depreciation and amortization expenses	22,498	(2,427)	20,071
Income (loss) before taxes on income	(3,781)	2,427	(1,354)
Net income (loss)	(1,778)	1,820	42
Earnings (loss) per share (dollar)	(0.001)	0.001	(*)

(*) Less than \$0.001

NOTE 2 – BASIS OF PREPARATION (CONT'D)

D. Use of estimates and judgments (cont'd)

	Balance before change in estimate	Effect of change in estimate	Balance in the financial statements (after change in estimate)
For the three-month period ended September 30, 2007 (Unaudited)			
Depreciation and amortization expenses	21,051	(2,427)	18,624
Income before taxes on income	9,998	2,427	12,425
Net income	16,234	1,820	18,054
Earnings per share (dollar)	0.008	0.001	0.009
For the year ended December 31, 2007 (Audited)			
Depreciation and amortization expenses	81,967	(9,709)	72,258
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 28 years is a decrease in depreciation expenses in the amount of \$ 9.7 million per year, compared to the depreciation expenses that were included in respect of the prior estimate.

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 Olefins) are subject to compliance with financial covenants, including a minimum balance of equity (see Note 12B and Note 15 of the annual financial statements).

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES

The consolidated interim financial statements have been prepared on the basis of International Financial Reporting Standards and their interpretations (IFRS) in issues that are effective or available for early adoption at the Group's first IFRS annual reporting date, December 31, 2008, and that are the basis for the Group's accounting policy.

IFRS that will be effective or available for 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 this annual period that are relevant to this interim financial information will be determined only when the first IFRS financial statements are prepared at 31 December 2008.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

The preparation of the consolidated interim financial statements in accordance with IAS 34 resulted in changes to the accounting policies compared to the most recent annual financial statements prepared under generally accepted accounting principles in Israel (Israeli GAAP). The accounting policies set out below have been applied consistently to all periods presented in these consolidated interim financial statements. They also have been applied in preparing an opening IFRS balance sheet as on January 1, 2007 for the purposes of the transition to IFRS, as required by IFRS 1. The impact of the transition from Israeli GAAP to IFRS is explained in Note 11.

The accounting policies of IFRS 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 Olefins, a jointly controlled company. Commencing from May 1, 2008 the consolidated financial statements include proportionate consolidation (50%) of Domo Chemicals N.V. (see Note 8).

(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 are exercisable immediately 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.

(2) Jointly-controlled entities (accounted by the proportional consolidation method)

Jointly-controlled entities are those entities over whose activities the Group has joint control, established by contractual agreement and requiring joint consent with the other investors for strategic financial and operating decisions. Jointly-controlled entities are accounted for on a proportionate consolidation basis from the date that joint control commences until the date that joint control ceases. 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, on the basis of the rate of holding in those entities, after adjustments to align the accounting policies with those of the Group.

(3) Affiliates

Affiliates are those entities in which the Group has significant influence, but not control, over their financial and operating policy. The investment in affiliates is accounted for using the equity method and is first recognized at cost. 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.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)**A. Basis of consolidation (cont'd)****(4) Transactions eliminated on consolidation**

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

(5) Early adoption of IFRS 3, IFRS 5 and IAS 27, revised

The Group elected to implement early adoption of IFRS 3 *Business Combinations*, IFRS 5 *Discontinued Operations* and IAS 27 *Consolidated and Separate Financial Statements*, revised (hereinafter: the revisions).

Implementation of the standards mainly affected the recognition of transaction costs in profit and loss in the transactions for acquisition of subsidiaries and is expected to affect the revaluation of the original investment in Carmel Olefins on the basis of fair value in profit and loss, subject to completion of the merger transaction and achieving control in Carmel Olefins (see Note 12 E).

(6) Acquisition of non-controlling interests in subsidiaries

The surplus cost created in transactions of non-controlling interests in subsidiaries are recognized directly in capital.

(7) Issuance of put options for holders of non-controlling interests

A put option issued by the Group for the holders of non-controlling interests are recognized as liabilities in fair value, accounted for as contingent acquisition costs of non-controlling interests. Changes in the fair value in the subsequent periods are recognized in profit or loss. The Company's share in the earnings of the acquired company include the share of the other shareholders that were granted put options by the Company.

B. Foreign currency**(1) Foreign currency transactions**

Transactions in currencies other than the functional currency of the Group (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 on the reporting date are translated to 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 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 retranslated to the functional currency at the exchange rate at the date that the fair value was determined.

(2) Foreign operations

Foreign operations are defined in IAS 21 as a subsidiary, associate, joint venture, or branch whose activities are based in a country or denominated in a currency other than that of the reporting enterprise.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)**B. Foreign currency (cont'd)****(2) Foreign operations (cont'd)**

The assets and liabilities of foreign operations, including fair value adjustments arising on acquisition, were translated to the dollar at exchange rates at the reporting date. The income and expenses of foreign operations were translated to the dollar at exchange rates at the dates of the transactions. Foreign currency differences are recognized directly in equity commencing January 1, 2007, the Group's date of transition to IFRS. According to IFRS 1, the Group chose to reset the cumulative translation differences for all foreign activities at the date of transition to IFRS.

When a foreign operation is realized, in part or in full, the relevant amount in the foreign currency translation reserve (FCTR) is transferred to profit or loss

C. 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 accepts 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 comprises cash balances for immediate use. Cash equivalents include highly liquid investments, including short-term investments that can be easily converted into known amounts of cash and that are exposed to an insignificant risk of changes in value.

b. Financial assets at fair value through profit or loss

A financial instrument is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. A financial instrument is 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 their changes are recognized in profit or loss.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)**C. Financial instruments (cont'd)****(1) Non-derivative financial instruments (cont'd)****c. Loans and accounts receivable**

Loans and receivables are non-derivative financial assets with fixed or determinable payments not quoted in an active market. After initial recognition, loans and receivables are measured at amortized cost by the effective interest method, taking into account transaction costs and less impairment provisions.

(2) Derivative financial instruments

The Group companies use financial instruments in order to hedge against risks relating to prices of commodities, 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. 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 in cost of sales whereas changes in fair value of derivatives on foreign currency and interest rates are classified as financing expenses.

- (3)** The embedded derivatives in financial instruments or any other host contract are separated from the host contract, if the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract, unless the instrument (including the embedded derivative) is recognized as a financial asset or a financial liability at fair value through profit or loss. Changes in the fair value of separable embedded derivatives are recognized immediately in profit or loss.

(4) CPI-linked assets and liabilities not measured at fair value

The value of the CPI-linked financial assets and liabilities, which are not measured at fair value, is revalued in each period according to the actual rate of rise in the CPI.

The table below presents details of the CPI and the dollar exchange rate:

	As of		
	September 30, 2008	September 30, 2007	December 31, 2007
CPI (2000 average basis)	118.62	112.41	113.63
Representative dollar/NIS exchange rate	3.421	4.013	3.846

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)**C. Financial instruments (cont'd)****(4) CPI-linked assets and liabilities not measured at fair value (cont'd)**

The table below presents details of fluctuations in the CPI and the dollar exchange rate in the reporting periods

	For the nine months ended September 30,		For the three months ended September 30,		For the year ended December 31,
	2008	2007	2008	2007	2007
	%	%	%	%	%
CPI	4.391	2.283	2.00	1.297	3.39
Representative exchange rate of \$1	(11.05)	(5.01)	2.05	(5.55)	(8.97)

(5) Share capital

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

D. 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.

E. Fixed assets**1. Recognition and valuation**

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 recognized 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.

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 IFRS (deemed cost).

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)**E. Fixed assets (cont'd)****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	(primarily 33)
Other equipment	25 - 50	
Buildings	5 - 50	
Computers	6	
Furniture and equipment	3 - 17	
Vehicles	5 - 7	

* Facilities for manufacturing aromatic materials

	<u>Years</u>
Production facilities	15 - 49
Storage facilities	50
Control system	30
Other equipment	31 - 50

Depreciation methods, useful lives and residual values are reviewed at least at the end of each reporting year. 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).
6. Advance payments for the purchase of property, plant and equipment are recognized in property, plant and equipment.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (CONT'D)**F. Intangible assets**

- (1) 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:

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

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

(2) **Goodwill**

Goodwill and negative goodwill arise on the acquisition of subsidiaries (including non-controlling acquisitions), affiliates (including acquisitions of additional interests in affiliates) and joint ventures.

