

C. MER INDUSTRIES LTD.

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2008

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AUDITORS' REPORT**To the Shareholders of****C. MER INDUSTRIES LTD.**

We have audited the accompanying consolidated balance sheets of C. Mer Industries Ltd. ("the Company") as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in equity and cash flows for each of the then years ended. These financial statements are the responsibility of the Company's board of directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of certain subsidiaries, whose assets constitute approximately 37.79% and 46.52% of total consolidated assets as of December 31, 2008 and 2007, respectively, and whose revenues constitute approximately 42.22% and 43.50% of total consolidated revenues for the years then ended, respectively. Furthermore, we did not audit the financial statements of certain associates that are presented at equity the investment in which amounted to NIS 8,978 thousand and NIS 25,199 thousand as of December 31, 2008 and 2007, respectively, and the Company's share of their earnings (losses) amounted to NIS (878) thousand and NIS 1,454 thousand for the years then ended, respectively. The financial statements of those companies were audited by other auditors, whose reports have been furnished to us, and our opinion, insofar as it relates to amounts included for those companies, is based on the reports of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards in Israel, including those prescribed by the Auditors' Regulations (Auditor's Mode of Performance), 1973. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the board of directors and management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the Company and its subsidiaries as of December 31, 2008 and 2007, and the results of their operations, changes in their equity and cash flows for each of the years then ended, in conformity with International Financial Reporting Standards ("IFRS") and with the provisions of the Israeli Securities Regulations (Preparation of Annual Financial Statements), 1993.

Tel-Aviv, Israel
March 25, 2009KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

CONSOLIDATED BALANCE SHEETS

	Note	December 31		Convenience translation (Note 1c)
		2007	2008	December 31
		N I S		2008
				U.S. \$
(In thousands)				
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	3	48,863	41,519	10,920
Short-term investments	4	10,771	740	195
Trade and unbilled receivables	5	192,909	222,692	58,572
Other accounts receivable	6	17,111	35,849	9,429
Inventories	7	67,199	89,858	23,634
		<u>336,853</u>	<u>390,658</u>	<u>102,750</u>
NON-CURRENT ASSETS:				
Long-term trade receivables and receivables		-	4,017	1,057
Investments in investees	8	34,091	14,607	3,842
Available-for-sale financial assets	9	4,190	43,883	11,542
Prepaid operating leases expenses	2k2	1,323	1,417	373
Fixed assets, net	10	32,658	34,225	9,002
Goodwill		640	-	-
Employee benefit assets	16	5,338	6,826	1,795
Deferred taxes	17	7,560	7,053	1,855
		<u>85,800</u>	<u>112,028</u>	<u>29,466</u>
		<u>422,653</u>	<u>502,686</u>	<u>132,216</u>

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

CONSOLIDATED BALANCE SHEETS

	Note	December 31		Convenience translation (Note 1c)
		2007	2008	December 31
		N I S		2008
				U.S. \$
(In thousands)				
LIABILITIES AND EQUITY				
CURRENT LIABILITIES:				
Credit from banks and others	11	103,407	135,034	35,517
Trade payables	12	57,499	54,563	14,351
Other accounts payable	13	39,186	50,503	13,283
		<u>200,092</u>	<u>240,100</u>	<u>63,151</u>
LONG-TERM LIABILITIES:				
Loans from banks and others	14	12,426	7,375	1,940
Debentures	14	45,674	25,240	6,639
Stock options		20	-	-
Other long-term liabilities	14	1,785	1,638	431
Employee benefit liabilities, net	16	473	4,857	1,277
Deferred taxes	17	17,140	16,963	4,462
		<u>77,518</u>	<u>56,073</u>	<u>14,749</u>
EQUITY:				
Share capital	19	14,538	14,538	3,824
Share premium		51,693	51,693	13,596
Treasury shares		(7,401)	(8,192)	(2,155)
Capital reserve from translation differences		(10,111)	(25,658)	(6,749)
Capital reserve from share-based payment		-	704	185
Retained earnings		89,556	148,187	38,976
Capital reserve from available-for-sale financial assets		2,022	20,259	5,329
		<u>140,297</u>	<u>201,531</u>	<u>53,006</u>
Minority interests		4,746	4,982	1,310
<u>Total equity</u>		<u>145,043</u>	<u>206,513</u>	<u>54,316</u>
		<u>422,653</u>	<u>502,686</u>	<u>132,216</u>

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

March 25, 2009			
Date of approval of the financial statements	H. Mer Chairman of the Board	M. Cohen Chief Executive Officer	S. Hustiq Chief Financial Officer

CONSOLIDATED STATEMENTS OF INCOME

	Note	Year ended December 31		Convenience translation (Note 1c)
		2007	2008	Year ended December 31 2008
		NIS		U.S. \$
(In thousands, except per share data)				
Revenues from sales		408,710	611,102	160,732
Cost of sales	21b	303,665	451,131	118,656
Gross profit		105,045	159,971	42,076
Research and development costs, net		2,205	4,038	1,062
Selling and marketing expenses	21c	41,352	49,389	12,990
General and administrative expenses	21d	42,871	47,803	12,573
Other income	21g	394	40,621	10,684
Operating income		19,011	99,362	26,135
Financial income	21e	2,722	7,182	1,889
Financial expenses	21f	22,139	29,380	7,728
Company's share of earnings (losses) of associates, net		964	(4,029)	(1,060)
Income (loss) before income tax		558	73,135	19,236
Income tax expense	17	(1,420)	(13,966)	(3,673)
Net income (loss)		(862)	59,169	15,563
Attributable to:				
Equity holders of the Company		(1,628)	58,631	15,421
Minority interests		766	538	142
		(862)	59,169	15,563
Net earnings (loss) per share attributable to equity holders of the Company:	22			
Basic net earnings (loss)		(0.89)	7.21	1.89
Diluted net earnings (loss)		(0.89)	7.21	1.89

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Attributable to equity holders of the Company							Total	Minority interests	Total equity
	Share capital	Share premium	Treasury shares	Retained earnings	Capital reserve from translation differences	Capital reserve from available-for-sale financial assets	Capital reserve from share-based payment			
	N I S									
	(In thousands)									
Balance as of January 1, 2007	14,538	51,693	(7,401)	91,184	-	1,347	-	151,361	6,196	157,557
Gain from available-for-sale financial assets, net	-	-	-	-	-	675	-	675	-	675
Currency translation adjustment of foreign operations	-	-	-	-	(10,111)	-	-	(10,111)	-	(10,111)
Total amounts recognized directly in equity	-	-	-	-	(10,111)	675	-	(9,436)	-	(9,436)
Net income (loss)	-	-	-	(1,628)	-	-	-	(1,628)	766	(862)
Total recognized income (expenses)	-	-	-	(1,628)	(10,111)	675	-	(11,064)	766	(10,298)
Acquisition of minority interests	-	-	-	-	-	-	-	-	(1,841)	(1,841)
Distribution of dividend to minority	-	-	-	-	-	-	-	-	(375)	(375)
Balance as of December 31, 2007	14,538	51,693	(7,401)	89,556	(10,111)	2,022	-	140,297	4,746	145,043
Gain from available-for-sale financial assets, net	-	-	-	-	-	18,237	-	18,237	-	18,237
Currency translation adjustment of foreign operations	-	-	-	-	(15,547)	-	-	(15,547)	(23)	(15,570)
Total amounts recognized directly in equity	-	-	-	-	(15,547)	18,237	-	2,690	(23)	2,667
Net income	-	-	-	58,631	-	-	-	58,631	538	59,169
Total recognized income (expenses)	-	-	-	58,631	(15,547)	18,237	-	61,321	515	61,836
Share-based payment - grant of options to employees	-	-	-	-	-	-	704	704	323	1,027
Distribution of dividend to minority	-	-	-	-	-	-	-	-	(602)	(602)
Repurchase of shares	-	-	(791)	-	-	-	-	(791)	-	(791)
Balance as of December 31, 2008	14,538	51,693	(8,192)	148,187	(25,658)	20,259	704	201,531	4,982	206,513

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Attributable to equity holders of the Company							Total	Minority interests	Total equity
	Share capital	Share premium	Treasury shares	Retained earnings	Capital reserve from translation differences	Capital reserve from available-for-sale financial assets	Capital reserve from share-based payment			
	Convenience translation into U.S. \$ (Note 1c)									
	(In thousands)									
Balance as of January 1, 2008	3,824	13,596	(1,947)	23,555	(2,660)	532	-	36,900	1,248	38,148
Gain from available-for-sale financial assets, net	-	-	-	-	-	4,797	-	4,797	-	4,797
Currency translation adjustment of foreign operations	-	-	-	-	(4,089)	-	-	(4,089)	(7)	(4,096)
Total amounts recognized directly in equity	-	-	-	-	(4,089)	4,797	-	708	(7)	701
Net income	-	-	-	15,421	-	-	-	15,421	142	15,563
Total recognized income (expenses)	-	-	-	15,421	(4,089)	4,797	-	16,129	135	16,264
Share-based payment - grant of options to employees	-	-	-	-	-	-	185	185	85	270
Distribution of dividend to minority	-	-	-	-	-	-	-	-	(158)	(158)
Repurchase of shares	-	-	(208)	-	-	-	-	(208)	-	(208)
Balance as of December 31, 2008	<u>3,824</u>	<u>13,596</u>	<u>(2,155)</u>	<u>38,976</u>	<u>(6,749)</u>	<u>5,329</u>	<u>185</u>	<u>53,006</u>	<u>1,310</u>	<u>54,316</u>

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	December 31		Convenience translation (Note 1c)
	2007	2008	December 31 2008
	N I S		U.S. \$
	(In thousands)		
<u>Cash flows from operating activities:</u>			
Net income (loss)	(862)	59,169	15,563
Adjustments to reconcile net income (loss) to net cash used in operating activities (a)	(5,803)	(106,883)	(28,112)
Net cash used in operating activities	(6,665)	(47,714)	(12,549)
<u>Cash flows from investing activities:</u>			
Purchase of fixed assets	(6,464)	(13,082)	(3,441)
Payment for operating lease	(1,323)	(124)	(33)
Proceeds from sale of fixed assets	7,450	1,709	450
Purchase of associates	(2,166)	(4,300)	(1,131)
Purchase of available-for-sale financial assets	-	(3,985)	(1,048)
Proceeds from realization of investments in associates	-	52,366	13,773
Proceeds from sale of securities at fair value through profit or loss, net	518	10,445	2,747
Grant of long-term loans and other credit	(62)	(1,920)	(505)
Net cash provided by (used in) investing activities	(2,047)	41,109	10,812
<u>Cash flows from financing activities:</u>			
Repurchase of shares	-	(791)	(208)
Distribution of dividend to minority	(375)	(602)	(158)
Redemption of debentures	(17,644)	(22,433)	(5,900)
Receipt of long-term loans and other liabilities	2,859	5,275	1,387
Repayment of long-term loans and other liabilities	(11,936)	(9,908)	(2,606)
Short-term credit from banks and others, net	29,284	29,793	7,836
Net cash provided by financing activities	2,188	1,334	351
Translation differences from balances of foreign operations	68	(2,073)	(545)
Decrease in cash and cash equivalents	(6,456)	(7,344)	(1,931)
Cash and cash equivalents at the beginning of the year	55,319	48,863	12,851
Cash and cash equivalents at the end of the year	48,863	41,519	10,920

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	<u>December 31</u>		<u>Convenience translation (Note 1c) December 31</u>
	<u>2007</u>	<u>2008</u>	<u>2008</u>
	<u>N I S</u>		<u>U.S. \$</u>
	(In thousands)		
(a) <u>Adjustments to reconcile net income (loss) to net cash used in operating activities:</u>			
Income and expenses not involving cash flows:			
Depreciation and impairment of fixed assets	9,270	9,391	2,470
Amortization of prepaid operating lease expenses	-	30	8
Amortization of goodwill	-	640	168
Gain from sale of fixed assets, net	(635)	(751)	(198)
Gain from realization of investments in associates	-	(39,603)	(10,416)
Revaluation of long-term liabilities to banks and liabilities	2,622	2,622	690
Revaluation of long-term debts receivable	(2,202)	106	28
Company's share of losses (earnings) of associates, less dividends received, net	(964)	4,029	1,060
Deferred taxes, net	(11,456)	(5,591)	(1,471)
Change in employee benefit liabilities, net	968	2,896	762
Decrease (increase) in value of securities at fair value through profit or loss	563	(414)	(109)
Share-based payment	-	1,027	270
Amortization of discount and expenses relating to issuance of debentures	1,517	1,314	346
Transfer to the statement of income for impairment of available-for-sale securities	-	100	26
Gain from early redemption of debentures	-	(609)	(160)
	<u>(317)</u>	<u>(24,813)</u>	<u>(6,526)</u>
Changes in asset and liability items:			
Decrease (increase) in trade receivables	9,488	(44,110)	(11,603)
Decrease (increase) in short and long-term other accounts receivable	504	(24,863)	(6,539)
Increase in inventories	(20,599)	(32,541)	(8,559)
Increase (decrease) in trade payables	9,843	(1,165)	(306)
Increase (decrease) in other accounts payable	(4,722)	20,609	5,421
	<u>(5,486)</u>	<u>(82,070)</u>	<u>(21,586)</u>
	<u>(5,803)</u>	<u>(106,883)</u>	<u>(28,112)</u>
(b) <u>Additional cash flow information:</u>			
Cash paid during the year for:			
Interest	<u>7,968</u>	<u>8,135</u>	<u>2,140</u>
Taxes on income	<u>3,248</u>	<u>16,492</u>	<u>4,338</u>
Dividend	<u>1,406</u>	<u>251</u>	<u>66</u>

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1:- GENERAL

- a. C. Mer Industries Ltd. ("the Company") and its investees are engaged in the development, manufacturing and establishment of communication systems, electronic security systems and control and management systems, in the manufacture, establishment and planning of communication towers, buildings for communication equipment and construction of sites. The Company and its subsidiaries operate mainly in Israel, Mexico, South America and Africa.

- b. Definitions:

The Company	- C. Mer Industries Ltd.
The Group	- C. Mer Industries Ltd. and its investees, as detailed in the accompanying appendix.
Subsidiaries	- companies that are controlled by the Company (as defined in IAS 27) and whose accounts are consolidated with those of the Company.
Associates	- companies over which the Company has significant influence and that are not subsidiaries. The Company's investment therein is included in the consolidated financial statements of the Company at equity.
Investees	- subsidiaries and associates. As for the list of companies, see accompanying appendix.
Controlling shareholders	- as defined in the Israeli Securities Regulations (Presentation of Transactions Between Corporation and Controlling Shareholder Therein in Financial Statements), 1996.
Interested parties	- as defined in the Israeli Securities Regulations (Preparation of Annual Financial Statements), 1993.
Related parties	- as defined in IAS 24.

- c. Convenience translation into U.S. dollars:

The financial statements as of December 31, 2008 and for the year then ended have been translated into dollars using the representative exchange rate as of that date (\$ 1 = NIS 3.802). The translation was made solely for the convenience of the reader. The amounts presented in these financial statements should not be construed to represent amounts receivable or payable in dollars or convertible into dollars, unless otherwise indicated in these statements.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

- a. Basis of presentation of the financial statements:

The Company's financial statements have been prepared on a cost basis, except for derivatives, certain financial instruments, employee liabilities and liabilities for share-based payment arrangements that have been measured at fair value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)*The preparation format of the financial statements:*

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). These Standards comprise:

1. International Financial Reporting Standards (IFRS).
2. International Accounting Standards (IAS).
3. Interpretations issued by the IFRIC and by the SIC.

Furthermore, the financial statements have been prepared in conformity with the provisions of the Israeli Securities Regulations (Preparation of Annual Financial Statements), 1993.

These financial statements are the Company's first annual financial statements prepared in accordance with IFRS. The Company first adopted IFRS in 2008 and, accordingly, the date of transition to reporting pursuant to IFRS is January 1, 2007.

Prior to the adoption of IFRS, the Company prepared its financial statements in accordance with Israeli GAAP. The Company's last annual financial statements prepared in accordance with Israeli GAAP were as of December 31, 2007 and for the year then ended.