The goodwill represents the excess of the cost of the acquisition over the Group's interests in the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquired entity. When the excess is negative (negative goodwill), it is recognized in profit or loss as incurred (see Note 8 below).

Subsequent measurement: Goodwill is measured at cost less accumulated impairment losses. In respect of equity accounted investees, the carrying amount of goodwill is included in the carrying amount of the investment.

G. 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 Land Administration (ILA) that are not accounted for as investment property are operating leases. Lease fees are paid routinely to the ILA and are recognized in the statement of income.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES – (CONT'D)**H. 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

I. Impairment of assets**(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.

When examining impairment of available-for-sale financial assets that are capital instruments, the Company also examines the gap between the fair value of the asset and its original cost, with reference to the standard deviation of the rate of the instrument, for as long as the fair value of the asset is lower than its original cost and the changes in the company's technological, financial, legal or market environment.

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. An impairment loss in respect of an available-for-sale financial asset is calculated on the basis of its fair value.

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. Reversal of a loss from impairment for financial assets classified as available for sale, which are capital instruments, is recognized directly in capital.

(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 (hereinafter: 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.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES – (CONT'D)**I. Impairment of assets (cont'd)****(2) Non-financial assets (cont'd)**

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.

J. 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.

(2) Defined benefit plans

The Group's net obligation in respect of defined benefit pension 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 recognized at its present value and the fair value of any plan assets is deducted. 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.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES – (CONT'D)**J. Employee benefits (cont'd)****(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 on 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.

(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 to terminate 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 payments

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 are expected to vest.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES – (CONT'D)**K. 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) Reorganization

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.

(2) Litigation

A provision for litigation is recognized when the Group has a legal or constructive obligation as a result of a past event and it is more than likely than not that financial resources will be required to settle the obligation and it can be estimated reliably. When the effect of the time value is material, the provision is measured on the basis of its present value. Furthermore, in rare cases in which the outcome of the contingency cannot be assessed, no provision is included in the financial statements.

L. 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.

M. 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.

N. 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.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES – (CONT'D)**O. Lease payments**

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

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.

P. Financing income and expenses

Financing income comprises interest income on funds invested, dividend income, gains on the sale 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 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.

Q. Income tax expenses

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)**Q. Income tax expenses (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.

R. 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.

S. 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 based on transaction prices during regular business.

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.

T. Business combinations

The Company elected to adopt IFRS 3 *Business Combinations* (revised) commencing from January 1, 2007. Business combinations are measured through the acquisition method. The cost of the business combination is measured at the fair value of the transferred assets, the liabilities used in favor of the former owners and the capital instruments issued by the Group in consideration for achieving control in the acquisition. Transactions costs are recognized in profit or loss as incurred.

Contingent consideration resulting from a business combination and constituting a financial liability as defined in IAS 32 is first measured at fair value. Changes in the fair value in the subsequent periods are recognized in profit or loss.

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 recognized in profit and loss. 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. Reclassified

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 this 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 \$ 342 million and \$ 199 million in the consolidated financial statements for the nine and three months ended September 30, 2007, respectively in order to adapt them to the current manner of presentation in the financial statements as of September 30, 2008.

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 recognize credit costs as an expense in profit and loss 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.
- 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.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES – (CONT'D)**W. New standards and interpretations not yet adopted (cont'd)**

- Revised IFRS 2, *Share-Based Payments* (hereinafter: the Standard): The Standard provides that vesting conditions determine whether the parent 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.
- 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, and instruments that require to entity to transfer, on liquidation only, a proportionate share of the net assets of the entity to another party, 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 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 27, *Consolidated and Separate Financial Statements*, and IFRS 1, *First-time Adoption of International Financial Reporting Standards* (hereinafter: the Standards). In accordance with the revised standards, a company that chooses the cost method for measuring its investments in subsidiaries, jointly-controlled companies and affiliated companies, in the separate financial statements (stand-alone financial statements) is permitted to measure these investments on the date of transition to IFRS at their fair value in accordance with IAS 39 or at their carrying value according to previous GAAP. Furthermore, a dividend received from subsidiaries, jointly-controlled companies and affiliated companies shall be recognized as income in the separate financial statements of the holding company.

It was further provided that under certain circumstances the receipt of a dividend indicates impairment of the investment in the investee company.

The new Standards shall apply to annual reporting periods beginning on or after January 1, 2009. Earlier application is permitted, each standard separately, while providing disclosure. The changes attributable to IAS 27 shall be applied prospectively. 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.

- In the framework of the *Improvements to IFRS* project, in May 2008 the IASB published and approved 35 amendments to various IFRS on a wide range of accounting issues. The amendments are divided into two parts: (1) amendments that result in accounting changes for presentation, recognition or measurement purposes and (2) terminology or editorial amendments that are expected to have either no or only minimal effects on accounting.

Most of the amendments shall apply to periods beginning on or after January 1, 2009 and permit early adoption, subject to the specific conditions of each amendment and subject to the transitional provisions relating to a first-time adopter of IFRS. 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.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES – (CONT'D)**W. New standards and interpretations not yet adopted (cont'd)**

- IFRIC 15, *Agreements for the Construction of Real Estate* (hereinafter: the Interpretation). The Interpretation provides guidance on how to determine whether an agreement for the construction of real estate is within the scope of IAS, *Revenue*, according to which the revenue from construction of the real estate is recognized at the same time and using the same method as the revenue from the sale of a product or service, or within the scope of IAS 11, *Construction Contracts*, according to which the revenue will be recognized according to the stage of completion of the development.

The Interpretation will apply retroactively for annual periods beginning on or after January 1, 2009. Early adoption is permitted, with disclosure.

Management estimates that adoption of the Interpretation will not have an effect on the financial statements of the Company.

- IFRIC 16, *Hedges of a Net Investment in a Foreign Operation* (hereinafter: the Interpretation). The Interpretation refers to cases where there is investment in a foreign operation and provides guidelines for hedging this investment. The Interpretation refers, inter alia, to the nature of the hedged risk and the amount of the hedged item to which the hedging relations relate, to the position of the hedging instrument in the Group companies and the accounting of the capital fund at the time of deducting a foreign operation. Management estimates that adoption of the Interpretation will not have an effect on the financial statements of the Company.
- IFRIC 13, *Customer Loyalty Programme* (hereinafter: the Interpretation). The Interpretation addresses how companies, that grant their customers loyalty award credits when buying goods or services, should account for their obligation to provide free or discounted goods or services if and when the customers redeem the points.

The Interpretation will apply retroactively for annual periods beginning on or after July 1, 2008. Early adoption is permitted.

Management estimates that adoption of the Interpretation will not have an effect on the financial statements of the Company.

- Hedgeable items, Amendment to IAS 39 – *Financial Instruments: Recognition and Measurement* (hereinafter: the Amendment). The Amendment clarifies that changes in cash flows or changes in the fair value of a one-sided risk can be designated as a hedged item, in other words, a risk defined as a risk of exposure to fluctuations above or below a certain price or a defined variable. The Amendment also clarifies that an inflationary component can be designated as a separate risk, provided it is contractually specified in the cash flows of index-linked debentures, so that it can be identified separately and measured reliably, and if the other cash flows of the instrument are not affected by the inflationary component. The Amendment will apply retroactively for annual periods beginning on or after July 1, 2009. Early adoption is permitted, with disclosure.

At this point, management is unable to evaluate the effect of implementation of the Amendment on its financial position and results of operations.