See Note 25 for the reconciliations between reporting pursuant to Israeli GAAP and reporting pursuant to IFRS.

Consistent accounting policies and initial adoption of IFRS:

The accounting policies adopted in the financial statements are consistent with those of all periods presented.

Consolidated financial statements:

The consolidated financial statements include the accounts of companies that are controlled by the Company (subsidiaries). Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity under a statute. The effect of potential voting rights that are exercisable at the balance sheet date are considered when assessing whether an entity has control. The consolidation of the financial statements commences on the date on which control is obtained until the date that such control ceases.

Significant intragroup balances and transactions and gains or losses resulting from intragroup transactions are eliminated in full in the consolidated financial statements.

Minority interests represent the minority shareholders' proportionate interest in the earnings or losses of the subsidiaries and fair value of the net assets upon the acquisition of the subsidiaries. They are presented in equity separately from the equity attributable to the Company. Acquisitions of minority interests are carried against a capital reserve and calculated as the difference between the consideration paid and the relative amount of minority interests acquired at the date of acquisition.

The financial statements of the Company and of the subsidiaries are prepared as of the same dates and periods. The accounting policy in the financial statements of the subsidiaries was applied consistently and uniformly with the policy applied in the financial statements of the Company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

- b. Significant accounting judgments, estimates and assumptions used in the preparation of the financial statements:

Judgments:

In the process of applying the Group's accounting policies, management has made the following judgments which have the most significant effect on the amounts recognized in the financial statements:

Estimates and assumptions:

The preparation of the financial statements requires management to make judgments, estimates and assumptions that affect the adoption of the accounting policy and the reported amounts of assets, liabilities, income and expenses. The basis of the estimates and assumptions is reviewed regularly. The changes in accounting estimates are reported in the period of the change in estimate.

The key assumptions made in the financial statements concerning uncertainties at the balance sheet date and the critical estimates computed by the Group to which a material adjustment will change the carrying amounts of assets and liabilities for the next financial year are discussed below.

- Deferred tax assets:

Deferred tax assets are recognized for unused carryforward tax losses and temporary differences to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits together with future tax planning strategies. Additional information is provided in Note 2q2.

- Pensions and other post-employment benefits:

The liability in respect of defined benefit plans after the completion of employment is determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases and mortality rates. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty. Further details are given in Note 16.

- Fair value of unquoted equity instruments:

The unquoted equity instruments are valued based on the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics. The expected future cash flows and discount rates are subject to uncertainty. Further details are given in Note 15e.

- c. Functional and foreign currencies:

1. Functional and presentation currencies:

The financial statements are presented in New Israeli Shekels ("NIS"), which is the Company's functional currency.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The functional currency, which is the currency that best reflects the economic environment in which the Company operates and conducts its transactions, is separately determined for each Group entity, including an associate presented using equity accounting, and is used to measure its financial position and operating results. When the Group entity's functional currency differs from the presentation currency, that entity represents a foreign operation whose financial statements are translated so that they can be included in the consolidated financial statements as follows:

- a) Assets and liabilities for each balance sheet presented (including comparative data) are translated at the closing rate at the date of that balance sheet. Goodwill and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation are treated as assets and liabilities of the foreign operation and are translated at the closing rate at the date of that balance sheet.
- b) Income and expenses for each period presented in the statement of income (including comparative data) are translated at average exchange rates for the presented periods; however, if exchange rates fluctuate significantly, income and expenses are translated at the exchange rates at the date of the transactions.
- c) Share capital, capital reserves and other changes in capital are translated at the exchange rate prevailing at the date of incurrence.
- d) Retained earnings are translated based on the opening balance translated at the exchange rate at that date and other relevant transactions during the period are translated as described in b) and c) above.
- e) All resulting translation differences are recognized as a separate component of capital reserve in equity "currency translation adjustment".

Intragroup loans for which settlement is neither planned nor likely to occur in the foreseeable future are, in substance, a part of the investment in that foreign operation and are accounted for as part of the investment and the exchange differences arising in these loans are recognized in the same component of equity as discussed in e) above.

2. Transactions in foreign currency:

Transactions denominated in foreign currency are recorded on initial recognition at the exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currency are translated at each balance sheet date into the functional currency at the exchange rate at that date. Exchange rate differences are recognized in the statement of income. Non-monetary assets and liabilities are translated into the functional currency at the exchange rate at the date of the transaction.

d. Cash equivalents:

The Company considers unrestricted highly liquid investments, including short-term bank deposits purchased with original maturities of three months or less, to be cash equivalents.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

e. Allowance for doubtful accounts:

The allowance for doubtful accounts is determined in respect of specific debts whose collection, in the opinion of the Company's management, is doubtful. Impaired debts are derecognized when they are assessed as uncollectible.

f. Inventories:

Inventories are measured at the lower of cost and net realizable value. The cost of inventories comprises costs of purchase and costs incurred in bringing the inventories to their present location and condition. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated selling costs.

Cost of inventories is assigned as follows:

Raw materials and auxiliary - at cost of purchase using the first-in, first-out method.

Finished goods - on the basis of average costs which take into account direct materials, direct labor and other indirect costs.

The Company periodically evaluates the condition and age of inventories and makes provisions for slow moving inventories accordingly.

If in a particular period production is not at normal capacity, the cost of inventories does not include additional fixed overheads in excess of those allocated based on normal capacity. Such unallocated overheads are recognized as an expense in the statement of income in the period in which they are incurred. Furthermore, cost of inventories does not include abnormal amounts of materials, labor or other costs resulting from inefficiency.

g. Contract work:

Costs of projects based on contract work are recognized at cost that includes identifiable direct costs, joint indirect costs and capitalized borrowing costs.

When a loss is expected from contract work, the full amount of the expected loss is recognized through the completion of the contract activity.

Receivables for contract work is separately calculated for each contract and presented in the balance sheet at the aggregate amount of costs incurred and recognized profits less recognized losses and progress billings. If the amount balance is positive, it is recorded in the balance sheet as an asset under receivables for contract work. If it is negative, it is recorded in the balance sheet as a liability for contract work.

h. Financial instruments:

Financial assets within the scope of IAS 39 are initially recognized at fair value plus directly attributable transaction costs, except for investments at fair value through profit or loss in respect of which transaction costs are carried to the statement of income.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

After initial recognition, the accounting treatment of investments in financial assets is based on their classification into one of the following four categories:

- financial assets at fair value through profit or loss;
- held-to-maturity investments;
- loans and receivables; and
- available-for-sale financial assets.

1. Financial assets at fair value through profit or loss:

The Group has financial assets at fair value through profit or loss comprising financial assets held for trading and financial assets designated upon initial recognition as at fair value through profit or loss.

Financial assets are classified as held for trading if they are acquired principally for the purpose of selling or repurchasing in the near term, if they form part of a portfolio of identified financial instruments that are managed together to earn short-term profits or if they are a derivative not designated as hedging instrument. Gains or losses on investments held for trading are recognized in profit and loss when incurred.

Derivatives, including separated embedded derivatives, are classified as held for trading unless they are designated as effective hedging instruments. In the event of a financial instrument that contains one or more embedded derivatives, the entire combined instrument shall be designated upon initial recognition as a financial asset at fair value through profit or loss.

2. Loans and receivables:

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial recognition, loans and receivables are measured at amortized cost using the effective interest method taking into account transaction costs and less any allowance for impairment. Gains and losses are recognized in the statement of income when the loans and receivables are derecognized or impaired, as well as through the systematic amortization process.

3. Available-for-sale financial assets:

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or are not classified in any of the preceding categories. After initial recognition, available-for-sale financial assets are measured at fair value. Gains or losses from fair value adjustments, except exchange differences that relate to monetary debt instruments that are carried to the statement of income in financing, are recognized directly in equity in the net unrealized gains reserve. When the investment is disposed of or in case of impairment, the cumulative gain or loss previously recorded in equity is recognized in the statement of income. Interest income on investments in debt instruments is recognized in the statement of income using the effective interest method. Dividends earned on investments are recognized in the statement of income when the right of payment has been established.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

4. Fair value:

The fair value of investments that are actively traded in organized financial markets is determined by reference to market prices on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; discounted cash flow or other valuation models.

5. Treasury shares:

Company shares held by the Company and/or subsidiaries are recognized at cost and deducted from equity. Gains or losses on purchase, sale, issue or cancellation of treasury shares are recognized directly in equity.

i. Impairment of financial assets:

The Group assesses at each balance sheet date whether the following financial asset or group of financial assets is impaired.

1. Assets carried at amortized cost:

If there is objective evidence that an impairment loss on loans and receivables carried at amortized cost has been incurred, the amount of the loss carried to the statement of income is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through use of an allowance account (see also allowance for doubtful accounts discussed above). The amount of the loss is recognized in the statement of income.

2. Available-for-sale assets:

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the cost (net of any principal repayment and amortization) and fair value, less any impairment loss previously recognized in the statement of income. This loss is removed from equity and recognized in the statement of income. Impairment loss for financial instruments is not reversed through the statement of income and if in a subsequent period the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the statement of income, the impairment loss is reversed, with the amount of the reversal recognized in the statement of income.

j. Derivative financial instruments:

From time to time, the Group enters into contracts with derivative financial instruments such as forward currency contracts (forward) in respect of foreign currency to hedge its risks associated with foreign exchange rates and interest rate fluctuations. Such derivative financial instruments are initially recognized at fair value and attributable transactions costs are carried to the statement of income when incurred. After initial recognition, the derivatives are measured at fair value. Derivatives are carried in the balance sheet as assets when the fair value is positive and as liabilities when the fair value is negative.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Any gains or losses arising from changes in fair value on derivatives that do not qualify for hedge accounting are carried directly to the statement of income.

The fair value of forward currency contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles.

k. Leases:

The tests for classifying leases as finance or operating leases depend on the substance of the agreements and are made at the inception of the lease in accordance with the principles as set out in IAS 17.

1. Finance leases:

Finance leases transfer to the Group substantially all the risks and benefits incidental to ownership of the leased asset. At the commencement of the lease term, the leased assets are measured at the fair value of the leased asset or, if lower, at the present value of the minimum lease payments. The liability for lease payments is presented at its present value and the lease payments are apportioned between finance charges and a reduction of the lease liability using the effective interest method.

2. Operating leases:

Lease agreements where the Group does not actually transfer substantially all the risks and benefits incidental to ownership of the leased asset are classified as operating leases. Initial direct costs incurred are added to the carrying amount of the leased asset and recognized over the lease term.

Lease of land from the Israel Lands Administration, which is not accounted for as investment property at fair value, is treated as an operating lease with the amount attributed to land being presented in the balance sheet as "prepaid operating lease expenses" and recognized as an expense in the statement of income on a straight-line basis over the lease term.

l. Investments in associates:

Associates are companies in which the Group has significant influence over the financial and operating policies without having control.

The investment in an associate is accounted for using the equity method of accounting. Under the equity method, the investment in the associate is presented in the balance sheet at cost plus changes in the Group's share of net assets and the capital reserves of the associate.

Goodwill relating to the acquisition of an associate is initially measured as the difference between the acquisition cost and the Group's share in the net fair value of the associate's identifiable assets, liabilities and contingent liabilities. After initial recognition, goodwill is measured at cost and is not systematically amortized. Goodwill is examined for impairment as part of the investment in an associate as a whole. See also o below.

The statement of income reflects the share of the operating results of the associate. Profits and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

m. Fixed assets:

Items of fixed assets are measured at cost with the addition of direct acquisition costs, less accumulated depreciation, less accumulated impairment losses and less related investment grants and excluding day-to-day servicing expenses. Cost includes spare parts and auxiliary equipment that can be used only in connection with the machinery and equipment.

Depreciation is calculated on a straight-line basis over the useful life of the assets at annual rates as follows:

	<u>%</u>	<u>Mainly %</u>
Buildings *)	4	
Machinery and equipment	10 - 33	15
Motor vehicles	15	
Office furniture and equipment	6 - 15	7
Computers and peripheral equipment	33	33
Leasehold improvements	over the lease term including the extension option	

*) As for the land component, see 2k above.

Leasehold improvements are depreciated on a straight-line basis over the shorter of the lease term (including the extension option held by the Group and intended to be exercised) and the expected life of the assets.

The residual value and useful life of an asset are reviewed at least each year-end and the changes are accounted for as a prospective change in accounting estimate. As for testing the impairment of fixed assets, see o below.

Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale and the date that the asset is derecognized. An asset is derecognized on disposal or when no further economic benefits are expected from its use. The gain or loss arising from the derecognition of the asset (determined as the difference between the net disposal proceeds and the carrying amount in the financial statements) is included in the statement of income when the asset is derecognized.

n. Real estate under construction:

Real estate under construction is measured at cost. Cost of real estate includes borrowing costs relating to the financing of the construction of the assets until their operation, planning and design costs, indirect costs attributable to construction and other related costs.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

o. Impairment of non-financial assets:

The Company evaluates the need to record an impairment of the carrying amount of fixed assets and goodwill whenever events or changes in circumstances indicate that the carrying amount is not recoverable. If the carrying amount of non-financial assets exceeds their recoverable amount, the assets are reduced to their recoverable amount. The recoverable amount is the higher of the net selling price and value in use. In measuring value in use, the estimated future cash flows are discounted using a pre-tax discount rate that reflects the risks specific to the asset. The recoverable amount of an asset that does not generate independent cash flows is determined for the cash-generating unit to which the asset belongs.

Impairment losses are recognized in the statement of income.

The following criteria are applied in assessing impairment of the following specific assets:

1. Goodwill:

The Company reviews goodwill for impairment once a year on December 31 or more frequently if events or changes in circumstances indicate that there is impairment.

Impairment is recognized for goodwill by assessing the recoverable amount of the cash-generating unit, to which the goodwill belongs. If the recoverable amount of the cash-generating unit is less than the carrying amount of the cash-generating unit to which goodwill has been allocated, an impairment loss is recognized. Impairment losses recognized for goodwill cannot be reversed.

2. Associates:

After application of the equity method of accounting, the Company determines whether it is necessary to recognize any additional impairment loss with respect to the Company's investment in the associates. The Company determines at each balance sheet date whether there is any objective evidence that the investment in an associate is impaired. If this is the case, the Company calculates the amount of loss as the difference between the recoverable amount of the investment in the associate and its carrying amount. The amount of the loss is recognized in the statement of income in the Company's share of earnings (losses) of associates, net.

p. Government grants:

Government grants are recognized where there is reasonable assurance that the grant will be received and the Company will comply with the attached conditions. Where the Government investment grants relate to assets such as fixed assets, they are presented as a deduction from the carrying amount of the asset.

Government grants from the Office of the Chief Scientist in Israel for funding research and development activities that include a liability to pay royalties to the State depending on future sales from development are recognized upon receipt as a liability if an outflow of economic benefits from the research activity has become probable and leads to sales entitling the State to royalties. Amounts paid as royalties are recognized as settlement of liability. When no such economic benefits are probable, the receipts from the grant are deducted from research and development costs in the statement of income. In such event, the royalty liability is accounted for as a contingent liability pursuant to IAS 37.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

At each balance sheet date, the Company evaluates whether there is reasonable assurance that the liability, in whole or in part, will not be settled (since the Company will not be required to pay royalties) based on the best estimate of future sales, if any, and if so, the appropriate liability is derecognized and a gain is recognized in the statement of income. If in a later period, the estimated future sales indicate that there is no such reasonable assurance, the appropriate liability reflecting the anticipated royalty payments is recognized concurrently with a loss in the statement of income.

q. Taxes on income:

Taxes on income in the statement of income comprise current and deferred taxes. The tax results in respect of current or deferred taxes are carried to the statement of income except to the extent that the tax arises from items which are recognized directly in equity. In such cases, the tax effect is also carried to the relevant item in equity.

1. Income taxes:

The current tax liability is measured using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date as well as adjustments required in connection with the tax liability in respect of previous years.

2. Deferred taxes:

Deferred taxes are computed in respect of temporary differences between the carrying amounts in the financial statements and the amounts attributed for tax purposes, except in a limited number of exceptions. Deferred taxes are carried directly to equity if the tax relates to items that are taken to equity.

Deferred tax balances are measured at the tax rates that are expected to apply to the period when the taxes are taken to the statement of income or to equity, based on tax laws that have been enacted or substantively enacted by the balance sheet date. The amount for deferred taxes in the statement of income represents the changes in said balances during the reported period.

Taxes that would apply in the event of the sale of investments in investees have not been taken into account in computing the deferred taxes, as long as the sale of the investments in investees is not expected in the foreseeable future. Also, deferred taxes that would apply in the event of distribution of earnings by investees as dividends have not been taken into account in computing the deferred taxes, since it is the Company's policy not to initiate distribution of dividends that triggers an additional tax liability.

Deferred tax assets and deferred tax liabilities are presented in the balance sheet as non-current assets and long-term liabilities, respectively. Deferred taxes are offset if there is a legally enforceable right to set off a current tax asset against a current tax liability and the deferred taxes relate to the same taxpayer and the same taxation authority.

r. Share-based payment transactions:

The Company's employees are entitled to remuneration in the form of share-based payment transactions as consideration for equity instruments ("equity-settled transactions").

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The cost of equity-settled transactions with employees is measured at the fair value of the equity instruments granted at grant date. The fair value is determined using a standard pricing model.

The cost of equity-settled transactions is recognized in the statement of income, together with a corresponding increase in equity, during the period which the service conditions are to be satisfied, ending on the date on which the relevant employees become fully entitled to the award ("the vesting period"). The cumulative expense recognized for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The charge or credit to the statement of income represents the movement in cumulative expense recognized at the beginning and end of that reported period.

No expense is recognized for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether the market condition is satisfied, provided that all other performance conditions are satisfied.

s. Employee benefit liabilities:

The Group has several employee benefit plans:

1. Short-term employee benefits:

Short-term employee benefits include salaries, paid annual leave, recreation and social security contributions and are recognized as expenses as the services are rendered. A liability in respect of a cash bonus or a profit-sharing plan is recognized when the Group has a legal or constructive obligation to make such payment as a result of past service rendered by an employee and a reliable estimate of the amount can be made.

2. Post-employment benefits:

The Group operates a defined benefit plan in respect of severance pay pursuant to the Severance Pay Law. According to the Law, employees are entitled to severance pay upon dismissal or retirement. The compensation are computed according to the last monthly salary of the employee at the time of termination multiplied by the number of years of employment.

The plans are normally financed by contributions to insurance companies and they are classified defined contribution plans and as defined benefit plans.

The Company makes current deposits in respect of its liabilities to pay compensation to certain of its employees in pension funds and insurance companies ("the plan assets").

The cost of compensation is presented by the projected unit credit method. Actuarial gains and losses are recognized in the statement of income in the period in which they occur.

The liability for employee benefits presented in the balance sheet presents the present value of the defined benefit obligation minus the fair value of the plan assets. Assets arising from this calculation are limited to past service cost plus the present value of available refunds and reductions in future contributions to the plan.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

t. Revenue recognition:

Revenues are recognized in the statement of income when the revenues can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Revenues are measured at the fair value of the consideration received less any trade discounts, volume rebates and returns.

Revenues from credit sales transactions that include a financing element are recorded at present value such that the difference between the fair value of the transaction and the amount of the consideration is recognized in the statement of income as financial income using the effective interest method.

The following specific recognition criteria must also be met before revenue is recognized:

Revenues from sale of goods:

Revenues from sale of goods are recognized when all the significant risks and rewards of ownership of the goods have passed to the buyer and the seller no longer retains continuing managerial involvement. The delivery date is usually the date on which ownership passes.

Revenues from construction contracts:

Revenues from construction contracts are recognized by the percentage of completion method when all the following conditions are satisfied: the revenues are known or can be estimated reliably, collection is probable, costs related to performing the work are determinable or can be reasonably determined, there is no substantial uncertainty regarding the Company's (performing contractor) ability to complete the contract and to meet the contractual terms and the percentage of completion can be estimated reliably. The percentage of completion is determined based on completion of engineering stages of the work. When a loss is expected from works, a provision is recorded for the full amount of the expected loss.

If not all the criteria for recognition of revenue from construction contracts are met, then revenue is recognized only to the extent of costs whose recoverability is probable ("zero profit margin" presentation).

u. Cost of revenues:

Cost of sales includes expenses for loss, storage and conveyance of inventories to the end point of sale. Cost of sales also includes impairment losses in respect of inventories, inventory write offs and provisions for slow-moving inventories.

v. Earnings (loss) per share:

Earnings per share are calculated based on the number of Ordinary shares. Basic earnings (loss) per share only include shares that were actually outstanding during the period. Potential Ordinary shares (convertible securities such as convertible debentures, stock options and employee options) are only included in the computation of diluted earnings (loss) per share when their conversion decreases earnings per share or increases loss per share from continuing operations. Furthermore, potential Ordinary shares that are converted during the period are included in diluted earnings (loss) per share only until the conversion date and from that date in basic earnings (loss) per share. The investor's share of earnings of an investee is included based on the earnings per share of the investee multiplied by the number of shares held by the investor.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

w. Provisions:

A provision is recognized when the Group has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect is material, provisions are measured according to the estimated future cash flows discounted using a pre-tax interest rate that reflects the market assessments of the time value of money and, where appropriate, those risks specific to the liability.

A provision for warranty for sale of products was recognized in the financial statements.

x. Disclosure of new IFRS Standards in the period prior to their adoption:

1. IFRS 8 - Operating Segments:

IFRS 8 ("the Standard") deals with operating segments and replaces IAS 14. The Standard applies to companies whose securities are traded or are in the process of filing with any securities stock exchange. The Standard is effective for annual financial statements for periods beginning after January 1, 2009. Earlier application is permitted. The provisions of the Standard will be applied retrospectively, by restatement, unless the necessary information is not available or impractical to obtain.

The Standard determines that an entity will adopt a management approach in reporting on the financial performance of the operating segments. The segment information would be the information that is internally used by management in order to assess its performance and allocate resources to the operating segments.

Furthermore, information is required to be disclosed about the products or services (or group of products and similar services) from which the entity derives its revenues, the countries in which these revenues or assets are derived and major customers, irrespective of whether management uses this information for making operating decisions.

The Company believes that the effect of the new Standard on the current presentation of segments is not expected to be material.

2. IAS 23 (Revised) - Borrowing Costs:

In accordance with the revised IAS 23, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset must be capitalized. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale and includes fixed assets, investment property and inventories that take a substantial period of time to get ready for sale. The possibility of immediately carrying these costs as an expense has been removed.

The revised Standard is effective for the financial statements for the year beginning January 1, 2009. Earlier application is permitted.

The Company believes that the effect of the revised Standard on its financial condition, results of operations and cash flows is not expected to be material.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

3. IAS 1 (Revised) - Presentation of Financial Statements:

IAS 1 (Revised) introduces an additional statement, "statement of comprehensive income". The statement may be presented as a separate statement which includes net income and all items carried in the reported period directly to equity that do not result from transactions with the shareholders in their capacity as shareholders (other comprehensive income) such as adjustments arising from translating the financial statements of foreign operations, fair value adjustments of available-for-sale financial assets, changes in revaluation reserve of fixed assets and the tax effect of these items carried directly to equity, with allocation between the Company and the minority interests. Alternatively, the items of other comprehensive income may be displayed along with the items of the statement of income in a single statement entitled "statement of comprehensive income" which replaces the statement of income, while properly allocated between the Company and the minority interests. Items carried to equity resulting from transactions with the shareholders in their capacity as shareholders (such as capital issues, dividend distribution etc.) will be disclosed in the statement of changes in equity as will the summary line carried forward from the statement of comprehensive income, with allocation between the Company and the minority interests.

IAS 1 (Revised) also prescribes that in cases of restatement of comparative figures as a result of the retroactive adoption of the change in accounting policy, the entity must include an opening balance sheet disclosing the restated comparative figures.

IAS 1 (Revised) is effective for annual financial statements for periods beginning after January 1, 2009. Earlier application is permitted.

The effect of the adoption of IAS 1 (Revised) will require the Company to disclose the above items in the financial statements.

4. IFRS 3 (Revised) - Business Combinations and IAS 27 - Consolidated and Separate Financial Statements:

IFRS 3 (Revised) and the amendments to IAS 27 ("the Standards") will be effective for annual financial statements for periods beginning on January 1, 2010. The combined early adoption of the two Standards is permitted from the financial statements for periods beginning on January 1, 2008.

The principal changes expected to take place following the adoption of the Standards are:

- IFRS 3 currently prescribes that goodwill, as opposed to the acquiree's other identifiable assets and liabilities, will be measured as the excess of the cost of the acquisition over the acquirer's share in the fair value of the identifiable assets, net on the acquisition date. According to the Standards, goodwill can be measured at its full fair value and not only for the acquired part, this in respect of each business combination transaction measured separately.
- Contingent consideration in a business combination will be measured at fair value and changes in the fair value of the contingent consideration, which do not represent adjustments to the acquisition cost in the measurement period, will not be simultaneously recognized as goodwill adjustment. Normally, the contingent consideration will be considered a financial derivative within the scope of IAS 39 and will be presented at fair value through profit or loss.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

- Direct acquisition costs attributed to a business combination transaction will be recognized in the statement of income as incurred as opposed to the previous requirement of carrying them as part of the consideration of the cost of the business combination, which has been removed.
- A transaction with the minority interests, whether a sale or an acquisition, will be accounted for as an equity transaction and will therefore not be recognized in the statement of income or have any effect on the amount of goodwill, respectively.
- A subsidiary's losses, even if resulting in a capital deficiency in a subsidiary, will be allocated between the parent company and minority interests, even if the minority has not guaranteed or has no contractual obligation of sustaining the subsidiary or of investing further amounts.
- On the loss of control of a subsidiary, the remaining investment in the subsidiary, if any, will be revalued to fair value against gain and loss from the sale and this fair value will represent the cost basis for the purpose of subsequent treatment.

The Company believes that the effect of the Standards on its financial condition, results of operations and cash flows is not expected to be material.

5. IFRS 2 - Share-based Payment:

Pursuant to an amendment to IFRS 2 ("the amended Standard"), the definition of vesting terms will only include service conditions and performance conditions and the cancellation of a grant that includes non-vesting conditions by the Company or the counterparty, will be accounted for by way of acceleration of vesting and not by forfeiture. The Standard will be applied retrospectively for financial statements for periods beginning on January 1, 2009. Earlier application is permitted.

Vesting conditions include service conditions which require the counterparty to complete a specified period of service and performance conditions which require specified performance targets to be met. Conditions that are other than service and performance conditions will be viewed as non-vesting conditions and must therefore be taken into account when estimating the fair value of the instrument granted.

The Company believes that the effect of the amendment on its financial position, operating results and cash flows is not expected to be material.

6. IAS 19 - Employee Benefits:

Pursuant to an amendment to IAS 19, a group of other long-term benefits will also include employee benefits that are due in the short-term and are expected to be utilized within one year of the end of the period qualifying for the benefits, such as cumulative benefits in respect of vacation pay and sick leave that are expected to be used within one year of the balance sheet date. Accordingly, these benefits are now required to be recognized in the financial statements based on an actuarial calculation taking into account future salaries and discounted to present value. The amendments will be retrospectively adopted starting from the financial statements for periods beginning on January 1, 2009. Earlier application is permitted.

The Company believes that the effect of the amendment on its financial position, operating results and cash flows is not expected to be material.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

7. IAS 20 - Government Grants:

Pursuant to an amendment to IAS 20, an interest-free / low interest loan received by a company from a government will be accounted for upon initial recognition and in subsequent periods pursuant to the provisions of IAS 39, "Financial Instruments: Recognition and Measurement". Accordingly, the loan will be initially measured at fair value and discounted at market interest. The difference between the loan amount received and the fair value will be accounted for thereafter as a Government grant according to the provisions of the Standard. The Standard will be prospectively adopted starting from the financial statements for periods beginning on January 1, 2009 for Government loans received subsequent to that date. Earlier application is permitted.

The Company believes that the effect of the amendment on its financial position, operating results and cash flows is not expected be material.

8. IAS 28 - Investment in Associates:

Pursuant to an amendment to IAS 28, the test of impairment of an investment in an associate will be carried out with reference to the entire investment. Accordingly, a recognized impairment loss is not allocated specifically to goodwill that forms part of the investment but rather attributed to the investment as a whole and, therefore, the entire impairment loss previously recognized may be reversed to the extent that the relevant conditions are satisfied. The Standard may be adopted retrospectively or prospectively starting from the financial statements for periods beginning on January 1, 2009. Earlier application is permitted.

The Company believes that the effect of the amendment on its financial position, operating results and cash flows is not expected be material.

9. IFRIC 16 - Hedges of a Net Investment in a Foreign Operation:

IFRIC 16 ("the Interpretation") prescribes that a risk arising from foreign exchange differences of the presentation currency of a company does not create an exposure to which hedge accounting can be applied, consequently, a hedged risk may be designated only in respect of the company's functional currency. Moreover, the risk arising from foreign exchange differences of the functional currency of any subsidiary may be hedged by any entity within the Group even if that subsidiary is indirectly controlled by another entity within the Group. The Interpretation also prescribes that the hedging instrument may be held by any entity within the Group. The Interpretation applies to annual financial statements for periods beginning on or after January 1, 2009. Earlier application is permitted.

The Company believes that the effect of the new Interpretation on its financial position, operating results and cash flows is not expected be material.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

y. Early adoption of IFRS:

IFRS 1 (Revised) - First-time Adoption of IFRS and IAS 27 (Revised) - Consolidated and Separate Financial Statements.

Pursuant to the amendments to these Standards, an exemption has been added with respect to the retrospective adoption of IFRS in the opening balance sheet pursuant to IFRS 1 on first-time adoption of IFRS reporting in the separate financial statements ("solo" financial statements). According to this exemption, in these financial statements, the cost of investment in shares of subsidiaries, jointly controlled entities and associates may also be determined, other than at historical cost or fair value, at deemed cost based on the carrying amount of the investment under previous accounting principles namely, at equity. The election may be adopted for each investment individually. Furthermore, dividends in respect of investments in companies as above will be recognized in the separate financial statements as income irrespective whether they had been distributed in respect of earnings retained before or after the date of purchase of the investment. The Standard was adopted in the separate financial statements as above with the date of transition being on or after January 1, 2007.

NOTE 3:- CASH AND CASH EQUIVALENTS

	December 31,	
	2007	2008
	NIS in thousands	
Cash in NIS	4,082	623
Cash and deposits for immediate withdrawal in foreign currency	44,781	31,648
Short-term deposits and loans	-	9,248
	<u>48,863</u>	<u>41,519</u>

At balance sheet date, cash at banks earn floating interest based on daily bank deposit rates (1.5% to 6%). Deposits for immediate withdrawal in foreign currency do not earn interest.

As for the linkage terms relating to the cash and the short-term deposits, see Note 15b.

NOTE 4:- SHORT-TERM INVESTMENTS

	December 31,	
	2007	2008
	NIS in thousands	
Marketable securities held for trading:		
Shares	4,852	42
Stock options	1,398	698
Government bonds and loans	4,521	-
	<u>10,771</u>	<u>740</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5:- TRADE AND UNBILLED RECEIVABLES

a. Composition:

	December 31,	
	2007	2008
	NIS in thousands	
Open accounts (1)	79,374	120,490
Unbilled receivables	111,964	91,571
Notes receivable	1,571	1,419
Current maturities of long-term trade receivables	-	9,212
	<u>192,909</u>	<u>222,692</u>
(1) Less - allowance for doubtful accounts	<u>16,713</u>	<u>14,295</u>

b. The movement in the allowance for doubtful accounts is as follows

	NIS in thousands
Balance at January 1, 2007	15,688
Charge for the year	1,079
Reversal of collected doubtful accounts	(8)
Adjustments arising from translating the financial statements of foreign operations	<u>(46)</u>
Balance at December 31, 2007	16,713
Charge for the year	798
Recognition of derecognized of bad debts	(1,993)
Reversal of collected doubtful accounts	(308)
Adjustments arising from translating the financial statements of foreign operations	<u>(915)</u>
Balance at December 31, 2008	<u>14,295</u>

c. An analysis of past due but not impaired trade receivables (allowance for doubtful accounts), trade receivables, net, with reference to balance sheet date:

	Past due trade receivables with ageing of						Total
	Neither past due (nor ageing)	< 30 days	30 – 60 days	60 – 90 days	90 – 120 days	>120 days	
	NIS in thousands						
December 31, 2007	<u>72,609</u>	<u>3,935</u>	<u>1,641</u>	<u>562</u>	<u>1,343</u>	<u>855</u>	<u>80,945</u>
December 31, 2008	<u>114,824</u>	<u>12,211</u>	<u>2,804</u>	<u>584</u>	<u>4,089</u>	<u>626</u>	<u>135,138</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6:- OTHER ACCOUNTS RECEIVABLE

	December 31,	
	2007	2008
	NIS in thousands	
Employees (1)	1,456	2,641
Government authorities	10,434	16,322
Associates (2)	1,691	563
Other related companies (2)	16	1,193
Prepaid expenses	559	9,543
Accrued income	100	1,273
Advances to suppliers and other receivables	2,855	4,314
	<u>17,111</u>	<u>35,849</u>

(1) The balances are linked to the Israeli CPI and in part bear annual interest at the rate of 4%.