NOTE 4 – SEASONAL FLUCTUATIONS

The Company manufactures oil products based on standards that changes 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 to 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:

1. Refining: refining of crude oil and production of fuel products
2. Trade: trade in crude oil and its products and trade in derivatives on the prices of oil and its products
3. Polymers: production of polymer raw materials in the plastics industry
4. 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 SEPTEMBER 30, 2008
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Business segments	<u>Refining</u>		<u>Trade</u>		<u>Petrochemicals</u>				<u>Adjustments to consolidated</u>		<u>Consolidated</u>	
					<u>Polymers</u>		<u>Aromatics</u>					
	<u>For the nine months ended September 30</u>											
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
<u>(Unaudited)</u>												
Total segment revenues	6,397,390	3,504,349	368,728	-	383,147	233,117	473,916	392,140	(641,757)	(461,690)	6,981,424	3,667,916
Gross profit in the segment	170,709	223,686	9,098	-	19,915	33,691	45,249	46,320	(3,702)	(3,256)	241,269	300,441
Sales, general and administrative expenses	(50,690)	(41,609)	(1,334)	-	(20,263)	(12,856)	(21,907)	(19,291)	3,369	1,870	(90,825)	(71,886)
Privatization grant	-	(23,389)	-	-	-	(2,853)	-	(2,118)	-	-	-	(28,360)
Reduction of negative goodwill created upon acquisition	-	-	-	-	14,535	-	-	-	-	-	14,535	-
Operating profit	<u>120,019</u>	<u>158,688</u>	<u>7,764</u>	<u>-</u>	<u>14,187</u>	<u>17,982</u>	<u>23,342</u>	<u>24,911</u>	<u>(333)</u>	<u>(1,386)</u>	<u>164,979</u>	<u>200,195</u>
Financing income											67,953	34,123
Financing expenses											(157,096)	(76,484)
Company's share in earnings of investees (net of tax)											437	857
Income before income tax											<u>76,273</u>	<u>158,691</u>
Income tax											<u>(2,754)</u>	<u>(34,237)</u>
Net profit for the period											<u>73,519</u>	<u>124,454</u>

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2008
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NOTE 5 – SEGMENT REPORTING (CONT'D)

Business segments

	Refining		Trade		Petrochemicals				Adjustments to consolidated		Consolidated	
					Polymers		Aromatics					
	2008	2007	2008	2007	For the three months ended September 30				2008	2007	2008	2007
				2008	2007	2008	2007	2008	2007	2008	2007	
	(Unaudited)											
Total segment revenues	2,495,586	1,232,478	57,259	-	141,750	82,796	164,197	145,646	(234,127)	(172,288)	2,624,665	1,288,632
Gross profit in the segment	54,209	35,373	4,611	-	11,966	12,097	10,348	16,400	662	(1,095)	81,796	62,775
Sales, general and administrative expenses	(15,456)	(12,106)	(1,334)	-	(6,965)	(4,728)	(6,296)	(7,585)	1,063	1,095	(28,988)	(23,324)
Reduction of negative goodwill created upon acquisition	-	-	-	-	692	-	-	-	-	-	692	-
Operating profit	38,753	23,267	3,277	-	5,693	7,369	4,052	8,815	1,725	-	53,500	39,451
Financing income											15,579	16,004
Financing expenses											(67,144)	(36,762)
Company's share in earnings (losses) of investees (net of tax)											(3,289)	(6,268)
Income (loss) before income tax											(1,354)	12,425
Tax benefits											1,396	5,629
Net income for the period											42	18,054

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2008
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NOTE 5 SEGMENT REPORTING (CONT'D.)

	<u>Refining</u>	<u>Trade</u>	<u>Petrochemicals</u>		<u>Adjustments to consolidated</u>	<u>Consolidated</u>
			<u>Polymers</u>	<u>Aromatics</u>		
For the year ended December 31, 2007						
(Audited)						
Total segment revenues	<u>5,009,956</u>	<u>-</u>	<u>342,549</u>	<u>523,452</u>	<u>(639,012)</u>	<u>5,236,945</u>
Gross profit in the segment	<u>306,784</u>	<u>-</u>	<u>48,586</u>	<u>62,067</u>	<u>(5,714)</u>	<u>411,723</u>
Sales, general and administrative expenses	(61,090)	-	(19,021)	(25,742)	4,308	(101,545)
Privatization grant	<u>(23,389)</u>	<u>-</u>	<u>(2,853)</u>	<u>(2,118)</u>	<u>-</u>	<u>(28,360)</u>
Operating profit	<u>222,305</u>	<u>-</u>	<u>26,712</u>	<u>34,207</u>	<u>(1,406)</u>	<u>281,818</u>
Financing income						34,625
Financing expenses						(136,750)
Company's share in earnings of investees (net of tax)						6,913
Profit before income tax						186,606
Income tax						(44,937)
Net profit for the year						141,669

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
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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 (hereinafter: 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 shall 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

In the nine-month period ended September 30, 2008 the Group signed agreements for the purchase of fixed assets in the amount of \$75 million.

Fixed assets as of September 30, 2008 includes advance payments made by the Company for purchase of fixed assets in the amount of \$24 million.

NOTE 8 – DOMO CHEMICALS N.V. ACQUISITION TRANSACTION

- A. On January 23, 2008, Carmel entered into an agreement, through a wholly-owned subsidiary Colland Polymers B.V. (hereinafter: Colland) with Domo Chemicals N.V. (hereinafter: Domo). Domo is a petrochemical company incorporated in Holland 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 for €20 million. In addition, commencing from 2013, the shareholders of Domo who sold Carmel Olefins the Company's shares (hereinafter: the sellers) could 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. Carmel Olefins, through Colland, has a call option from the purchase date 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 the sellers, plus interest at a rate of 5% per annum. The sellers have a put option, exercisable commencing on July 1, 2011 for the sale of the remaining 51% in Domo to Carmel Olefins at the same terms. The transaction was completed on April 25, 2008.

Carmel Olefins consolidates Domo results commencing from May 1, 2008.

Carmel Olefins recognized a financial liability of \$15.5 million (the Company's share is \$7.8 million) for the put option, against an increase of the cost of the acquisition. The call option is exercisable immediately, conferring on Carmel Olefins access to the economic benefits accompanying the ownership of Domo shares, Domo results were fully consolidated and no minority interests were included for the share of the other shareholders in Domo commencing May 1, 2008 in their financial statements.

Carmel Olefins recognizes financial liabilities for future payments contingent on margins between the price of propylene and polypropylene, as an embedded derivative in the Domo acquisition transaction. See Note 3C(3).

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
(in USD thousands)

NOTE 8 – DOMO CHEMICALS N.V. ACQUISITION TRANSACTION
(CONT'D)

B. Analysis of the acquired assets and liabilities

	Book value	Adjustment to fair value	Fair value at acquisition
According to the Company's holding in Carmel Olefins (50%)			
Current assets	32,339	-	32,339
Non-current assets	4,212	29,897	34,109
Current liabilities	(18,241)	-	(18,241)
Non-current liabilities	(779)	(7,624)	(8,403)

C. On May 6, 2008 Carmel Olefins paid €20 million in cash in consideration for 49% of Domo shares.

D. Attribution of the taxes on the surplus cost is calculated on the basis of a tax rate of 25.5%.

E. Assets (including intangible: expertise and the commercial agreement with the main raw material supplier) and liabilities of Domo were included in the consolidated balance sheet on the basis of the fair values on the date the transaction was completed.

F. In the consolidated statements of income, Domo's fixed assets are depreciated over 15 year, expertise is depreciated over 15 years and the supplier agreement is depreciated over 37 months.

G. According to Carmel Olefin's allocation of the purchase cost as a result of the acquisition, there is negative goodwill of \$14.5 million. A one-time profit for this negative goodwill was recorded in the consolidated statements of income. This amount was amended in the third quarter of 2008, following an adjustment of the contingent liabilities in the amount of \$692,000. See also Note 12(I).

As of the date of the financial statements, Carmel Olefins has not yet completed attribution of the surplus cost of assets on the recognized liabilities. Attributed surplus cost was depreciated on the basis of section F above.

H. Net cash flow on acquisition:

	For the nine months ended September 30,		For the three months ended September 30,		For the year ended December 31,
	2008	2007	2008	2007	2007
	(Unaudited)		(Unaudited)		(Audited)
Total value of acquisition	(*) 25,269	-	(692)	-	-
Less non-cash proceeds	(*) (9,527)	-	692	-	-
Proceeds paid in cash	15,742	-	-	-	-
Less cash and cash equivalents acquired	(1,280)	-	-	-	-
	14,462	-	-	-	-

* See section G

**NOTE 8 – DOMO CHEMICALS N.V. ACQUISITION TRANSACTION
(CONT'D)**

I. Impact of the purchase on the Group's results

The net income for the nine month period ended September 30, 2008 included \$13.987 million, attributable to Domo. Were the acquisition to be effected at the beginning of the nine month period ended September 30, 2008, the total revenues of the Group would have amounted to \$7,031,875 thousand and the Group earnings would have amounted to a profit of \$74.648 million, respectively.