(2) Commercial balances, interest and linkage free.

NOTE 7:- INVENTORIES

	December 31,	
	2007	2008
	NIS in thousands	
Raw materials and auxiliary	15,679	9,969
Finished goods (1)	51,193	77,930
Advances on account of inventories	327	1,959
	<u>67,199</u>	<u>89,858</u>
(1) Less - impairment of inventories	<u>-</u>	<u>71</u>

NOTE 8:- INVESTMENTS IN INVESTEEES

a. Composition:

	Associates	
	December 31,	
	2007	2008
	NIS in thousands	
Cost of shares	33,614	22,570
Post-acquisition earnings (losses), net	10,175	(12,747)
Currency translation adjustment of foreign operations	(12,588)	80
	<u>31,201</u>	<u>9,903</u>
Other investments:		
Long-term loans and receivables (1)	2,890	4,704
	<u>34,091</u>	<u>14,607</u>

(1) The majority of the loans are interest free except for a loan of NIS 441 thousand that bears interest at the rate of 4%. As for linkage terms relating to investments and loans to investees, see Note 15.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8:- INVESTMENTS IN INVESTEEES (Cont.)

b. The movement in investments in 2008:

	<u>Associates</u> <u>NIS in</u> <u>thousands</u>
Balance at the beginning of the year	34,091
The movement during the year:	
Investments:	
In shares	4,300
In loans, net	1,814
Sale of investments	(12,763)
Transfer to available-for-sale portfolio	(8,815)
Group's share of losses, net	(4,029)
Currency translation adjustment of foreign operations	9
Changes in capital reserves	-
Balance at the end of the year	<u>14,607</u>

c. Summarized information of the financial statements of the associates:

	<u>December 31,</u>	
	<u>2007</u>	<u>2008</u>
	<u>NIS in thousands</u>	
Group's share of the associates' balance sheet based on the interests therein at balance sheet date:		
Current assets	48,439	7,656
Non-current assets *)	193,369	12,335
Current liabilities	(21,828)	(6,327)
Long-term liabilities	(188,770)	(3,761)
Net assets	<u>31,201</u>	<u>9,903</u>

*) Includes excess of cost and goodwill.

	<u>Year ended</u> <u>December 31,</u>	
	<u>2007</u>	<u>2008</u>
	<u>NIS in thousands</u>	
Group's share of the associates' operating results based on the interests therein during the year:		
Revenues	<u>36,527</u>	<u>12,411</u>
Net income (loss) *)	<u>964</u>	<u>(4,029)</u>

*) Includes adjustments to excess of cost.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**NOTE 8:- INVESTMENTS IN INVESTEEES (Cont.)**

- d. The fair value of investments in associates by reference to market prices:

	December 31,			
	2007		2008	
	Carrying amount	Fair value	Carrying amount	Fair value
	NIS in thousands			
Shares	19,124	78,122	-	-

- e. Additional information about investees:

1. As for list of subsidiaries and associates, see appendix to the financial statements.

2. Further details:

a) Acquisition of additional investment in subsidiary:

On April 1, 2007, the Group increased its stake in Rotal by 11% in consideration of an investment of NIS 6 million and sale of the entire interests in TMCS Communication Ltd. to Rotal. After the above acquisition, the Company's interest in Rotal is 86%.

b) Establishment of new companies in 2007:

In 2007, a subsidiary established Mer Guinea, Met Telcom Senegal and Mer Honduras which are engaged in projects in the field of wireless communication.

During 2007, a subsidiary invested in Arcus Technologies Ltd. ("Arcus") an amount of NIS 406 thousand in consideration of 6.6% of the share capital of Arcus.

Arcus is engaged in the development of a wide communication module that enables multi private channels and it operates in the framework of Xenia.

In 2007, the Company wrote down the entire investment in Arcus.

On February 4, 2008, an investment agreement was signed, according to which existing shareholders will invest approximately \$ 100 thousand in Arcus at value of \$ 1.95 million. The interest in Arcus is 13.12%.

c) Establishment of new companies in 2008:

In 2008, a subsidiary established Mer Telecom Tanzania, Mer Telcom DRC, Mer Telecom Ghana, Mer Panama, Mer Jamaica and Mer Infrastructure Argentina which are engaged in projects in the field of wireless communication.

- f. Acquisition of minority interests:

See e2a) above.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9:- AVAILABLE-FOR-SALE FINANCIAL ASSETS

	December 31,	
	2007	2008
	NIS in thousands	
Shares - unquoted	3,156	4,045
Shares - quoted	1,034	39,838
	<u>4,190</u>	<u>43,883</u>
Impairment recorded in the statement of income	<u>100</u>	<u>100</u>

a. H.L.L. Communications Ltd.:

H.L.L. Communications Ltd. ("H.L.L.") is mainly engaged in leasing space sections.

As of December 31, 2007, the Group owned 18.62% of the share capital and voting rights of H.L.L. and the investment therein was accounted for by the equity method of accounting.

On January 2, 2008, Eurocom Communication Ltd. published a special tender offer to all shareholders of H.L.L. Communication Ltd. ("H.L.L.") to acquire 2,718,313 Ordinary shares of H.L.L., representing about 23% of the issued and outstanding share capital of H.L.L. According to the Board's decision from February 14, 2008, the Company's subsidiary, M.M. Satellite and Communication Ltd. (100% owned) announced on its response to the terms of the special tender offer and agreed to sell 1,360,000 Ordinary shares of H.L.L. according to the terms of the special tender offer.

According to the results of the tender offer, the Company sold 1,149,179 shares of H.L.L., representing 9.72% of the share capital of H.L.L. in consideration of approximately NIS 52 million.

As a result of this sale, the Company recognized a capital gain of approximately NIS 39 million in the financial statements for 2008.

The Company's remaining interests in H.L.L. total about 1,050 thousand shares representing 7.29% of the issued share capital of H.L.L. The cost of the investment in H.L.L.'s shares totals approximately NIS 8,815 thousand. As of December 31, 2008, the investment in H.L.L.'s shares is presented with value of NIS 37,625 thousand.

On September 25, 2008, H.L.L. published a shelf offer to issue by way of rights issue between 3,461,180 and 4,433,443 Ordinary shares of H.L.L. of NIS 0.01 par value each. By the last day of use of rights, which occurred on October 29, 2008, rights to acquire 2,459,992 Ordinary shares, as above, have been used.

The Company did not use its right in this issuance and, accordingly, its stake in H.L.L. dropped to 7.29%.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9:- AVAILABLE-FOR-SALE FINANCIAL ASSETS (Cont.)

b. Xenia:

Xenia Venture Capital Ltd. ("Xenia") was incorporated to operate an industrial research and development center under the conditions of technological incubator in Kiryat Gat. The company is traded on the Tel Aviv Stock Exchange.

On May 25, 2008, Xenia published a shelf offer to issue by way of rights issue to the shareholders of Xenia. The Company participated in this raising in consideration of 1,130,143 shares and 645,796 options (series 2). The Company invested in Xenia NIS 3,300 thousand. The Company owns a total of 1,373,343 Ordinary shares representing 8.06% of the share capital of Xenia and, indirectly, the Company owns 15.62% of the share capital of Xenia.

c. Investment in Cvidya Networks Inc.:

A subsidiary invested NIS 1,361 thousand in the share capital of Cvidya Networks Inc. ("Cvidya"). As of the balance sheet date, the subsidiary's stake (after dilution) constitutes 2.14% of the share capital of Cvidya. The value of the investment is determined on the basis of the last financing round that the company effected.

d. Investment in Spark Enterprise:

The Company invested NIS 641 thousand in consideration of 1.5% interest in Spark Enterprise Venture Capital Fund. Until 2007, an amount of NIS 306 thousand of the investment was written down. In 2008 and 2007, the Company recorded an impairment loss of the investment of NIS 100 thousand in each year. As of the balance sheet date, the carrying amount of the investment is NIS 135 thousand.

e. Investment in MindCite:

During 2007, a subsidiary provided a loan convertible into shares and in dollars equivalent to NIS 395 thousand to MindCite. The Group owns 16% of the share capital of MindCite. The Group is not entitled to nominate directors in MindCite and, accordingly, the investment is presented at fair value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10:- FIXED ASSETS

a. Composition and movement:

2007:

	Machinery, computers and equipment	Office furniture and equipment	Motor vehicles	Leasehold improvements	Total
	NIS in thousands				
Cost:					
Balance at January 1, 2007	31,655	3,478	48,821	11,433	95,387
Additions during the year	2,865	424	2,256	919	6,464
Adjustments arising from translating the financial statements of foreign operations	(682)	(51)	(136)	-	(869)
Disposals during the year	(2,449)	(36)	(13,750)	(3,478)	(19,713)
Balance at December 31, 2007	<u>31,389</u>	<u>3,815</u>	<u>37,191</u>	<u>8,874</u>	<u>81,269</u>
Accumulated depreciation:					
Balance at January 1, 2007	21,235	360	26,205	4,698	52,498
Additions during the year	3,151	292	4,927	624	8,994
Adjustments arising from translating the financial statements of foreign operations	(190)	(16)	(51)	(2)	(259)
Disposals during the year	(1,764)	(16)	(9,311)	(1,807)	(12,898)
Balance at December 31, 2007	<u>22,432</u>	<u>620</u>	<u>21,770</u>	<u>3,513</u>	<u>48,335</u>
Depreciated cost at December 31, 2007	8,957	3,195	15,421	5,361	32,934
Less - provision for impairment	(276)	-	-	-	(276)
Balance of depreciated cost at December 31, 2007	<u><u>8,681</u></u>	<u><u>3,195</u></u>	<u><u>15,421</u></u>	<u><u>5,361</u></u>	<u><u>32,658</u></u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10:- FIXED ASSETS (Cont.)

2008:

	Machinery, computers and equipment	Office furniture and equipment	Motor vehicles	Leasehold improvements	Total
	NIS in thousands				
Cost:					
Balance at January 1, 2008	31,389	3,815	37,191	8,874	81,269
Additions during the year	5,058	514	7,264	246	13,082
Adjustments arising from translating the financial statements of foreign operations	(9,655)	(770)	(1,853)	(902)	(13,180)
Disposals during the year	(87)	-	(4,629)	-	(4,716)
Balance at December 31, 2008	<u>26,705</u>	<u>3,559</u>	<u>37,973</u>	<u>8,218</u>	<u>76,455</u>
Accumulated depreciation:					
Balance at January 1, 2008	22,432	620	21,770	3,513	48,335
Additions during the year	3,587	322	4,843	639	9,391
Adjustments arising from translating the financial statements of foreign operations	(10,092)	(345)	(1,108)	(470)	(12,015)
Disposals during the year	(65)	-	(3,692)	-	(3,757)
Balance at December 31, 2008	<u>15,862</u>	<u>597</u>	<u>21,813</u>	<u>3,682</u>	<u>41,954</u>
Depreciated cost at December 31, 2008	10,843	2,962	16,160	4,536	34,501
Less - provision for impairment	(276)	-	-	-	(276)
Balance of depreciated cost at December 31, 2008	<u><u>10,567</u></u>	<u><u>2,962</u></u>	<u><u>16,160</u></u>	<u><u>4,536</u></u>	<u><u>34,225</u></u>

b. As for charges, see Note 20.

NOTE 11:- SHORT-TERM CREDIT FROM BANKS AND OTHERS

	December 31,	
	2007	2008
	NIS in thousands	
Overdrafts and short-term loans (1) (2)	80,391	110,105
Current maturities of long-term loans (2)	5,600	7,728
Current maturities of long-term debentures (3)	17,416	17,201
	<u><u>103,407</u></u>	<u><u>135,034</u></u>

(1) The majority of the balances are unlinked and, in average, bear interest at the Prime rate plus 0.1% (at the balance sheet date - 5.85%).

(2) As for collaterals, see Note 20 and as for financial covenants, see Note 14d.

(3) As for financial covenants, see Note 14c.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**NOTE 12:- TRADE PAYABLES**

	December 31,	
	2007	2008
	NIS in thousands	
Open accounts	51,818	51,334
Notes payable	5,681	3,229
	<u>57,499</u>	<u>54,563</u>

Trade payables are non-interest bearing and are normally settled on current plus 60-day terms.

Accrued income are settled quarterly throughout the year.

NOTE 13:- OTHER ACCOUNTS PAYABLE

	December 31,	
	2007	2008
	NIS in thousands	
Employees and related accruals	12,029	16,736
Interested parties	159	-
Accrued expenses	5,768	11,475
Customer advances	3,095	2,533
Government authorities	12,023	15,759
Liability to other related companies (1)	78	-
Other payables	6,034	4,000
	<u>39,186</u>	<u>50,503</u>

(1) Commercial balances, interest and linkage free.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14:- LONG-TERM LIABILITIES

a. Composition:

December 31, 2007:

	Principal amount	Nominal interest rate	Effective interest rate	Balance	Balance less current maturities
	NIS in thousands	%	%	NIS in thousands	
Loans from banks	5,902	6.75	6.75	5,902	5,902
Debentures	63,090	4.15	4.19	63,090	45,674
Leasehold improvements obligations	2,021	6.06	6.06	2,021	1,785
Finance lease obligation	11,888	5.00	5.38	11,888	6,524
Stock options	-			20	20
Total	82,901			82,921	59,905

December 31, 2008:

	Principal amount	Nominal interest rate	Effective interest rate	Balance	Balance less current maturities
	NIS in thousands	%	%	NIS in thousands	
Loans from banks	2,464	5.00	5.00	2,464	-
Debentures	47,838	4.15	4.19	42,441	25,240
Leasehold improvements obligations	1,947	6.06	6.06	1,947	1,638
Finance lease obligation	12,330	4.50	4.61	12,330	7,375
Total	64,579			59,182	34,253

b. The repayment dates after the balance sheet date as of December 31, 2008:

	First year	Second year	Third year	Fourth year	Fifth year	Sixth year and thereafter	Total
	NIS in thousands						
Debentures	19,696	18,948	9,194	-	-	-	47,838
Loans from banks	2,464	-	-	-	-	-	2,464
Leasehold improvements obligations	309	309	309	309	309	402	1,947
Finance lease obligation	4,955	3,496	1,863	1,557	459	-	12,330
	27,424	22,753	11,366	1,866	768	402	64,579

c. On May 10, 2005, the Company's Board resolved to approve a capital raising by issuance to institutional investors, as follows:

A series of NIS 79.4 million par value of non-marketable debentures (series C) of NIS 1 par value each at the price of NIS 1 per debenture. The debentures (series C) are redeemable in nine equal semi-annual payments from May 30, 2007 to May 30, 2011, bear annual interest at the rate of 4.15% and are linked (principal and interest) to the Israeli CPI published for March 2005 which is payable semi-annually on the unpaid balance of the debentures. Interest was first paid on November 30, 2005. The outstanding par value of debentures (series C) is NIS 40,777.

As for the allocation of stock options (series 3), see Note 19d.