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
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NOTE 9 – CAPITAL AND FUNDS

- A.** On April 28, 2008 the general meeting of the Company approved the distribution of a dividend in the amount of NIS 240 million (\$71.6 million, \$0.036 per share), which was paid on May 20, 2008.
- B.** On August 13, 2008 the general meeting of an increase in the Company's registered capital by NIS 1,000,000,000 divided by 1,000,000,000 ordinary shares of NIS 1 par value each, such that after increasing the share capital, the Company's registered capital will be NIS 3,000,000,010 divided by 3,000,000,010 ordinary shares of NIS 1 par value each.
- C.** On August 13, 2008 the general meeting of the Company approved an amendment to the Company Articles such that the Company's board of directors will have the authority to resolve the distribution of a dividend (and not the general meeting, as was the case previously) and to approve the lifting of the prohibition for a subsidiary or company controlled by the Company to acquire the shares of the Company.

Additional changes in shareholders' equity

	Share capital	Capital reserve for share-based payment	Capital reserve for translation differentials	Capital reserve for financial assets available for sale	Capital reserve	Retained earnings	Total
For the nine-month period ended September 30, 2008							
(Unaudited)							
Balance as of January 1, 2008 (audited)	472,478	558	-	-	28,478	298,289	799,803
Total earnings for the period	-	-	(867)	(12,354)	-	68,469	55,248
Company's share in capital reserves in an investee	-	13	-	-	41	-	54
Dividend declared and paid	-	-	-	-	-	(71,599)	(71,599)
Share-based payment	-	3,131	-	-	-	-	3,131
Balance as of September 30, 2008 (unaudited)	472,478	3,702	(867)	(12,354)	28,519	295,159	786,637

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
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NOTE 9 – CAPITAL AND FUNDS (CONT'D)

Additional changes in shareholders' equity (cont'd)

	Share capital	Capital reserve for share-based payment	Capital Reserve for translation differentials	Capital reserve for financial assets available for sale	Capital reserve	Retained earnings	Total
For the nine-month period ended September 30, 2007 (Unaudited)							
Balance as of January 1, 2007 (audited)	239,819	-	-	-	-	454,504	694,323
Distribution of bonus shares	232,659	-	-	-	-	(232,659)	-
Payment of issuance expenses to a controlling shareholder	-	-	-	-	-	(923)	(923)
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
Total income for the period	-	-	(25)	-	-	124,454	124,429
Balance as of September 30, 2007 (unaudited)	472,478	-	(25)	-	28,526	345,376	846,355

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NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
(in USD thousands)

NOTE 9 – CAPITAL AND FUNDS (CONT'D)

Additional changes in shareholders' equity (cont'd)

	Share capital	Capital reserve for share-based payment	Capital Reserve for translation differentials	Capital reserve for financial assets available for sale	Capital reserve	Retained earnings	Total
For the three-month period ended September 30, 2008 (Unaudited)							
Balance as of July 1, 2007 (audited)	472,478	2,660	219	(11,090)	28,551	300,002	792,820
Total revenue for the period	-	-	(1,086)	751	-	(4,843)	(5,178)
Company's share in capital reserves in an investee	-	-	-	-	(19)	-	(19)
Share-based payment	-	1,029	-	-	-	-	1,029
Balance as of September 30, 2008 (unaudited)	472,478	3,689	(867)	(10,339)	28,532	295,159	786,637

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
(in USD thousands)

	Share capital	Capital reserve for share-based payment	Capital Reserve for translation differentials	Capital reserve for financial assets available for sale	Capital reserve	Retained earnings	Total
	For the three-month period ended September 30, 2007 (Unaudited)						
Balance as of July 1, 2007 (unaudited)	472,478	-	-	-	28,569	327,322	828,369
Payment of issuance expenses to a controlling shareholder	-	-	-	-	(43)	-	(43)
Total income for the period	-	-	(25)	-	-	18,054	18,029
Balance as of September 30, 2007 (unaudited)	472,478	-	(25)	-	28,526	345,376	846,355

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
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NOTE 9 – CAPITAL AND FUNDS (CONT'D)

Additional changes in shareholders' equity (cont'd)

	Share capital	Capital reserve for share-based payment	Capital Reserve for translation differentials	Capital reserve for financial assets available for sale	Capital reserve	Retained earnings	Total
	For the year ended December 31, 2007 (Audited)						
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 in an affiliate	-	-	-	-	(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)
Total income for the period	-	-	-	-	-	146,900	146,900
Balance as of December 31, 2007 (Audited)	<u>472,478</u>	<u>558</u>	<u>-</u>	<u>-</u>	<u>28,478</u>	<u>298,289</u>	<u>799,803</u>

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NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
(in USD thousands)

NOTE 10 – 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. During the reporting period the suit was dismissed with the consent of all the parties and the plaintiff undertook not to renew the claim.
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 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 signed a compromise agreement according to which the lawsuit against Carmel will be dismissed and all procedures relating exclusively to Carmel will be deleted from the expert opinion on behalf of the plaintiff. In the compromise agreement, Carmel 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 is negotiating with the plaintiffs so that it will not be 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 estimate that Carmel will not be charged a material amount for this suit, if at all.

4. Subsequent to the reporting period, the Company and Gadiv reached an agreement with the Haifa municipality in respect of property tax payments. The financial results of the agreement are reflected in the financial statements. In February 2008, the Haifa municipality served the Company an amended assessor notice for 2008 in the amount of \$6 million. Pursuant to this notice, the details of the new assessment were updated from October 26, 2005 and an additional charge of \$3 million was added for the period from October 26, 2005 to December 31, 2007. The balance of the debt claimed by the Haifa municipality up to February 29, 2008 is \$11 million. The assessment has not yet been updated in the books of the Haifa municipality, therefore updated information is not available as of September 30, 2008. The Haifa municipality and parties to the petition agreed that the reservations and appeals filed for charges in 2006 will also apply to the assessor notice for 2007. Based on the opinion of its legal counsels, Carmel Olefins believes that the company will pay property taxes that are lower than the full amount charged by the Haifa municipality. Carmel Olefins believes that the provisions in its books for the demands of the municipality are sufficient.

NOTE 10 – CHANGES IN CONTINGENT LIABILITIES AND AGREEMENTS (CONT'D)

A. Litigation (cont'd)

5. The Haifa Rowing Club filed a class action in the Haifa Magistrate's Court under the Prevention of Environmental Hazards Law (Civil Claims), 5752-1992 against a number of factories along the banks of the Kishon River. The claim is petitioning for an injunction to stop the flow of effluents into the Kishon, and an order to restore the river to its former state. Dozens of factories were included in the claim as third parties, including the Company, Gadiv and Carmel Olefins, as well as authorities, including the State of Israel. On March 29, 2007, the Court summarily dismissed the claim and permitted the authorities to exercise their discretion concerning granting permits for discharge of effluents into the Kishon, noting the practical steps taken by the authorities and the defendants to improve the condition of the Kishon and the considerable improvement in recent years in the quality and condition of the river's water. In September 2008 the District Court struck out the appeal against the ruling as part of the agreement by the parties, according to which the dismissal of the claim by the magistrate's court will not prevent any of the parties from taking legal steps, if there is an appropriate factual basis.
6. 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. (hereinafter: PEI), Eilat Ashkelon Pipeline Company Ltd. (hereinafter: 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.
7. On April 10, 2008 the Ministry of Environmental Protection sent a letter to Carmel 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 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 Carmel disagrees with the orders for emission in the event of a malfunction in the Personal Order (which includes a provision according to which smoke emission will not exceed a cumulative period of six minutes an hour), as it alleges that the orders are not practical and Carmel is unable to comply with them. Carmel is working with the Ministry of Environmental Protection to change the orders for emission in the event of a malfunction.

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

**NOTE 10 – CHANGES IN CONTINGENT LIABILITIES AND AGREEMENTS
(CONT'D)**

A. Litigation (cont'd)

7. (cont'd)

On May 19, 2008 Carmel Olefins 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 best available technique (BAT), including the backup required to prevent malfunctions, to the satisfaction of the Ministry and the Haifa District Municipal Association (hereinafter: the demand).

On May 25, 2008 Carmel shut down the installations (hereinafter: the temporary shutdown). In the framework of the temporary shutdown, Carmel carried out various operations to ensure that BAT in Lapid will be operated in optimum processes, including backups required to prevent malfunctions. Carmel estimates that after the temporary shutdown, it is in compliance with all the requirements presented by the district manager regarding Lapid. However, Carmel emphasized to the district manager that this will not solve the matter of the orders for emission in the event of a malfunction and requested the appointment of a professional committee to study the matter.