NOTE 14:- LONG-TERM LIABILITIES (Cont.)

The net issuance proceeds which were attributed to the debentures amounted to approximately NIS 70.6 million, net of issuance expenses in the amount of approximately NIS 0.7 million. The issuance expenses of the debentures were recorded as deferred charges, presented as a deduction of the balance of the debentures and are amortized over the term of the debentures in proportion to the outstanding debentures.

Midroog Ltd. rated the debentures at the date of their issuance (A3) and as of the balance sheet date, the debentures are rated Baa1 with stable rating outlook.

The Company has undertaken that its overall net financial debt will not exceed NIS 185 million, linked to the Israeli CPI published for April 2005 (as of December 31, 2008 - NIS 205 million). However, the Company may increase its net financial debt above said sum provided that its rating does not fall below Baa1. If the Company's rating declines below Baa1, it will be considered as a cause entitling to demand the immediate redemption of the debentures unless it is accepted otherwise by a ordinary majority of the holders of debentures in a meeting convened for that purpose that in this case the debentures are not to be paid immediately. For this purpose, the overall net financial debt is defined as liabilities in respect of debentures, short and long-term liabilities to banks, including liabilities in respect of leasing net of cash and cash equivalents, short-term deposits and marketable securities. As of the balance sheet date, the Company is meeting this covenant.

The debentures are available for immediate redemption upon the occurrence of events as stipulated in the deed of trust among which are decline in the Company's rating below Baa2, non-compliance with liabilities in respect of the overall net financial debt, under the terms stipulated above, non-payment of amounts, liquidation, receivership etc. and in the event that the number of shares held by the controlling shareholders, jointly or severally, drops below 30% of the voting rights in the Company.

On November 19, 2008, the Company made an early redemption of NIS 4,000 thousand par value of debentures in consideration of NIS 3,824 thousand. As a result of the early redemption, the Company recognized a gain from early redemption of approximately NIS 589 thousand.

After the balance sheet, the Company made an early redemption of NIS 3,500 thousand par value of debentures in consideration of NIS 2,991 thousand. As a result of the early redemption, the Company will recognized a gain from early redemption of approximately NIS 500 thousand.

d. Financial covenants in connection with loans from banks:

The Company has undertaken to maintain financial covenants towards banks that give borrowings to the Company. According to this undertaking, the amount of equity will not be less than NIS 120,000 thousand. Further, the Company has undertaken towards the banks that the equity will not drop below 29% of total balance sheet and that the operating income will be positive, the ratio between the financial debts and liabilities of the Company less 30% of the Company's holding in H.L.L. net (less cash) at market value plus customer advances and the EBITDA shall not exceed at any time 3.7, and that the ratio between the total financial debts and liabilities of the Company plus bank guarantees from all banks net (less cash) and equity shall not exceed at any time 2.

As of the balance sheet date, the Company is meeting the above financial covenants.

e. As for the linkage terms and interest relating to long-term liabilities, see Note 14a.

NOTE 15:- FINANCIAL INSTRUMENTS

a. Financial risk factors:

The Group's activities expose it to various financial risks such as market risk (including currency risk and fair value risk in respect of interest rate), credit risk and cash flow risk in respect of interest rate.

Risk management is carried out the Group's chief financial officer according to the policy that was approved by the Board. The Board determines the specific policy in respect of exposures to risks such as exchange rate risk, interest rate risk, credit risk and investments of liquidity surplus.

1. Exchange rate risk:

The Group operates in a large number of countries and is exposed to foreign exchange risk resulting from the exposure to different currencies, mainly the Mexican Peso and the U.S. dollar.

Foreign exchange risk arises from forward commercial transactions, recognized assets and liabilities denominated in a different currency from the Group's measurement currency and net investments in foreign operations.

The Company examines from time to time the use of derivatives to reduce the exposures.

2. Credit risk:

Credit risk reflects the risk that may arise if a counterparty will not meet its obligations to the Company under a financial instrument (mainly trade receivables and receivables).

3. Interest rate risk:

The Group's interest rate risk mainly derives from credit and loans from banks and debentures. The liabilities that bear variable interest rates expose the Group to interest rate risk in respect of cash flows and those bearing fixed interest rates expose the Group to interest rate risk in respect of fair value.

4. Cash flow risk in respect of interest rate:

The Group is exposed to risk in respect of changes in the market interest deriving from short-term loans bearing variable interest. The Group's policy is to manage the financial costs relating to interest while using a mixture between variable interest and fixed interest for the Group's long-term loans.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15:- FINANCIAL INSTRUMENTS (Cont.)

b. Linkage terms of monetary items:

	December 31, 2007					December 31, 2008				
	In or linked to foreign currency (1)	Linked to the Israeli CPI	In Mexican Peso	Unlinked	Total	In or linked to foreign currency (1)	Linked to the Israeli CPI	In Mexican Peso	Unlinked	Total
	NIS in thousands									
Assets:										
Cash and cash equivalents	33,650	-	11,131	4,082	48,863	35,772	-	5,126	621	41,519
Short-term investments	-	-	-	10,771	10,771	-	-	-	740	740
Trade receivables	47,944	9,046	69,688	66,231	192,909	88,602	11,283	34,590	88,217	222,692
Other accounts receivable (2)	5,401	5,178	1,078	4,895	16,552	10,243	8,732	2,480	4,851	26,306
Long-term loans to associates (4)	2,890	-	-	-	2,890	441	4,263	-	-	4,704
	<u>89,885</u>	<u>14,224</u>	<u>81,897</u>	<u>85,979</u>	<u>271,985</u>	<u>135,058</u>	<u>24,278</u>	<u>42,196</u>	<u>94,429</u>	<u>295,961</u>
Liabilities:										
Short-term credit from banks and others	832	-	-	79,559	80,391	-	-	-	110,105	110,105
Trade payables	14,701	-	3,989	38,809	57,499	11,682	-	2,532	40,349	54,563
Other accounts payable (3)	12,838	1,052	3,789	14,560	32,239	19,363	-	4,463	21,787	45,613
Long-term liabilities (4)	-	76,999	-	5,902	82,901	206	56,512	-	7,321	64,039
	<u>28,371</u>	<u>78,051</u>	<u>7,778</u>	<u>138,830</u>	<u>253,030</u>	<u>31,251</u>	<u>56,512</u>	<u>6,995</u>	<u>179,562</u>	<u>274,320</u>

- (1) Mainly in or linked to the U.S. dollar.
- (2) Other accounts receivable are presented less advances to suppliers and prepaid expenses.
- (3) Other accounts payable are presented less advances from customers and deferred revenues.
- (4) Includes current maturities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15:- FINANCIAL INSTRUMENTS (Cont.)

- c. Positions in derivatives:

	U.S. dollar/NIS			
	Par value		Fair value	
	Less than one year		Less than one year	
	Long	Short	Long	Short
NIS in thousands				
Derivatives designated as hedging instruments - do not qualify for hedge accounting:				
Call option	16,400	-	(153)	-
Put option	-	22,405	-	470

- d. Credit risk:

Concentrations of credit risk:

Credit risk is the risk that a counterparty will not meet its obligations under a financial instrument leading to a financial loss. Concentration of credit risks may arise from the exposure of holding several financial instruments with a single entity (single concentration) or from transactions with several groups of debtors with similar economic characteristics whose ability to discharge their obligations will be similarly affected by changes in economic or other conditions (group risk). Factors that have the potential of creating concentrations of risks consist of the nature of the debtors' activities, such as their business sector, the geographical area of their business and the financial strength of groups of borrowers.

1. As of the balance sheet date, the balance of trade receivables and debts of several customers in the countries in which the Company operates in respect of which there are concentrations of credit risks as follows:

	December 31,	
	2007	2008
NIS in thousands		
Customers in Israel and other	107,466	119,144
Allowance for doubtful accounts	(16,357)	(13,736)
Customers in Israel and other, net	91,109	105,408
Customers in Central and South America	88,125	78,554
Allowance for doubtful accounts	(356)	(559)
Customers in Central and South America, net	87,769	77,995
Customers in Africa	14,031	39,289

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15:- FINANCIAL INSTRUMENTS (Cont.)

Sales to these customers totaled as follows:

	Year ended December 31,	
	2007	2008
	NIS in thousands	
Israel and other	201,906	254,363
Average day terms	163	128
Central and South America	144,593	243,897
Average day terms	258	128
Africa	62,211	113,027
Average day terms	51	105

The Company sells to its customers under payment conditions comprising an advance and the balance at 15-90-day term from the date the customer approves the issuance of the invoice. The Company regularly monitors the credit extended to its customers and their general financial condition but does not require collateral as security for these receivables. The Company provides an allowance for doubtful accounts based on the factors that affect the credit risk of certain customers, past experience and other information. The Company insures with credit insurance part of its customers based on the factors that affect the credit risk of the customers, past experience and other information.

2. The Company maintains cash and cash equivalents, short-term and long-term investments and other financial instruments in various financial institutions. These financial institutions are located in different geographical areas around the world. The Company's policy is to diversify its investments among the various institutions. According to the Company's policy, the relative credit stability of the various financial institutions is evaluated on a regular basis.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15:- FINANCIAL INSTRUMENTS (Cont.)

e. Fair value:

The following table demonstrates the carrying amount and fair value of the groups of financial instruments that are presented in the financial statements not at fair value:

	<u>Carrying amount</u>		<u>Fair value</u>	
	<u>December 31,</u>		<u>December 31,</u>	
	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>
	<u>NIS in thousands</u>			
Financial assets:				
Investment in quoted shares (1)	<u>23,524</u>	<u>-</u>	<u>82,725</u>	<u>-</u>
Financial liabilities:				
Long-term loan with fixed interest (2)	13,917	12,330	13,947	12,305
Other loans with variable interest (3)	4,782	2,464	4,782	2,464
Debentures	<u>63,090</u>	<u>42,441</u>	<u>65,075</u>	<u>34,559</u>
	<u>81,789</u>	<u>57,235</u>	<u>83,804</u>	<u>49,328</u>
Total	<u>(58,265)</u>	<u>57,235</u>	<u>1,079</u>	<u>(49,559)</u>

- (1) The fair value is based on price quotations in an active market at the balance sheet date.
- (2) The fair value of long-term loan given with fixed interest is based on the computation of the present value of cash flows using interest rate currently available for loan with similar terms.
- (3) The carrying amount approximates fair value.

The carrying amount of cash and cash equivalents, short-term investments, trade receivables, other accounts receivable, investment in marketable securities, loans to associates, long-term loans granted, credit from banks and others, trade payables and other accounts payable approximate their fair value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15:- FINANCIAL INSTRUMENTS (Cont.)

f. Concentration of liquidity risk:

The table below presents the maturity profile of the Group's financial liabilities based on contractual undiscounted payments:

December 31, 2007:

	<u>On demand</u>	<u>Less than 3 months</u>	<u>3 to 12 months</u>	<u>1 to 2 years</u>	<u>2 to 3 years</u>	<u>3 to 4 years</u>	<u>4 to 5 years</u>	<u>> 5 years</u>	<u>Total</u>
NIS in thousands									
Loans from banks	80,392	566	1,749	2,466	-	-	-	-	85,173
Debentures	-	-	18,774	18,774	18,774	9,385	-	-	65,707
Trade payables	18,166	39,333	-	-	-	-	-	-	57,499
Payables	8,532	-	23,707	-	-	-	-	-	32,239
Leasehold improvements obligations	-	60	184	259	274	291	309	644	2,021
Finance lease obligations	-	1,339	4,024	4,268	1,824	422	271	-	12,148
	<u>107,090</u>	<u>41,298</u>	<u>48,438</u>	<u>25,767</u>	<u>20,872</u>	<u>10,098</u>	<u>580</u>	<u>644</u>	<u>254,787</u>

December 31, 2008:

	<u>On demand</u>	<u>Less than 3 months</u>	<u>3 to 12 months</u>	<u>1 to 2 years</u>	<u>2 to 3 years</u>	<u>3 to 4 years</u>	<u>4 to 5 years</u>	<u>> 5 years</u>	<u>Total</u>
NIS in thousands									
Loans from banks	110,105	616	1,848	-	-	-	-	-	112,569
Debentures	-	-	19,696	18,948	9,194	-	-	-	47,838
Trade payables	17,884	36,679	-	-	-	-	-	-	54,563
Payables	10,493	23,685	16,325	-	-	-	-	-	50,503
Leasehold improvements obligations	-	77	232	309	309	309	309	402	1,947
Finance lease obligations	-	1,272	3,683	3,496	1,863	1,557	459	-	12,330
	<u>138,482</u>	<u>62,329</u>	<u>41,784</u>	<u>22,753</u>	<u>11,366</u>	<u>1,866</u>	<u>768</u>	<u>402</u>	<u>279,750</u>

g. Sensitivity tests relating to changes in market factors:

December 31, 2008:

<u>Instrument</u>	<u>Sensitivity test to changes in interest rates</u>	
	<u>Gain (loss) from the change</u>	
	<u>Increase of 2% in interest</u>	<u>Decrease of 2% in interest</u>
	<u>NIS in thousands</u>	
Short-term deposits and loans	(2,202)	2,202
Loans from banks	(49)	49
Total	<u>(2,251)</u>	<u>2,251</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15:- FINANCIAL INSTRUMENTS (Cont.)

Instrument	Sensitivity test to changes in the U.S. \$ exchange rate	
	Gain (loss) from the change	Gain (loss) from the change
	Increase of 12% in U.S. \$ rate	Decrease of 12% in U.S. \$ rate
	NIS in thousands	
Trade and other receivables, short-term loans and deposits	7,172	(7,172)
Cash	3,405	(3,405)
Trade and other payables and current liabilities	(1,572)	1,572
Transactions on options	(1,111)	2,357
Total	7,894	(6,648)

Instrument	Sensitivity test to changes in the Mexican Peso exchange rate	
	Gain (loss) from the change	Gain (loss) from the change
	Increase of 30%	Decrease of 30%
	NIS in thousands	
Trade and other receivables, short-term loans and deposits	11,121	(11,121)
Cash	1,538	(1,538)
Trade and other payables and current liabilities	(2,099)	2,099
Total	10,560	(10,560)

Instrument	Sensitivity test to changes in the Israeli CPI	
	Gain (loss) from the change	Gain (loss) from the change
	Increase of 3% in CPI	Decrease of 3% in CPI
	NIS in thousands	
Debentures	(1,312)	1,312
Other liabilities	(502)	502
Total	(1,814)	1,814

Instrument	Sensitivity test to changes in the market price of listed securities	
	Change in equity	Change in equity
	Increase of 20% in market factor	Decrease of 20% in market factor
	NIS in thousands	
Investment in shares in the category available-for-sale instruments	8,777	(8,777)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15:- FINANCIAL INSTRUMENTS (Cont.)*Sensitivity tests and principal work assumptions:*

The selected changes in the relevant risk variables were determined based on management's estimate as to reasonable possible changes in these risk variables.

The Company has performed sensitivity tests of principal market risk factors that are liable to affect its reported operating results or financial position. The sensitivity tests present the profit or loss and/or change in equity (before tax) in respect of each financial instrument for the relevant risk variable chosen for that instrument as of each reporting date. The test of risk factors was determined based on the materiality of the exposure of the operating results or financial condition of each risk with reference to the operating currency and assuming that all the other variables are constant.

The sensitivity test for long-term loans with variable interest was only performed on the variable component of interest.

The sensitivity tests for listed investments with quoted market price (bid price) were performed on possible changes in these market prices.

h. Management of the capital in the Company:

The Company's capital management objectives are:

To preserve the Group's ability to ensure business continuity thereby creating a return for the shareholders, investors and other interested parties and to maintain a strong credit rating and healthy capital ratios in order to support business activity and maximize shareholders value.

In connection with loans from banks (see also Note 14a), the Company is required to meet financial covenants, including: the amount of equity will not be less than NIS 120,000 thousand. Further, the Company has undertaken towards the banks that the equity will not drop below 29% of total balance sheet and that the operating income will be positive, the ratio between the financial debts and liabilities of the Company less 30% of the Company's holding in H.L.L. net (less cash) at market value plus customer advances and the EBITDA shall not exceed at any time 3.7, and that the ratio between the total financial debts and liabilities of the Company plus bank guarantees from all banks net (less cash) and equity shall not exceed at any time 2.