On July 6, 2008, a hearing was held for Carmel at the district manager following the district manager's allegations of failure to comply with the provisions of the Personal Order and generation of unreasonable pollution regarding the smoke emission event from the Carmel Olefin plant on June 21, 2008. In the minutes of this hearing, the district manager ordered the company, inter alia, to shut down one of its polyethylene plants until tests are completed and conclusions drawn, and ordered a test by a German expert within two weeks from the date of the hearing. The district manager further ordered that the conclusions of the German expert's report will be applied within one month of the hearing. Carmel implemented the requirements set forth in the minutes of the hearing and shut down one of its polyethylene plants, which was reopened after the test on July 18, 2008.

- 8.** On September 17, 2008 the Supreme Court ruled to approve the arrangement between Carmel Olefins and the State, according to which Carmel Olefins would be convicted at its own admission, in a revised indictment filed against it following two events of smoke emission in the fall of 2003. Following the conviction, Carmel Olefins was fined and it undertakes not to commit another violation of this type for two years. Following the ruling, Carmel Olefins made a provision in the amount of the fine.
- 9.** On October 23, 2008 Carmel Olefins was served an application for the certification as a class action pursuant to the Class Actions Law 5766-2006, filed on October 5, 2008 with the Tel Aviv District Court (hereinafter: the application).

The application was filed for non-monetary damages allegedly caused by two smoke emission events which occurred on September 15, 2003 and October 5, 2003 (hereinafter: the events). In a prior class action that was filed against the Company and Carmel Olefins, the plaintiffs agreed to strike out Carmel Olefins from the claim.

In the application, the applicant asks to represent the residents of the Haifa Bay area and those who were present in the area (hereinafter: the group) and were exposed to the smoke emissions on the said dates.

The applicant claims that each of the members of the group is to be compensated NIS 1,000 for the damage allegedly caused.

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
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NOTE 10 – CHANGES IN CONTINGENT LIABILITIES AND AGREEMENTS
(CONT.)

A. Litigation

9. (cont'd)

The application does not quote the estimated number of the group's members and does not quote the total amount that the application claims should compensate the group.

The applicant claimed that he filed the application following the results of the criminal procedure against Carmel Olefins, under which Carmel Olefins was convicted, at its own admission, in a revised indictment relating to the events, by the Supreme Court.

Based on the opinion of the legal advisors of Carmel Olefins, in view of the early stage of the claim, the complexity of the process and the fact that no amount was quoted in the application, the Company is unable to evaluate the amount of the exposure, if any exists.

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 \$ 168 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, PEI and EAPC which own crucial infrastructure pertaining to the unloading, shipping, storage, and issuance of crude oil and distillates. In the first six months of 2009, PEI is expected to carry out reinforcement works on the marine pipeline used to unload crude oil in Haifa bay, subject to approvals by the competent authorities.

NOTE 11 – IMPACT OF TRANSITION TO IFRS

A. General

As noted in Note 2(A) above, these are the 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 consolidated interim financial statements for the nine- and three-months periods ended September 30, 2008, the comparative data for the nine- and three-months periods ended September 30, 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 have 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 JUNE 30, 2008
(in USD thousands)

NOTE 11 – IMPACT OF TRANSITION TO IFRS (CONT'D)

B. Balance sheet

		January 1, 2007			
		Israeli GAAP	Impact of change of functional currency to USD	Impact of transition	IFRS
Note H	NIS thousands	USD thousands *	USD thousands	USD thousands	USD thousands
Current assets					
		523,570	123,921	-	123,921
		414,749	98,165	-	98,165
		2,175,459	514,902	-	514,902
	4,8	446,010	104,716	5,813	110,529
		8,691	2,057	-	2,057
	4	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					
	13	191,002	52,864	4,826	57,690
		7,409	1,755	-	1,755
	2	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	<u>3,827,045</u>	<u>883,519</u>	<u>75,003</u>	<u>958,522</u>
Fixed assets, net					
	7	48,100	10,678	1,998	12,676
		<u>10,500,885</u>	<u>2,467,682</u>	<u>75,045</u>	<u>2,542,727</u>
		<u>10,500,885</u>	<u>2,467,682</u>	<u>75,045</u>	<u>2,542,727</u>

* See Note H (1) below.

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
(in USD thousands)

NOTE 11 – IMPACT OF TRANSITION TO IFRS (CONT'D)

B. Balance sheet (cont'd)

		January 1, 2007			
		Israeli GAAP	Impact of change of currency to USD	Impact of transition	IFRS
Note H	NIS thousands	USD thousands *	USD thousands	USD thousands	USD thousands
Current liabilities					
	Credit from banking institutions and other credit providers	899,142	212,815	-	212,815
	Trade payables	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
8	Deferred taxes	498,352	112,827	11,309	124,136
	Liabilities for financing lease	29,275	6,929	-	6,929
2	Employee benefits	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>
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
		<u>2,714,677</u>	<u>630,063</u>	<u>64,260</u>	<u>694,323</u>
		<u>10,500,885</u>	<u>2,467,682</u>	<u>75,045</u>	<u>2,542,727</u>

(*) See Note H (1) below

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
(in USD thousands)

NOTE 11 – IMPACT OF TRANSITION TO IFRS (CONT'D)

C. Balance sheet

		As of September 30, 2007			
		Israeli GAAP	Impact of change of functional currency to USD	Impact of transition	IFRS
Note H	NIS thousands	USD thousands *	USD thousands	USD thousands	
Current assets					
	78,346	19,523	-	19,523	
4			4,485	4,485	
	429,057	106,917	-	106,917	
	1,591,932	396,693	-	396,693	
4,8	411,528	86,406	(10,898)	75,508	
	(**) 6,124	1,526	-	1,526	
4	3,237,905	778,204	(7,311)	770,893	
	<u>5,754,892</u>	<u>1,389,269</u>	<u>(13,724)</u>	<u>1,375,545</u>	
Investments and long-term loans					
13	169,847	54,751	(725)	54,026	
4	-	1,922	(1,922)	-	
	303,664	75,670	-	75,670	
	(**) 18,028	2,021	-	2,021	
2	36,400	9,070	(2,389)	6,681	
	<u>527,939</u>	<u>143,434</u>	<u>(5,036)</u>	<u>138,398</u>	
3,5,6,7	3,852,442	893,130	79,088	972,218	
Intangible assets and deferred expenses, net					
7	(**) 88,543	20,421	1,997	22,418	
	<u>10,223,816</u>	<u>2,446,254</u>	<u>62,325</u>	<u>2,508,579</u>	

(*) See Note H (1) below

(**) Reclassified

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
(in USD thousands)

NOTE 11 – IMPACT OF TRANSITION TO IFRS (CONT'D)

C. Balance sheet (cont'd)

		As of September 30, 2007			
		Israeli GAAP	Impact of change of functional currency to USD	Impact of transition	IFRS
Note H	NIS thousands	USD thousands *	USD thousands	USD thousands	USD thousands
Current liabilities					
	Credit from banking institutions and other credit providers	1,118,226	278,650	-	278,650
	Trade payables	1,500,022	372,706	-	372,706
2,4	Other payables	418,690	75,722	(10,440)	65,282
	Provisions	66,307	16,523	-	16,523
4	Derivatives	-	-	4,013	4,013
	Declared dividend	280,000	69,773	(69,773)	-
		<u>3,383,245</u>	<u>813,374</u>	<u>(76,200)</u>	<u>737,174</u>
Long term liabilities					
	Debentures	974,246	242,726	-	242,726
	Bank loans	1,934,173	482,293	-	482,293
8	Deferred taxes	539,697	110,368	8,881	119,249
	Liabilities for financing lease	29,187	7,273	-	7,273
4	Long-term derivative instrument	4,280	1,067	(1,067)	-
2	Employee benefits	254,204	63,345	10,164	73,509
		<u>3,735,787</u>	<u>907,072</u>	<u>17,978</u>	<u>925,050</u>
	Total liabilities	<u>7,119,032</u>	<u>1,720,446</u>	<u>(58,222)</u>	<u>1,662,224</u>
Shareholders' equity					
	Share capital	2,000,000	239,819	-	472,478
	Capital reserve	117,986	27,536	-	28,501
	Retained earnings	986,798	458,453	120,547	345,376
		<u>3,104,784</u>	<u>725,808</u>	<u>120,547</u>	<u>846,355</u>
		<u>10,223,816</u>	<u>2,446,254</u>	<u>62,325</u>	<u>2,508,579</u>

(*) See Note H (1) below

(**) Reclassified

OIL REFINERIES LTD.
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NOTE 11 – IMPACT OF TRANSITION TO IFRS (CONT'D)