NOTE 16:- EMPLOYEE BENEFIT ASSETS AND LIABILITIES

- a. According to the labor laws and Severance Pay Law in Israel, the Company is required to pay compensation to an employee upon dismissal or retirement. The computation of the Company's employee benefit liability is made in accordance with a valid employment contract based on the employee's salary and employment term which, in management's opinion, establish the entitlement to receive the compensation.
- b. The Group accounts for that part of the payment of compensation that is not covered by contributions, as above, as a defined benefit plan for which an employee benefit liability is recognized.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 16:- EMPLOYEE BENEFIT ASSETS AND LIABILITIES (Cont.)

Information about defined benefit plans:

1. Expenses in respect of employee benefits, net:

	Year ended December 31,	
	2007	2008
	NIS in thousands	
Current service cost	3,339	3,994
Interest cost on benefit obligation	1,336	1,611
Expected return on plan assets	(943)	(2,056)
Net actuarial loss (gain) recognized in the year	(1,799)	2,366
Total employee benefit expenses	<u>1,933</u>	<u>5,915</u>

The expenses are presented in the statement of income as follows:

Cost of sales	982	3,930
Research and development costs, net	43	99
Selling and marketing expenses	686	1,233
General and administrative expenses	222	653
	<u>1,933</u>	<u>5,915</u>

2. The plan assets, net:

	December 31,	
	2007	2008
	NIS in thousands	
Defined benefit obligation	28,984	33,207
Fair value of plan assets	<u>33,849</u>	<u>35,176</u>
Total assets, net	<u>4,865</u>	<u>1,969</u>

3. Changes in the present value of defined benefit obligation:

	2007	2008
	NIS in thousands	
Balance at January 1,	26,820	28,984
Interest cost	1,336	1,611
Current service cost	3,339	3,994
Benefits paid	(3,714)	(2,398)
Net actuarial loss	1,203	1,016
Balance at December 31,	<u>28,984</u>	<u>33,207</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 16:- EMPLOYEE BENEFIT ASSETS AND LIABILITIES (Cont.)

4. Plan assets:

a) Plan assets comprise assets held by a long-term employee benefit fund and qualifying insurance policies.

b) The movement in the fair value of the plan assets:

	<u>2007</u>	<u>2008</u>
	<u>NIS in thousands</u>	
Balance at January 1,	29,849	33,849
Expected return	943	2,056
Contributions by employer	3,217	3,886
Benefits paid	(3,162)	(3,265)
Net actuarial gain (loss)	<u>3,002</u>	<u>(1,350)</u>
Balance at December 31,	<u>33,849</u>	<u>35,176</u>

5. The principal assumptions used in determining the obligation for the defined benefit plan:

	<u>2007</u>	<u>2008</u>
Discount rate	<u>5.8</u>	<u>5-5.3</u>
Expected rate of return on plan assets	<u>2.6-5.8</u>	<u>1.9-5.3</u>
Future salary increases	<u>5</u>	<u>4.5</u>

6. The amounts for the current and previous years:

	<u>Year ended December 31,</u>	
	<u>2007</u>	<u>2008</u>
	<u>NIS in thousands</u>	
Present value of defined benefit obligation	<u>28,984</u>	<u>33,207</u>
Fair value of plan assets	<u>33,849</u>	<u>35,176</u>
Surplus in the plan	<u>4,865</u>	<u>1,969</u>

NOTE 17:- TAXES ON INCOME

a. Tax laws applicable to the Group companies:

1. Companies in Israel:

Companies in Israel are taxed pursuant to the Income Tax Ordinance (New Version), 1961. Until the end of 2007, the results for tax purposes were also measured pursuant to the Income Tax (Inflationary Adjustments) Law, 1985.

In February 2008, the "Knesset" (Israeli parliament) passed an amendment to the Income Tax (Inflationary Adjustments) Law, 1985, which limits the scope of the law starting 2008 and thereafter. Starting 2008, the results for tax purposes are measured in nominal values, excluding certain adjustments for changes in the Israeli CPI carried out in the period up to December 31, 2007. The amendment to the law includes, inter alia, the elimination of the inflationary additions and deductions and the additional deduction for depreciation starting 2008.

The Law for the Encouragement of Capital Investments, 1959 ("the Law"):

According to the Law, the companies are entitled to various tax benefits by virtue of the "approved enterprise" or "beneficiary enterprise" status granted to part of their enterprises, as implied by this Law.

In March 2005, the Israeli Parliament passed the Arrangements Law for fiscal year 2005, which includes a broad and comprehensive amendment to the provisions of the above Law ("Amendment No. 60 to the Law").

During 1999, an expansion program was filed under the alternative track of benefits and the investment was made during 1999 and 2000. The Company assigned the above program to Regard Ltd., a subsidiary which was incorporated in 2002. The above expansion program was not yet operated since Regard Ltd. has losses for tax purposes.

Further, during 2003, an additional expansion program under the alternative track of benefits was approved. In 2004, the Company was approved an additional expansion program under the alternative track of benefits which was not yet completed. The Company's expansion program from 2003 was operated in 2004.

Following the change in the structure of Systems in 2006, the Company intends to assign the programs to Mer Security and Communication Systems Ltd.

Further, in 2005, a subsidiary, Mer Metal Works Ltd., was established, which made and operated investments in development region A and which claims in respect of such investments benefits under the alternative track pursuant to Amendment No. 60 to the Law, based on the Company's position that the "approved program" satisfies the criteria of a "beneficiary enterprise" under the Law. An additional condition for receiving the benefits under the alternative track is for the enterprise to be a "competitive enterprise". Another condition for receiving the benefits under the alternative track is a minimum qualifying investment. This condition requires an investment in the acquisition of productive assets such as machinery and equipment which must be carried out within three years. The minimum qualifying investment required for setting up a plant is NIS 300 thousand.

NOTE 17:- TAXES ON INCOME (Cont.)

The principal benefits are:

a) Reduced tax rates:

Taxable income derived from the approved enterprises is tax exempt during the first two years and subject to a reduced tax rate of 25% during the five years beginning from the first year in which taxable income is earned, limited to 12 years from the year that the enterprise began operations, or 14 years from the year in which the approval was granted, whichever is earlier. Dividends paid from the profits of an approved enterprise are subject to tax at the rate of 15% in the hands of their recipient.

Taxable income derived from the beneficiary enterprise is tax exempt during a period of ten years from the year of election or the first year in which the Company has taxable income, provided that 14 years have not elapsed from the beginning of the year of election as to companies in development region A.

If dividends are distributed out of tax exempt profits, as above, the companies will then become liable for tax at the rate applicable to its profits from the approved enterprise or from beneficiary enterprise in the year in which the income was earned, as if was not in the tax exempt period. The companies' policy is not to distribute dividends out of these profits.

b) Accelerated depreciation:

The companies are eligible for accelerated depreciation on machinery, computers and equipment included in an approved enterprise during the first five years effective with year of operation of each asset.

c) Conditions for the entitlement to the benefits:

The above benefits are conditional upon the fulfillment of the conditions stipulated by the law, regulations published thereunder and the letters of approval for the specific investments in the approved enterprises. In the event of failure to comply with these conditions, the benefits may be canceled and the Company may be required to refund the amount of the benefits, in whole or in part, including interest. The managements believe that the companies are meeting the aforementioned conditions.

The Law for the Encouragement of Industry (Taxation), 1969:

Certain companies have "industrial company" status as defined by this law. From 1998 to 2005, the Company filed a consolidated report for tax purposes with its subsidiary, Mer and Co. (1982) Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17:- TAXES ON INCOME (Cont.)

Capital gains/losses:

Pursuant to the provisions of the Law for Amendment of the Income Tax Ordinance (No. 132), 2003 ("the reform law"), tax at a reduced rate of 25% will apply on capital gains accrued after January 1, 2003, instead of the regular tax rate. In case of the sale of properties purchased before the adoption of the reform law, the reduced tax rate will apply only to the portion of the profit which accrued after the adoption of the law, as computed according to the law. Further, the reform law states that capital losses carried forward for tax purposes may be offset against capital gains indefinitely. The reform law also provides for the possibility to offset capital losses from sales of properties outside Israel against capital gains in Israel.

2. Foreign subsidiaries:

Subsidiaries which were incorporated outside Israel are taxed according to the tax laws in their countries of residence.

b. Tax rates applicable to the income of the Group companies:

1. Companies in Israel:

In June 2004, an amendment to the Income Tax Ordinance (No. 140 and Temporary Provision), 2004 was passed by the "Knesset" (Israeli parliament) and on July 25, 2005, another law was passed, the amendment to the Income Tax Ordinance (No. 147) 2005, according to which the corporate tax rate is to be progressively reduced to the following tax rates: 2007 - 29%, 2008 - 27%, 2009 - 26%, 2010 and thereafter - 25%.

2. Foreign subsidiaries:

The principal tax rates applicable to the subsidiaries whose place of incorporation is outside Israel are between 17% and 34%.

Israel, Mexico, Netherlands and the U.S. have treaties for the avoidance of double taxation.

c. Tax assessments:

Final tax assessments:

The subsidiary, Infracomex S.A. de CV, received final tax assessments through 2007.

Most of the subsidiaries have received final tax assessments or assessments that are deemed final through 2004.

d. Losses carried forward for tax purposes:

Carryforward business losses of the subsidiaries total approximately NIS 88.8 million as of the balance sheet date. Deferred tax assets of approximately NIS 3.8 million relating to said losses were recorded in the financial statements.

Deferred tax asset relating to carryforward business losses of approximately NIS 73.6 million was not recorded due to the uncertainty of its utilization in the foreseeable future.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17:- TAXES ON INCOME (Cont.)

e. Deferred taxes:

Composition:

	<u>Balance sheet</u>		<u>Statement of income</u>	
	<u>December 31,</u>		<u>Year ended</u>	
	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>
	NIS in thousands			
Deferred tax liabilities:				
Measurement of available-for-sale investments at fair value *)	405	9,161	-	-
Timing differences on deduction of expenses and income **)	19,083	14,845	(12,305)	(1,403)
	<u>19,488</u>	<u>24,006</u>		
Deferred tax assets:				
Carryforward tax losses	1,993	3,824	235	(1,831)
Allowance for doubtful accounts	762	509	209	253
Employee benefits	627	881	405	(254)
Timing differences on deduction of expenses and income	6,526	8,882	-	(2,356)
	<u>9,908</u>	<u>14,096</u>		
Deferred tax income (expenses)			<u>(11,456)</u>	<u>(5,591)</u>
Deferred tax liabilities, net	<u>9,580</u>	<u>9,910</u>		

*) The change is carried to equity.

**) Part of the change is carried to equity.

The deferred taxes are reflected in the balance sheet as follows:

	<u>December 31,</u>	
	<u>2007</u>	<u>2008</u>
	NIS in thousands	
Non-current assets	7,560	7,053
Long-term liabilities	<u>(17,140)</u>	<u>(16,963)</u>
	<u>(9,580)</u>	<u>(9,910)</u>

The deferred taxes are computed at the average tax rate of 26% (2007 - 27%), based on the tax rates that are expected to apply upon realization.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17:- TAXES ON INCOME (Cont.)

Deferred taxes related to items carried to equity:

The amount of deferred taxes carried to equity related to:

	December 31, 2008
	NIS in thousands
Gain from available-for-sale financial assets	8,756
Loss from currency translation reserve	(2,835)
	<u>5,921</u>

f. Theoretical tax:

A reconciliation between the tax expense, assuming that all the income and expenses, gains and losses in the statement of income were taxed at the statutory tax rate and the taxes on income recorded in the statement of income is as follows:

	Year ended December 31,	
	2007	2008
	NIS in thousands	
Income before taxes on income	<u>558</u>	<u>73,135</u>
Statutory tax rate	<u>29%</u>	<u>27%</u>
Tax (tax saving) computed at the statutory tax rate	162	19,746
Increase (decrease) in taxes on income resulting from the following factors:		
Tax benefit deriving from reduction in tax rate of an "approved enterprise"	(5,926)	(9,280)
Loss for which deferred tax was not provided	5,256	3,507
Add (tax saving) in respect of income liable to other tax rate in foreign companies	(686)	51
Non-deductible expenses (exempt income), net	870	(124)
Taxes in respect of previous years	1,731	66
Differences in measurement basis and other	<u>13</u>	<u>-</u>
Taxes on income	<u>1,420</u>	<u>13,966</u>
Effective tax rate	<u>254%</u>	<u>19%</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17:- TAXES ON INCOME (Cont.)

- g. Taxes on income included in the statements of income:

	Year ended December 31,	
	2007	2008
	NIS in thousands	
Current taxes	11,145	19,491
Deferred taxes (see also e above)	(11,456)	(5,591)
Taxes in respect of previous years	1,731	66
	1,420	13,966

NOTE 18:- CONTINGENT LIABILITIES AND COMMITMENTS

- a. Guarantees:

1. The Company provided an unlimited guarantee to Mer Services Group Ltd.

In addition, there is a mutual guarantee, unlimited in amount, between the Company and Mer and Co. (1982) Ltd. Subsidiaries provided guarantees in respect of various tenders in the amount of approximately NIS 3.4 million. Subsidiaries provided guarantees in respect of lease of buildings in the amount of NIS 2.8 million.

2. The Company and subsidiaries provided to customers guarantees relating to the quality, advance and performance in connection with projects in the amount of approximately NIS 76 million.
3. Subsidiaries provided guarantees to leasing companies in the amount of approximately NIS 11 million.

- b. Litigation:

During 2008, former employees of the Company filed claims for payment of salary differences and delay of pay aggregating approximately NIS 151 thousand. The Company's management believes, based on the opinion of its legal counsels, that it does not expect that the Company will be liable to pay any amount and, accordingly, no provision has been made in the financial statements.

- c. Commitment for royalty payment:

The Company is committed to pay royalties to the Government of Israel on sales proceeds from products in which the Government participated in the research by way of grants. The royalties are at the rate of 3.5% of the selling price of the products developed within the framework of the research, up to 100% to 150% of the amount of the grant received, linked to the U.S. dollar. The Government of Israel, through the Fund for the Encouragement of Marketing Activities, participates in marketing expenses overseas. In return, the Company shall pay royalties at the rate of 3% to 5% of the increase in the Company's export sales. At December 31, 2008, the Company has a remaining obligation in respect of the above grants of \$ 850 thousand that is depending on sales. In April 2002, upon the formation of Regard Ltd., the Company assigned these obligations to Regard Ltd. A provision for this obligation has not been made in the financial statements since the Company does not expect future sales.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 18:- CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)

d. Employment contracts with controlling shareholders:

1. The related parties, Mr. Haim Mer and Mr. Itshak Ben Basat are entitled to an annual bonus of 5.4% and 2%, respectively, of the annual pre-tax income on the basis of the consolidated financial statements of the Company provided that the income in these statements exceeds NIS 2,604 thousand. The total amount of the bonus for both shareholders should not exceed NIS 659 thousand per year, linked to the Israeli CPI of December 2003 (2008 - NIS 731 thousand). In 2008, the full amount of the bonus was paid and in 2007 - a bonus of NIS 220 thousand was paid.
2. It was also determined that in the event that the consolidated annual pre-tax income in the consolidated financial statements of the Company is below adjusted NIS 1 million in two consecutive years in terms of NIS of March 1992 (approximately NIS 2.2 million in terms of reported NIS), the related parties, Mr. Haim Mer and Mr. Itshak Ben Basat, will waive half of their salary in the second year.

e. Lease agreements:

The Group leases several industrial and office premises for various periods ending between December 31, 2008 and 2010. The expected rentals payable under these agreements are linked to the Israeli CPI.

The expected payments under these agreements are as follows:

	December 31, 2008
	NIS in thousands
2009	4,986
2010	2,619
2011	1,693
	<u>9,298</u>

f. Financial covenants undertakings:

1. See Note 14d.

As of the balance sheet date, the Company is meeting the above financial covenants.

2. As for the commitment to comply with the financial covenants towards the holders of debentures, see Note 14c.

g. Commitments:

1. Operating lease commitments:

The Group has entered into operating lease agreements on commercial vehicles. These leases have average life of between three and five years with no renewal option included in the contract. There are no restrictions placed upon a lessee by entering into this lease contract.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 18:- CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)

Future minimum rentals payable under non-cancellable operating lease contracts as of December 31, are as follows:

	<u>2008</u> <u>NIS in</u> <u>thousands</u>
2009	3,075
2010	3,073
2011	<u>1,614</u>
	<u><u>7,762</u></u>

2. Capitalized leasehold rights from the Israel Lands Administration:

The Company has capitalized leasehold rights from the Israel Lands Administration in Ashkelon on which a new plant for the production of communication towers of the wireless communication division will be built. The amount attributed to the capitalized rights is presented in the balance sheet as prepaid operating lease expenses and is amortized over the lease term, see also Note 2m. The lease term ends in 2056.

NOTE 19:- EQUITY

a. The nominal share capital is composed as follows:

	<u>December 31, 2007 and 2008</u>	
	<u>Authorized</u>	<u>Issued and</u>
	<u>Number of shares</u>	
Ordinary shares of NIS 1 par value each	<u>12,000,000</u>	<u>8,401,495</u>

The shares are traded on the Tel-Aviv Stock Exchange

b. Company's shares held by the Company:

The interests of the Company in its shares are as follows:

	<u>December 31,</u>	
	<u>2007</u>	<u>2008</u>
	<u>%</u>	
Shares:		
Percentage of issued capital (in %)	<u>3.23</u>	<u>4.00</u>
	<u>NIS in thousands</u>	
Cost	<u>7,401</u>	<u>8,192</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19:- EQUITY (Cont.)

- c. Allocation of securities to the Company's employees:

In October 2000, the Company's Board approved a stock option plan for the issuance of 670,000 stock options for the purchase of the Company's shares to the employees of the Company and corporations controlled by the Company, to executives, consultants and other service providers. On October 4, 2000, which was the first trading day which preceded the date of the approval, the closing market price for the Company's share was NIS 64.2.

In the context of the plan, 534,077 stock options were issued for the exercise increment of NIS 1 to NIS 48 per one stock option, of which 428,183 options were exercised into shares and 101,694 options expired since employees terminated their employment.

The remaining 4,200 options are available for immediate exercise at an exercise increment of NIS 1.

- d. Issuance of stock options exercisable into the Company's shares:

On May 10, 2005, the Company's Board resolved to approve a capital raising by issuance to institutional investors, as follows:

A series of 357,300 non-marketable stock options (series 3) that are exercisable into Ordinary shares of NIS 1 par value each on every trading day from the date of their issuance until May 30, 2009 (inclusive) except between the 12 to 16 of each month, in such a manner that each stock option (series 3) is exercisable into an Ordinary share of NIS 1 par value against the cash payment of an exercise increment of NIS 75, linked to the Israeli CPI published for March 2005, subject to adjustments.

If all of the stock options (series 3) are fully exercised then, subsequent to the allocation, the underlying shares allocated may constitute about 4.08% of the voting rights and the issued and outstanding share capital of the Company.

The net issuance proceeds which were attributed to the stock options totaled approximately NIS 8 million and the total future proceeds (gross) that the Company may receive as a result of the exercise of all of the stock options (series 3) are approximately NIS 26.8 million, linked to the Israeli CPI published for March 2005, subject to adjustments.

The attribution of the net issuance proceeds was calculated based on the Black & Scholes model taking into account the Company's share price on the stock exchange (on the date of issuance) and according to a weekly standard deviation of 5.8%.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19:- EQUITY (Cont.)

Issuance of options to employees:

- The expense recognized in the financial statements:

The expense recognized in the financial statements for services received from employees is shown in the following table:

	Year ended December 31, 2008
	NIS in thousands
Equity-settled share-based plans	<u>704</u>
Total expense recognized for share-based transactions	<u><u>704</u></u>

- In 2008, according to the 2008 option plan, 110,000 of the Company's options were granted to three officers in the Company and also an officer in the Company was granted options in a subsidiary. The exercise price for the Company's share options is NIS 17.6, representing the market price of the shares on the grant date of the options.

The options vest over a period of up to four years from the grant date.

The fair value of the options is estimated on the grant date using a binomial model taking into account the conditions and terms upon which the share options were granted.

The expected contractual life of the share options, if vested, is six years from the grant date.

- Movement during the year:

The following table lists the number of share options, the weighted average exercise prices of share options and modification in employee option plans during the current year:

	December 31, 2008	
	Number of options	Weighted average exercise price NIS
Share options outstanding at beginning of year	-	-
Share options granted during the year	<u>110,000</u>	<u>17.6</u>
Share options outstanding at end of year	<u><u>110,000</u></u>	<u><u>17.6</u></u>
Share options exercisable at end of year	<u><u>80,000</u></u>	<u><u>17.6</u></u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19:- EQUITY (Cont.)

4. The following are the inputs to the binomial model used for the fair value measurement of options granted in the parent company for the above plan:

Standard range of deviation at grant date is 31.94% - 44.75%.

Risk-free interest rate ranges between 4.486% in the first year and 6.73% in the sixth year.

Expected life of share options is 6 years.

Dividend is not expected and, therefore, the dividend yield for the share is 0%.

Based on the above inputs, the fair value of the options granted is determined at NIS 899 on the grant date.

The following are the inputs to the binomial model used for the fair value measurement of options granted in the subsidiary for the above plan:

Standard range of deviation at grant date is 38.71% - 41.89%.

Risk-free interest rate ranges between 4.41% in the first year and 5.97% in the sixth year.

Expected life of share options is 4 years.

Dividend is not expected and, therefore, the dividend yield for the share is 0%.

Based on the above inputs, the fair value of the options granted in the subsidiary is determined at NIS 160 on the grant date.

- e. Other capital reserves:

1. Composition - attributable to the equity holders of the Company:

	Capital reserve for available- for-sale financial assets	Currency translation adjustment reserve	Reserve for share-based payment transactions	Total
	NIS in thousands			
Balance at January 1, 2007	1,347	-	-	1,347
Gain on available-for-sale financial assets, net	675	-	-	675
Adjustments arising from translating the financial statements of foreign operations	-	(10,111)	-	(10,111)
Balance at December 31, 2007	2,022	(10,111)	-	(8,089)
Gain on available-for-sale financial assets, net	18,237	-	-	18,237
Adjustments arising from translating the financial statements of foreign operations	-	(15,547)	-	(15,547)
Share-based payment expense	-	-	704	704
Balance at December 31, 2008	<u>20,259</u>	<u>(25,658)</u>	<u>704</u>	<u>(4,695)</u>

2. Other capital reserves:

Capital reserve for available-for-sale financial assets:

The reserve reflects changes in the fair value (less the tax effect) of financial assets classified as available-for-sale.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19:- EQUITY (Cont.)

Currency translation adjustment reserve:

The reserve is used to record exchange differences arising from the translation of the financial statements of foreign investees which constitute foreign operations and exchange differences arising from the translation of financial statements from the functional currency to the presentation currency. This reserve is also used to record exchange differences on a loan to a subsidiary which constitutes, in substance, an equity investment (see also Note 2c1).

Reserve for share-based payment transactions:

The reserve reflects the cost of equity-settled transactions with employees.

f. Minority interests:

Composition of minority interests in the balance sheet:

	December 31,	
	2007	2008
	NIS in thousands	
Share in equity *)	4,746	4,682
Capital reserve from share-based payment transactions in subsidiaries	-	323
	<u>4,746</u>	<u>4,982</u>

*) Includes share in attributable excess of cost.

NOTE 20:- CHARGES

- a. The Company - a floating charge was placed on all of the Company's assets and properties including the respective rights and the respective insurance rights in favor of Bank Hapoalim Ltd., Bank Leumi of Israel Ltd. and the First International Bank of Israel Ltd. Similarly, a fixed charge was placed on the unpaid share capital of the Company and its goodwill, funds and insurance rights in favor of the First International Bank of Israel Ltd. and Bank Leumi of Israel Ltd. The above charges were placed as collateral for the Group's liabilities.
- b. Mer and Co. (1982) Ltd. - a fixed charge, unlimited in amount, was placed on vehicles and equipment and on insurance rights related to these vehicles in favor of banks and financial institutions. A floating charge, unlimited in amount, was placed on a deposit in favor of Bank Hapoalim Ltd., and on marketable securities in favor of Bank Leumi of Israel Ltd.
- c. Misgav Industrial Park Ltd. - a floating charge on all the machinery, equipment, tools, instruments, real estate properties and insurance rights related to the above pledged assets in favor of the State of Israel.
- d. Rotal.com Ltd. - a fixed charge on deposits in Bank Hapoalim Ltd. and a floating charge on all the securities, notes and other marketable documents. A floating charge, unlimited in amount, on all proceeds that the company is or will be entitled to receive from a customer in favor of a supplier. Also a fixed charge was placed on vehicles and on insurance rights related to these vehicles in favor of Bank Leumi of Israel Ltd. and Leumi Leasing Investments Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 20:- CHARGES (Cont.)

- e. TMCS Communication Ltd. - a senior floating charge on the Company's assets and properties and the insurance rights in favor of Bank Hapoalim Ltd. A charge was placed on all the amounts due to the Company from Tevel International Communication in Israel Ltd. in favor of Bank Hapoalim Ltd.

NOTE 21:- ADDITIONAL INFORMATION TO THE STATEMENTS OF INCOME

- a. Major customers as a percentage of total sales:

	Year ended December 31,	
	2007	2008
	%	
Customer A	15	13
Customer B	9	8
Customer C	6	11
Total major customers	<u>30</u>	<u>32</u>

The exposure to credit risk in respect of trade receivables is limited due to the large number and the diversity of the customers. The Company earns most of its revenues from performing projects.

- b. Cost of sales:

	Year ended December 31,	
	2007	2008
	NIS in thousands	
Materials consumed and subcontracted work	209,307	347,139
Wages, salaries and related benefits	72,501	79,344
Depreciation	5,717	5,686
Other manufacturing expenses	26,165	35,699
Increase in inventories of finished goods	<u>(10,025)</u>	<u>(26,737)</u>
	<u>303,665</u>	<u>451,131</u>

- c. Selling and marketing expenses, net:

Wages, salaries and related benefits	23,753	24,899
Foreign travel	2,734	3,471
Other	<u>14,865</u>	<u>21,019</u>
	<u>41,352</u>	<u>49,389</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 21:- ADDITIONAL INFORMATION TO THE STATEMENTS OF INCOME (Cont.)

d. General and administrative expenses, net:

	Year ended December 31,	
	2007	2008
	NIS in thousands	
Wages, salaries and related benefits	12,617	15,662
Office maintenance	8,057	8,617
Depreciation	3,442	2,684
Expenses relating to doubtful accounts and bad debts	1,071	490
Other	17,684	20,350
	<u>42,871</u>	<u>47,803</u>

e. Financial income:

Income from loan to associate	120	316
Interest-bearing borrowings from banks	300	701
Gain from marketable securities, net	-	414
Other financial income, net	2,302	5,751
	<u>2,722</u>	<u>7,182</u>

f. Financial expenses:

Financial expenses in respect of short-term credit	3,449	5,378
Financial expenses in respect of debentures	7,541	4,819
Financial expenses in respect of long-term loans	1,162	1,474
Loss from marketable securities, net	563	-
Derivative financial instruments	181	-
Impairment of available-for-sale assets	100	100
Other financial expenses, net	9,143	17,609
	<u>22,139</u>	<u>29,380</u>

g. Other income:

Capital gain from realization of investments in associates	-	39,603
Capital gain from exercise of options	-	572
Capital gain from sale of fixed assets, net	635	751
Other income (expenses), net	(241)	(305)
	<u>394</u>	<u>40,621</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 22:- NET EARNINGS (LOSS) PER SHARE

- a. Details of the number of shares and income (loss) used in the computation of net earnings (loss) (loss) per share:

	Year ended December 31,			
	2007		2008	
	Weighted number of shares	Loss	Weighted number of shares	Net income (loss)
	In thousands	NIS in thousands	In thousands	NIS in thousands
Number of shares and income (loss) before Company's share of earnings (loss) of investees, net	8,130	(2,592)	8,127	62,660
Investor's share of basic earnings (loss) per share of investees, net	-	(4,636)	-	(4,067)
For the computation of basic net earnings (loss)	8,130	<u>(7,228)</u>	8,127	<u>58,593</u>
Investor's share of diluted earnings (loss) per share of investees, net	-	(4,636)	-	(4,067)
Effect of potential dilutive Ordinary shares	4	-	4	-
For the computation of diluted net earnings (loss)	<u>8,134</u>	<u>(7,228)</u>	<u>8,131</u>	<u>58,593</u>

- b. To compute diluted net earnings (loss) per share, stock options (series 3) have not been taken into account since their conversion increases the net diluted earnings (decreases the loss) compared to the basic net earnings (loss) per share (anti-dilutive effect):

NOTE 23:- BUSINESS SEGMENTS

- a. General:

1. The Company and its subsidiaries operate in three major divisions:

- a) Wireless communication division:

This division is engaged in the production, construction and planning of communication towers, buildings for communication equipment and construction of sites. Likewise, this division is also engaged in the installation of antennas and base stations, their connection to switches and the installation of switches.

- b) Broadband communication division:

This division provides installation, maintenance services and products to TV cable companies, to Bezeq, to providers of international communication services and to internet suppliers.

- c) Systems division:

The systems division is composed of a development group, manufacturing of products, integration engineering, technicians and installers. The principal activity of this division is in the field of military communication systems and security systems.

Likewise, the Company has operations that do not qualify for the definition of segment and are presented in others in segment reporting.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23:- BUSINESS SEGMENTS (Cont.)

2. All revenues and substantially all of the expenses are allocated directly to the business segments. The remaining expenses which are indirect are attributed to the segments on a reasonable basis.
3. The segments' results include intersegment sales. These sales are reported at arm's length basis in a manner similar to products and services sold to unrelated customers. These transactions have been eliminated in the consolidated financial statements.
4. The segment's assets include all the operating assets which are used by the segment and are composed mainly of cash and cash equivalents, checks receivable, trade receivables and fixed assets. Most of the assets can be attributed to a specific segment. The amounts for certain assets which are commonly used by two segments or more are attributed to the segments on the basis of sales ratio.

The segment's liabilities include all the operating liabilities which derive from the operating activities of the segment and are composed mainly of trade payables and other accounts payable. The segment's assets and liabilities do not include income tax assets.

b. Primary reporting about business segments:

1. Revenues:

	Year ended December 31,	
	2007	2008
	NIS in thousands	
Broadband communication	67,284	107,516
Wireless communication	218,388	393,657
Systems	121,984	107,530
Others	1,054	2,399
	408,710	611,102
Inter-segment revenues:		
Broadband communication	6,097	18,669
Wireless communication	2,649	2,692
Systems	8,658	1,932
Others	-	1,302
	17,404	24,595
Total revenues	426,114	635,697
Adjustments	(17,404)	(24,595)
Total in the statement of income	408,710	611,102

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23:- BUSINESS SEGMENTS (Cont.)

2. Segment results and adjustment to net income (loss):

	Year ended December 31,	
	2007	2008
	NIS in thousands	
Broadband communication	2,031	9,060
Wireless communication	14,717	64,008
Systems	3,652	(8,840)
Others	(1,389)	*) 34,564
Adjustments	-	570
Operating income	19,011	99,362
Financial expenses, net	(19,417)	(22,198)
Taxes on income	(1,420)	(13,966)
Group's share of earnings (losses) of associates **)	964	(4,029)
Net income (loss)	(862)	59,169

*) Includes one-time gain.

**) Group's share of earnings (losses) of associates is included in the segment - other.

3. Assets used by the segment:

	December 31,	
	2007	2008
	NIS in thousands	
Broadband communication	39,921	57,461
Wireless communication	189,426	259,770
Systems	56,129	59,934
Others	4,727	-
	290,203	377,165
Investments in associates:		
Other	34,091	14,607
Unallocated assets	98,359	110,914
Total assets	422,653	502,686

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23:- BUSINESS SEGMENTS (Cont.)