D. Balance sheet

		As of December 31, 2007			
		Israeli GAAP	Impact of change of functional currency to USD	Impact of transition	IFRS
Note H		NIS thousands	USD thousands *	USD thousands	USD thousands
Current assets					
	Cash and cash equivalents	997,363	259,325	-	259,325
	Derivatives at fair value through profit and loss	25,049	6,513	-	6,513
	Investment in other financial assets at fair value through profit and loss.	434,734	113,035	-	113,035
	Trade receivables	1,517,130	394,470	-	394,470
4,8	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					
13	Investment in investees accounted by the equity method	160,066	49,143	4,815	53,958
	Loan to Haifa Early Pensions Ltd.	307,827	80,038	-	80,038
	Long term loans and debit balances	13,635	3,631	-	3,631
4	Derivatives at fair value in profit and loss	3,655	865	1,706	2,571
2	Employee benefit plan assets	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	3,870,594	897,962	80,450	978,412
7	Intangible assets and deferred expenses, net	89,814	20,928	1,996	22,924
		<u>11,995,797</u>	<u>2,989,297</u>	<u>69,826</u>	<u>3,059,123</u>

(*) See Note H (1) below

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
(in USD thousands)

NOTE 11 – IMPACT OF TRANSITION TO IFRS (CONT'D)

D. Balance sheet (cont'd)

		As of December 31, 2007			
		Israeli GAAP	Impact of change of currency to USD	Impact of transition	IFRS
Note H		NIS thousands	USD thousands *	USD thousands	USD thousands
Current liabilities					
	Credit from banking institutions and other credit providers	830,818	216,021	-	216,021
	Trade payables	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>
Long term liabilities					
	Debentures	2,758,742	717,302	-	717,302
	Bank loans	1,738,983	452,154	-	452,154
8	Deferred taxes	563,569	116,884	8,403	125,287
	Liabilities for financing lease	29,857	7,763	-	7,763
2	Employee benefits	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>
	Total liabilities	<u>8,757,603</u>	<u>2,247,419</u>	<u>11,901</u>	<u>2,259,320</u>
Shareholders' equity					
	Share capital	2,000,000	472,478	-	472,478
	Capital reserve	114,564	29,036	-	29,036
1,2	Dividend declared subsequent to the balance sheet date	240,000	62,402	(62,402)	-
	Retained earnings	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 H (1) below

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
(in USD thousands)

NOTE 11 – IMPACT OF TRANSITION TO IFRS (CONT'D)

E. Statements of income

		For the nine months ended September 30, 2007			
		Israeli GAAP	Impact of change of functional currency to USD	Impact of transition	IFRS
Note H		NIS thousands	USD thousands *	USD thousands	USD thousands
	Revenue	**15,214,767	3,667,916	-	3,667,916
	Cost of sales, refinery and services	2,4,5,6 **13,966,498	3,354,004	(7,664)	3,346,340
	Revaluation of open positions in derivatives on prices of goods and margins, net	-	-	21,135	21,135
	Total cost of sales	13,966,498	3,354,004	13,471	3,367,475
	Gross profit	1,248,269	313,912	(13,471)	300,441
	Selling expenses	96,965	24,138	-	24,138
	General and administrative expenses	3 214,863	47,658	90	47,748
	Privatization grant	9 -	-	28,360	28,360
	Operating profit	936,441	242,116	(41,921)	200,195
	Financing income	4 35,184	32,494	1,629	34,123
	Financing expenses	2 (115,493)	(78,066)	1,582	(76,484)
	Privatization grant	9 (118,529)	(28,360)	28,360	-
	Company's share in earnings of investees	-	-	857	857
	Income before income tax	737,603	168,184	(9,493)	158,691
	Tax benefits (taxes on income)	2,4,5,6 204,202	36,653	(2,416)	(34,237)
	Earnings after taxes on income	533,401	131,531	(7,077)	124,454
	Company's share in earnings of investees	22,165	6,409	(6,409)	-
	Net profit for the period	555,566	137,940	(13,486)	124,454
	Earnings per ordinary share				
	Basic and diluted earnings per ordinary share	0.278	0.069	(0.007)	0.062

* See Note H (1) below

** Reclassified

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
(in USD thousands)

NOTE 11 – IMPACT OF TRANSITION TO IFRS (CONT'D)

E. Statements of income (cont'd)

		<u>For the three months ended September 30, 2007</u>			
		<u>Israeli GAAP</u>	<u>Impact of change of functional currency to USD</u>	<u>Impact of transition</u>	<u>IFRS</u>
	<u>Note H</u>	<u>NIS thousands</u>	<u>USD thousands *</u>	<u>USD thousands</u>	<u>USD thousands</u>
Revenues		4,773,772	1,288,632	-	1,288,632
Cost of sales, refinery and services	2,4,5,6	4,435,127	1,214,630	(22,330)	1,192,300
Revaluation of open transactions in derivatives on prices of goods and margins, net		-	-	33,557	33,557
Total cost of sales		<u>4,435,127</u>	<u>1,214,630</u>	<u>11,227</u>	<u>1,225,857</u>
Gross profit		338,645	74,002	(11,227)	62,775
Selling expenses		37,020	9,086	-	9,086
General and administrative expenses	3	<u>64,531</u>	<u>14,208</u>	<u>30</u>	<u>14,238</u>
Operating profit		237,094	50,708	(11,257)	39,451
Financing income	4	3,264	13,320	2,684	16,004
Financing expenses	2	-	(37,847)	1,085	(36,762)
Company's share in earnings of investees		<u>-</u>	<u>-</u>	<u>(6,268)</u>	<u>(6,268)</u>
Profit before income tax		<u>240,358</u>	<u>26,181</u>	<u>(13,756)</u>	<u>12,425</u>
Tax benefits (taxes on income)	2,4,5,6	<u>64,220</u>	<u>(4,131)</u>	<u>(1,498)</u>	<u>(5,629)</u>
Earnings after taxes on income		176,138	30,312	(12,258)	18,054
Company's share in earnings of investees		<u>2,002</u>	<u>(6,101)</u>	<u>(6,101)</u>	<u>-</u>
Net profit for the period		<u>178,140</u>	<u>24,211</u>	<u>(6,157)</u>	<u>18,054</u>
Earnings per ordinary share					
Basic and diluted earnings, net, per ordinary share		<u>0.089</u>	<u>0.012</u>	<u>(0.003)</u>	<u>0.009</u>

(*) See Note H (1) below

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
(in USD thousands)

NOTE 11 – IMPACT OF TRANSITION TO IFRS (CONT'D)

F. Statements of income

		For the year ended December 31, 2007			
	Note H	Israeli GAAP NIS thousands	Israeli GAAP USD thousands ^a	Impact of transition USD thousands	IFRS USD thousands
Revenue		21,339,364	5,236,945	-	5,236,945
Cost of sales, refinery and services	2,4,5,6	19,843,713	4,808,871	(3,805)	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	3	276,802	67,907	120	68,027
Privatization grant	9	-	-	28,360	28,360
Operating profit		1,081,772	326,649	(44,831)	281,818
Financing income	4	25,537	32,919	1,706	34,625
Financing expenses	2	(75,090)	(135,895)	(855)	(136,750)
Privatization grant	9	(117,833)	(28,360)	28,360	-
Company's share in earnings of affiliates		-	-	6,913	6,913
Income before income tax		914,386	195,313	(8,707)	186,606
Tax benefits (taxes on income)	2,4,5,6	(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 investees		19,833	6,875	(6,875)	-
Net profit for the period		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 H (1) below

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
(in USD thousands)

NOTE 11 – IMPACT OF TRANSITION TO IFRS (CONT'D)

H. 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 dismissed 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 are 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 income statement 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.

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
(in USD thousands)

NOTE 11 – IMPACT OF TRANSITION TO IFRS (CONT'D)

H. Notes for reconciliation to the balance sheet and the statement of income –cont.)

3. (cont'd)

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.

- 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 Israeli 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 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 life of some of the assets was changed (see section 6 below).
- 6.** Change in the estimate of the useful life of fixed assets
IAS 16 *Fixed Assets* stipulates that the useful life 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 life 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 life 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.

OIL REFINERIES LTD.
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NOTE 11 – IMPACT OF TRANSITION TO IFRS (CONT'D)

H. Notes for reconciliation to the balance sheet and the statement of income –cont.)

6. Change in the estimate of the useful life of fixed assets (cont'd)

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

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
(in USD thousands)

NOTE 11 – IMPACT OF TRANSITION TO IFRS (CONT'D)

H. Notes for reconciliation to the balance sheet and the statement of income – cont'd)

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 retained earnings.
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 for 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 may elect to present 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.
14. 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.

I. Material adjustments to the cash flow statement in 2007 and for the nine-month period ended September 30, 2007:

- (1) Interests received, interests paid and derivative transactions on interest rates were classified as cash flow from operating activities in accordance with Israeli GAAP. According to IFRS and based on the accounting policy adopted by the Company, interests received is classified as cash flows from investment operations and interests paid and derivative transactions on interest rates are classified as cash flows from financing operations.
- (2) The effect of exchange rate fluctuations on cash balances are entered as cash flow from operating activities, in accordance with Israeli GAAP. Under IFRS, the effects of exchange rate fluctuations on the cash balance were 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 12 – MATERIAL EVENTS IN THE REPORTING PERIOD

A. Trade receivables

In the reporting period, the Company and Carmel Olefins entered into an agreement with a banking institution (hereinafter: the bank) for the sale of specific debts of their customers. 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 September 30, 2008 the consolidated discount balance amounted to \$205 million.

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 shall 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 shall 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 revisions in the new financial covenants, all the other liabilities of Carmel Olefins towards the banks will continue to apply, as aforesaid.

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.

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
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NOTE 12 – MATERIAL EVENTS IN THE REPORTING PERIOD (CONT'D)

B. New financial covenants – cont'd

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 may be assessed for Carmel Olefins 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. Carmel Olefins will not distribute a dividend to its shareholders unless the company has sufficient cash at the distribution date for the next payment to the debenture holders subsequent to the distribution date.
7. The rating of the debentures will not fall below A.

Once the debentures have been listed for trading, sections 6 and 7 only will apply.

In September 2008, Carmel Olefins reached an agreement with the debenture holders to amend the financial stipulations.

The following amendments were approved:

1. Up to and including the financial statements for the second quarter of 2009, the ratio of net debt of the Company to cumulative EBITDA for the last four quarters will not exceed 6 in each quarterly financial statement.
2. Commencing from the financial statements for the third quarter of 2009, the ratio of net debt of Carmel Olefins to EBITDA for the last four quarters will not exceed 5 in each quarterly financial statement.
3. Carmel Olefins will not distribute a dividend in the third quarter of 2008 and the first and second quarters of 2009.

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

C. Transaction for the acquisition of Domo Chemicals N.V. – See Note 8

D. On May 29, 2008 the Company published a shelf prospectus on the basis of the Company's financial statements as of December 31, 2007, for the issuance of shares, debentures, convertible debentures, option warrants for ordinary shares and option warrants for debentures, as set forth in the prospectus.

OIL REFINERIES LTD.
NOTES TO THE FINANCIAL STATEMENTS AS OF JUNE 30, 2008
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NOTE 12 – MATERIAL EVENTS IN THE REPORTING PERIOD (CONT'D)

E. Carmel Olefins merger transaction

On June 24, 2008 the Company signed an agreement with IPE. The general meeting of the company's shareholders approved the agreement on August 13, 2008. The main points of the agreement are as follows:

1. On completion of the transaction, IPE will sell the Company all the shares it owns in Carmel Olefins, comprising 50% of the issued share capital of Carmel Olefins (hereinafter: the acquired Carmel Olefins shares) such that following the acquisition, the Company will hold the full issued share capital of Carmel Olefins. In consideration for the acquired Carmel Olefins shares, the Company will allot 516,672,961 ordinary shares to IPE, comprising (after the allotment and without dilution), 20.53% of the company's issued share capital and its voting rights (hereinafter: the allotted shares).
2. On completion of the transaction, the Company will sell IPE 3,741,680 of the shares it owns in IPE (hereinafter: the acquired IPE shares), comprising 12.29% of the share capital of IPE, in consideration for \$40 million.
3. As a precondition for closing the transaction after complying with all the other preconditions and prior to allotment of the allotted shares to IPE, the Company will distribute to its shareholders a dividend of \$60 million (hereinafter: the first dividend). In addition, on the date of closing the transaction, the Company's board of directors will resolve to distribute an additional dividend of \$100 million (hereinafter: the second dividend) and the allotted shares will participate in such distribution.

Completion of the transaction is subject to meeting a number of preconditions by December 31, 2008, including, inter alia, the receipt of regulatory approvals including approval of the Antitrust Commissioner and a permit from IPE pursuant to the Government Companies (Declaration of the State's Vital Interests in Oil Refineries Ltd) Order, 5767-2007 (the Interests Order) to purchase and hold the allotted shares (as required by the Law); approvals for the transaction and the operations involved therein by the organs required by law in each of the companies; approvals from third parties according to agreements, undertakings, licenses and approvals of Carmel Olefins detailed in the agreement; approval from the debenture holders of IPE or their trustee; and payment of the first dividend. Another precondition is that during the period from the date the agreement is signed and until the closing date, no events occurred as a result of which representations of the Company or representations of IPE, as relevant, were incorrect and which cause in the aggregate to the reduction of the value of the acquired Carmel Olefins shares or the value of the allotted shares, as relevant, in an amount exceeding \$50 million and payment of the first dividend. As of the reporting date, IPE has not yet received a permit pursuant to the Interests Order and approval from the Tax Authority pursuant to section 103C of the Income Tax Ordinance and has not yet received permits from all of the third parties.

4. If all the preconditions are not met by December 31, 2008, the agreement will terminate. If all the preconditions are met and on the same date an application for approving a distribution pursuant to the agreement by one of the parties is pending before the court, the last date for complying with the preconditions will be postponed to March 31, 2009. Each of the dates stated above can be extended with the agreement of the parties, by a resolution adopted by their boards of directors.
5. The agreement included the undertakings of the parties in respect of their operations in the interim period, from the date of signing the agreement until the completion of the transaction. If there is any material deterioration in respect of the representation given by one of the parties to the agreement, which results in the value of the acquired shares of Carmel Olefin or the allotted shares, as the case may be, dropping below \$50 million, the party impaired by the change may withdraw from the agreement.

OIL REFINERIES LTD.
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NOTE 12 – MATERIAL EVENTS IN THE REPORTING PERIOD (CONT'D)

E. Carmel Olefins merger transaction (cont'd)

6. The Company undertook that if the distribution of the first or second dividend does not meet the distribution tests prescribed in the Companies Law, the Company will apply to the court for approval. IPE made a similar commitment in relation to the purchase of its acquired shares.
7. The agreement included a system to indemnify each of the parties for damages or losses resulting from incorrect representation or declaration given by that party to the agreement (subject to exceptions). In general, the duty to indemnify will only apply after the cumulative amounts of all damages incurred to the injured party and for which it is entitled to indemnification exceeds \$15 million, in which case the duty to indemnify will apply from \$7.5 million until the indemnification limit of \$75 million. . The right to indemnification is limited by time. Each party waived its right to claim for indemnification from subsidiaries and officers of the other party in respect of incorrect representation given in the context of the agreement.
8. The Company undertook not to carry out, and to ensure that Carmel Olefins would not carry out, activities set forth in section 103C of the Income Tax Ordinance (New Version), which will compromise the exemption to be given to IPE by the Tax Authority in respect of the agreement.

On August 4, 2008, Israel Corporation announced that has it signed a third letter of undertaking in favor of IPE and PCH regarding an agreement for joint control in the Company, replacing a previous letters of undertaking, on the same subject. The Israel Corporation also announced that after signing the third letter of undertaking, the Israel Corporation intends to vote in favor of the Carmel Olefins merger agreement at the general meeting.

On September 28, 2009 the Company and IPE signed an addendum to the agreement enabling the completion of the agreement, also in the instance whereby IPE does not receive a control permit in accordance with the Interests Order (hereinafter: the control permit). The main points in the addendum to the agreement are as follows:

1. The Company will declare the first dividend within three business days from the date on which all the preconditions are met, with the exception of receiving the control permit.
2. The completion date will fall on or before December 31, 2008, as agreed between the parties, subject to meeting, up to that date, all the preconditions, with the exception of receiving the control permit, subject to the option for extending the dates as set forth in section 5 above.
3. On the completion date, the Company will allot to IPE 216,445,781 shares, which together with the shares held ,directly or indirectly, by IPE on that date, will comprise 23.99% of the Company's issued capital (hereinafter: the immediately allotted shares).
4. IPE is entitled to an allotment of 300,227,180 shares, comprising the balance of the allotted shares (hereinafter: the deferred allotted shares) subject to receiving the control permit, renewing the validity of the approval of the Antitrust Authority and receiving the approval of the Tel Aviv Stock Exchange to list the deferred allotted shares for trading, should their validity expire, and subject to the agreement of the parties to which the rights of IPE were pledged pursuant to the agreement, to the extent required.

NOTE 12 – MATERIAL EVENTS IN THE REPORTING PERIOD (CONT'D)

E. Carmel Olefins merger transaction (cont'd)

5. At the time of the allotment of the deferred allotted shares, IPE will be entitled to receive payment from the Company equal to the amount which IPE would have received as a dividend for that deferred allotted share, had it been allotted to IPE on the completion date, and the income from them as accrued (the amounts of the adjustment of the dividend). The Company will deposit these amounts, when distributing each dividend, in a special deposit managed by the attorneys of IPE and the Company (hereinafter: the earmarked deposit). The earmarked deposit will not be considered as the property of ORL, and ORL will not have any right to the funds to be deposited in it, and will not be responsible in any way for its management, investment, balance or value. Protection provisions will apply to the deferred allotted shares in the event of any capital transaction with the Company's shares.
6. The amount of the second dividend will be determined in such a way that the amount which will be distributed as a dividend together with the amount deposited for it in an earmarked deposit, will be equal to \$100 million.
7. IPE is entitled to instruct the Company to allot the deferred allotted shares to a trustee on behalf of IPE and to transfer to it the adjusted amounts of the dividend at any time prior to receiving the control permit, subject to submission of approval of the competent authorities to allot the shares to a trustee and subject to the preconditions set forth in section 9 above, with the exception of receiving the control permit. IPE will be entitled to instruct the Company to allot the deferred allotted shares and to transfer the amounts of the adjusted dividend to a buyer as instructed by IPE.
8. Up to the date of the allotment of the balance of the deferred allotted shares to IPE and/or to the trustee or buyer according to section 12 above, at any time that the rate of IPE's holdings in the Company's shares drops below 23%, the Company will allot to IPE, subject to the valid approval of the private placement by the Tel Aviv Stock Exchange and subject to the agreement of the parties to which the rights of IPE are pledged under the agreement, to the extent required, shares so that after the allotment the rate of holdings of IPE in the Company's shares, directly or indirectly, will represent 23.99% of the Company's issued capital. IPE will be entitled to exercise its right if its shareholding in the Company's shares will be higher than 23%.
9. With the exception of any amendments in the addendum to the agreement, all the provisions in the agreement will continue to apply to the parties without any change.

As of the date of approval of the financial statements, the Company is negotiating with IPE to change certain details in the transaction. These changes will not have a material impact on the transaction and its conditions, according to the demands and limitations of the competent authorities, with the intention of completing the transaction by the end of this year.

F. Mercury Aviation (Israel) Ltd. acquisition transaction

On June 30, 2008 the Company signed an agreement to purchase 31.25% of the shares of Mercury Aviation (Israel) Ltd. (hereinafter: Mercury) in consideration of NIS 2.705 million (\$796,000). Mercury is a refueling company operating at Ben Gurion Airport. The transaction was completed on September 24, 2008.

NOTE 12 – MATERIAL EVENTS IN THE REPORTING PERIOD (CONT'D)

G. The Clean Air Law

On July 22, 2008 Israel's Knesset (parliament) passed the second and third reading of the Clean Air Law 2768-2008 (hereinafter: the Clean Air Law). The Clean Air Law, which will come into effect on January 1, 2011 (hereinafter: the effective date) is expected to tighten the monitoring of emissions and require plants emitting substances into the air to receive an emission permit for their operation.

In addition, the Clean Air Law will intensify the criminal and administrative sanctions that could be imposed on any party contravening the provisions of the Law and causing strong or unreasonable air pollution.

Pursuant to the interim provisions of the Clean Air Law, a plant operating in the Company's field of operations and which operated an emission source pursuant to the provisions of the Personal Order, before the Clean Air Law came into effect, may continue to operate without a permit under the Clean Air Law until September 30, 2016 or until a decision is made on its application for an emission permit, whichever earlier, provided it applies for an emission permit no later than March 1, 2014.

It is noted that the Company is in compliance with the provisions of the Personal Order. The secondary legislator was certified by law to formulate material and central provisions related to implementation of the Clean Air Law, including provisions defining strong or unreasonable air pollution and steps and means to prevent such pollution. These provisions have not yet been formulated.

- H.** As a result of the dramatic fluctuation in the prices of crude oil and its products in the reporting period, the Company recognized a loss for impairment of inventory on September 30, 2008 in the amount of \$69 million, which was mainly offset by hedging transactions for inventory in the futures market in the amount of \$26 million. The loss reflects the difference between the cost of inventory and the value of its sale, net, on the same day. The impairment was recognized in profit and loss under cost of sales, refinery and services.
- I.** In the 2008 third quarter results, the Company included expenses of \$3 million for the second quarter of 2008 (expenses for the Company's share in results of IPE in the amount of \$4.9 million, less adjustment for negative goodwill created upon acquisition of Domo in the amount of \$0.8 million, as described in Note G, and less net financing income of \$1.1 million).

OIL REFINERIES LTD.
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NOTE 13 – MATERIAL EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

A. Subsequent to the date of the balance sheet, Carmel Olefins was served an application for the classification of a class action concerning two smoke emission events which occurred on in the autumn of 2003. For further details, see Note 10A(9).

B. On October 12, 2008 the Company's board of directors approved the establishment of a hydrocracker at the Haifa refinery for a total investment of \$670 million, (including an investment of \$37 million approved by the board of directors in November 2007 in order to advance the project), as part of the strategic plan adopted in November 2007. The hydrocracker will produce middle distillates (diesel oil and kerosene) and is expected to be operational in 2011.

The board of directors instructed the Company's management to complete the organization of the credit facility through the Export Credit Agency to finance the purchase of the main equipment from foreign suppliers, and to act to receive additional long-term credit required for the project, from various sources.

C. On November 11, 2008 Standard & Poor's Maalot announced that it has downgraded the Company's debentures (Series A, B and C as well as untraded debentures) from AA/Stable to A/Negative.

D. Changes in the economic environment subsequent to the date of the financial statements

Subsequent to the balance sheet date, there were changes in the foreign currency exchange rate of the functional currency of the Company, compared to the shekel, alongside dramatic changes in the prices of crude oil and its products:

Exchange rate: There was a devaluation of 16% in the shekel-dollar exchange rate from the end of the reporting period and until the date of the approval of the balance sheet. The effect of the depreciation on the Group's business results, based on the linkage balance on September 30, 2008 is estimated as \$21 million in net financing income.

Price of crude oil and its products – Subsequent to the balance sheet date and until the date of the approval of the financial statements the price of crude oil and its products dropped by 40%. At the end of the third quarter the price of crude oil was \$94/barrel. The price continued to drop subsequent to the reporting period. On the date of approval of the financial statements, the price of crude oil was \$50/barrel. The Company estimates, based on exposure management policy and hedging transactions for inventory prices and assuming the inventory balance on September 30, 2008 is realized in October and November, the impact of this decrease on the inventory balance amounted to \$106 million, which was partially offset by hedging transactions for inventory in the amount of \$32 million, therefore amounting to \$74 million.

Prices of naphtha and LPG: From the end of the reporting period and up to the approval of the financial statements of Carmel Olefins, there was a dramatic decrease in the prices of naphtha and LPG (hereinafter : "feedstock products") and in the price of the polymers sold by Carmel Olefins. As the feedstocks are a material part of the finished goods inventory at Carmel Olefins, the company estimates that the changes in the prices of feedstock and polymers sold by it, based on the assumption that the inventory balance on September 30, 2008 was sold mainly in the months October and November, will affect the value of inventory in the balance sheet of Carmel Olefins in the amount of \$32 million.

E. The dividend

On November 23, 2008 the Board of Directors of the Company approved the distribution of a cash dividend in the amount of \$50 million (hereinafter : "the dividend"), from the distributable profits according to the financial statements as of September 30, 2008. If the Company will distribute the "first dividend", as defined in the agreement for the purchase of the remaining shares of Carmel Olefins, between the Company and IPE from June 24, 2008, the dividend will be considered part of the "first dividend".