4. Segment liabilities:

	December 31,	
	2007	2008
	NIS in thousands	
Broadband communication	9,260	24,261
Wireless communication	41,599	49,085
Systems	28,056	23,152
	<u>78,915</u>	<u>96,498</u>
Unallocated liabilities	198,695	199,675
	<u>277,610</u>	<u>296,173</u>

5. Cost of purchase of long-term assets:

	Year ended	
	December 31,	
	2007	2008
		NIS in thousands
Broadband communication	926	6,120
Wireless communication	4,470	6,054
Systems	351	1,537
Others	255	432
	<u>6,002</u>	<u>14,143</u>

6. Depreciation and amortization:

	Year ended	
	December 31,	
	2007	2008
		NIS in thousands
Broadband communication	3,670	3,441
Wireless communication	4,718	4,934
Systems	457	963
Others	425	53
	<u>9,270</u>	<u>9,391</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**NOTE 23:- BUSINESS SEGMENTS (Cont.)**

c. Secondary reporting about geographical areas:

The geographical segments are presented based on the location of customers and are divided to four areas:

1. Israel - the activities in this segment are: broadband communication, wireless communication and systems.
2. Europe - the activity in this segment is in the field of systems and broadband communication.
3. South America - the activity in this segment is in the field of wireless communication and systems.
4. Central America - the activity in this segment is in the field of wireless communication and systems, mainly in Mexico.
5. Africa - the activity in this segment is in the field of wireless communication and systems.

Following is information about the consolidated sales classified by geographic markets (not taking into account the manufacturing location of products):

Sales by geographic markets:

	Year ended December 31,	
	2007	2008
	NIS in thousands	
Israel	181,922	241,452
Europe	2,583	12,390
South America	45,766	64,008
Central America	98,827	174,865
Africa	62,211	105,350
Other	17,401	13,037
	<u>408,710</u>	<u>611,102</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23:- BUSINESS SEGMENTS (Cont.)

The carrying amount for assets and the cost of the purchase of long-lived assets by geographical areas in which the assets are located:

	Segment assets		Cost of purchase of long-term assets	
	December 31,		Year ended December 31,	
	2007	2008	2007	2008
	NIS in thousands			
Israel	126,097	172,869	4,578	11,001
South America	28,424	39,256	599	771
Central America	110,094	100,152	792	881
Africa	7,473	49,220	-	1,472
Other	18,115	15,668	33	18
	<u>290,203</u>	<u>377,165</u>	<u>6,002</u>	<u>14,143</u>

NOTE 24:- TRANSACTIONS AND BALANCES WITH INTERESTED AND RELATED PARTIES

- a. Balances with interested and related parties:

Composition:

December 31, 2007:

	Controlling shareholder	Associates	Other interested party and related parties
	NIS in thousands		
Loans to associates	-	2,890	-
Other accounts receivable	-	144	16
Other accounts payable	159	78	-

December 31, 2008:

	Controlling shareholder	Associates	Other interested party and related parties
	NIS in thousands		
Loans to associates	-	4,704	-
Trade receivables	-	38	-
Other accounts receivable	-	681	69
Trade payables	-	502	-
Other accounts payable	43	-	-

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 24:- TRANSACTIONS AND BALANCES WITH INTERESTED AND RELATED PARTIES (Cont.)

b. Benefits to interested and related parties:

	Year ended December 31,	
	2007	2008
	NIS in thousands	
Salaries and benefits to those employed by the Company or on its behalf	4,191	8,047
Directors' fees to those not employed by the Company or on its behalf	288	239
Rental fees to a related party	147	151
Fees to interested party for services	373	150
Number of individuals to whom the salary and benefits relate:		
Interested and related parties employed by the Company or on its behalf	4	4
Directors not employed by the Company	5	5
Related parties not employed	1	1
	10	10

c. Transactions with interested and related parties:

December 31, 2007:

	Controlling shareholder	Associates	Other related parties
	NIS in thousands		
Sales	-	368	244
Cost of sales	147	-	-
	147	368	244

December 31, 2008:

	Controlling shareholder	Other related parties
	NIS in thousands	
Sales	-	422
Cost of sales	151	-
Financial income	-	177
	151	599

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 24:- TRANSACTIONS AND BALANCES WITH INTERESTED AND RELATED PARTIES (Cont.)

- d. Income and expenses from interested and related parties:

Conditions of transactions with related parties

The sales to and purchases from related parties are made at market prices. Outstanding balances at the year-end are unsecured, interest free and settlement occurs in cash. There have been no guarantees provided or received for any related party receivables or payables. For the years ended December 31, 2008 and 2007, the Company has not recorded any allowance for doubtful accounts relating to amounts owed by related parties. This assessment of the allowance for doubtful accounts is undertaken each financial year through examining the financial position of the related party and the market in which the related party operates.

NOTE 25:- RECONCILIATIONS BETWEEN ISRAELI GAAP AND IFRS

As described in Note 2a, these financial statements are the first annual financial statements the Company has prepared in accordance with IFRS. The Company first adopted IFRS in 2008 and, accordingly, the date of transition to reporting pursuant to IFRS is January 1, 2007. The Company prepared an opening balance sheet as of the date of transition to IFRS.

Prior to the adoption of IFRS, the Company prepared its financial statements in accordance with Israeli GAAP. The annual financial statements as of December 31, 2007 and for the year then ended are the last the Company has prepared in accordance with Israeli GAAP.

Accordingly, the Company presents the following reconciliations between the amounts reported under Israeli GAAP and amounts reported under IFRS as of January 1, 2007 (the date of transition to IFRS), as of December 31, 2007 and for the year then ended (The Company's last annual financial statements prepared in accordance with Israeli GAAP).

According to IFRS 1, the adoption of IFRS in the opening balance sheet as of the date of transition is to be applied retrospectively.

Following are the exemptions elected by the Group pursuant to IFRS 1, which have not been retrospectively adopted on the date of transition to IFRS:

Translation differences:

As of January 1, 2007, the Group has not recognized the cumulative currency translation adjustment differences that relate to all foreign operations. Therefore, the reserve for currency translation adjustment is zero as of January 1, 2007.

Employee benefits:

The Group has recognized all cumulative actuarial gains and losses as of January 1, 2007 and recorded them in equity under retained earnings.

Goodwill and excess of cost:

The Group has not retrospectively adopted IFRS 3, "Business Combinations", and, accordingly, goodwill and excess of cost arising in business combinations which occurred prior to January 1, 2007 and relating to the acquisition of subsidiaries, associates and jointly controlled entities are not accounted for according to IFRS 3 but rather presented as previously accounted for under Israeli GAAP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 25:- RECONCILIATIONS BETWEEN ISRAELI GAAP AND IFRS (Cont.)

a. Reconciliations to balance sheets:

	Par.	January 1, 2007			December 31, 2007		
		Israeli GAAP	Effect of transition to IFRS	IFRS	Israeli GAAP	Effect of transition to IFRS	IFRS
							NIS in thousands
ASSETS							
CURRENT ASSETS:							
Cash and cash equivalents		55,319	-	55,319	48,863	-	48,863
Marketable securities		10,454	-	10,454	9,373	1,398	10,771
Trade receivables		208,485	-	208,485	192,909	-	192,909
Other accounts receivable	2	23,090	(6,657)	16,433	24,612	(7,501)	17,111
Inventories		49,238	-	49,238	67,199	-	67,199
		<u>346,586</u>	<u>(6,657)</u>	<u>339,929</u>	<u>342,956</u>	<u>(6,103)</u>	<u>336,853</u>
NON-CURRENT ASSETS:							
Long-term trade receivables and receivables		1,131	-	1,131	-	-	-
Employee benefit assets	5	1,435	2,270	3,705	2,058	3,280	5,338
Investments in investees	6,10,11	38,747	(3,616)	35,131	44,890	(10,799)	34,091
Available-for-sale financial assets	8b	2,766	1,229	3,995	3,161	1,029	4,190
Prepaid operating lease expenses		-	-	-	-	1,323	1,323
Fixed assets, net	1	46,560	(3,450)	43,110	37,053	(4,395)	32,658
Goodwill	1	640	-	640	640	-	640
Deferred taxes	2	316	5,659	5,975	247	7,313	7,560
		<u>91,595</u>	<u>2,092</u>	<u>93,687</u>	<u>88,049</u>	<u>(2,249)</u>	<u>85,800</u>
<u>Total assets</u>		<u>438,181</u>	<u>(4,565)</u>	<u>433,616</u>	<u>431,005</u>	<u>(8,352)</u>	<u>422,653</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 25:- RECONCILIATIONS BETWEEN ISRAELI GAAP AND IFRS (Cont.)

Par.	January 1, 2007			December 31, 2007		
	Israeli GAAP	Effect of transition to IFRS	IFRS	Israeli GAAP	Effect of transition to IFRS	IFRS
	NIS in thousands					
	LIABILITIES AND EQUITY					
	CURRENT LIABILITIES:					
	Credit from banks and others					
2,9	75,204	(29,544)	45,660	55,871	(16,685)	39,186
	<u>202,015</u>	<u>(29,544)</u>	<u>172,471</u>	<u>216,777</u>	<u>(16,685)</u>	<u>200,092</u>
	LONG-TERM LIABILITIES:					
	Loans from banks					
3	-	622	622	-	20	20
5	833	1,261	2,094	1,795	1,322	473
2	-	29,740	29,740	-	17,140	17,140
12	6,196	(6,196)	-	4,746	(4,746)	-
	<u>82,376</u>	<u>25,427</u>	<u>107,803</u>	<u>66,426</u>	<u>11,092</u>	<u>77,518</u>
	EQUITY:					
	Share capital					
3	8,041	(8,041)	-	8,041	(8,041)	-
6	(9,846)	9,846	-	(19,522)	9,411	(10,111)
8b	-	1,347	1,347	-	2,022	2,022
	<u>153,790</u>	<u>(2,429)</u>	<u>151,361</u>	<u>147,802</u>	<u>(7,505)</u>	<u>140,297</u>
12	-	6,196	6,196	-	4,746	4,746
	<u>153,790</u>	<u>3,767</u>	<u>157,557</u>	<u>147,802</u>	<u>(2,759)</u>	<u>145,043</u>
	<u>438,181</u>	<u>(350)</u>	<u>437,831</u>	<u>431,005</u>	<u>(8,352)</u>	<u>422,653</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 25:- RECONCILIATIONS BETWEEN ISRAELI GAAP AND IFRS (Cont.)

b. Reconciliations to the statement of income:

	Par.	Year ended December 31, 2007		
		Israeli GAAP	Effect of transition to IFRS NIS in thousands	IFRS
Revenues from sales		408,710	-	408,710
Cost of sales	5	303,853	(188)	303,665
Gross profit		104,857	188	105,045
Research and development costs, net	9	2,303	(98)	2,205
Selling and marketing expenses		41,352	-	41,352
General and administrative expenses		42,871	-	42,871
Other income	1,13	-	394	394
Operating income		18,331	680	19,011
Other income	13	16	(16)	-
Financial income	7	-	2,722	2,722
Financial expenses	7,6	16,388	5,751	22,139
Income (loss) before income tax		1,959	(2,365)	(406)
Income tax expense		(1,420)	-	(1,420)
Income (loss) after income taxes		539	(2,365)	(1,826)
Company's share of earnings of associates, net	6,9, 10,11	3,915	(2,951)	964
Minority interests of earnings of investees, net	12	(766)	766	-
Net income (loss)		3,688	(4,550)	(862)
Attributable to:				
Equity holders of the Company				(1,628)
Minority interests				766
				(862)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 25:- RECONCILIATIONS BETWEEN ISRAELI GAAP AND IFRS (Cont.)

c. Notes to the reconciliations to the financial statements:

1. Rights to land leased from the Israel Lands Administration:

A subsidiary had a development contract with the Israel Lands Administration for the construction of buildings with area of at least 20,000 sq.m., according to which by the end of the development period a lease agreement will be signed with the Administration for a period of 49 years with a renewal option for additional 49 years. A lease agreement has not yet been signed. The subsidiary paid capitalized lease fees to the Israel Lands Administration in the amount of approximately NIS 3,450 thousand.

According to Israeli GAAP, the amount paid for the above lease rights was presented under fixed assets as land that is not depreciated.

According to IFRS, this lease is classified according to the provisions of IAS 17, "Leases", as an operating lease and therefore the amount paid represents a prepaid lease fee.

Payments NIS 3,450 thousand for operating lease made in 2007 were classified in "prepaid operating lease expenses".

2. Deferred taxes:

According to Israeli GAAP, deferred taxes amounting to approximately NIS 7,501 thousand were presented in current assets under other accounts receivable and approximately NIS 16,735 thousand were presented in other accounts payable. Upon the transition to IFRS and according to IAS 12, "Income Taxes", these deferred taxes are presented in non-current assets and long-term liabilities, respectively.

3. Stock options, convertible debentures and attribution of proceeds from unit issues:

Stock options:

According to Israeli GAAP, based on the provisions of Accounting Standard No. 22 of the Israel Accounting Standards Board, proceeds amounting to approximately NIS 8,041 thousand attributed to stock options whose exercise price is linked to the Israeli CPI/to the exchange rate of the U.S. dollar were presented in equity.

According to IAS 32, "Financial Instruments - Presentation", these stock options are a financial liability since their exercise price is not fixed and are therefore presented under liabilities. The liabilities are measured in accordance with IAS 39, "Financial Instruments - Recognition and Measurement". Accordingly, the stock options are presented at fair value at each balance sheet date and the changes in fair value are included in the statement of income.

Upon the transition to IFRS, as of January 1, 2007, the proceeds attributable to stock options, amounting to approximately NIS 8,041 thousand, and included in equity, have been recognized as a long-term liability in the amount of approximately NIS 622 thousand, representing the fair value of the stock options on the transition date and the difference of approximately NIS 7,419 thousand was included in retained earnings.

NOTE 25:- RECONCILIATIONS BETWEEN ISRAELI GAAP AND IFRS (Cont.)

4. Business combinations:

According to Israeli GAAP, minority interest is presented in the balance sheet as a line item after liabilities and before equity and in the consolidated statement of income as an expense in determining the Group's consolidated net income. Pursuant to IAS 1, "Presentation of Financial Statements", the Company presents minority interest in the consolidated balance sheet within equity and minority interest is not deducted from the Group's net income.

5. Employee benefits:

According to Israeli GAAP, the severance pay liability is measured based on the employee's latest monthly salary multiplied by the number of years of employment as of each balance sheet date, based on the "shut down" method, and severance pay funds are measured at their surrender value at each balance sheet date.

According to IAS 19, "Employee Benefits", the Company's benefit plan is considered a defined benefit plan and, therefore, the severance pay liability is required to be calculated on an actuarial basis. The actuarial calculation takes into consideration future salary increases, the rates of employee turnover and the estimated timing of payments.

The amounts are presented based on expected future discounted cash flows at interest rates on government bonds whose redemption matches the period of the liability relating to the severance pay since the Company believes there is no deep market for corporate bonds in Israel. In accordance with IAS 19, the actuarial calculation must be based on interest rates on high quality NIS corporate bonds whose redemption matches the period of the liability relating to the severance pay. The issue of the discount interest is under examination and it is possible that a decision will ultimately be adopted in Israel whereby the proper discount rate is the one based on corporate bonds. In such case, the data included in the note may change since the use of interest at a higher rate will reduce the actuarial liability on the one hand and increase the current financial expenses in respect of the actuarial liability on the other.

In accordance with IFRS 1, the Company elected the exemption to recognize in retained earnings all cumulative actuarial gains and losses as of January 1, 2007. Upon the transition to IFRS, the balance of accrued severance pay decreased by approximately NIS 5,224 thousand and deferred taxes increased by approximately NIS 998 thousand such that the net difference in the net liability as of January 1, 2007 amounts to a decrease of approximately NIS 4,226 thousand (net of income taxes of approximately NIS 998 thousand).

6. Functional currency:

According to Israeli GAAP, the currency used for measurement in the financial statements of the Israeli subsidiaries is the NIS. Subsidiaries that are located and operate around the world are autonomous entities and the currency used for measurement in their financial statements is their functional currency.

NOTE 25:- RECONCILIATIONS BETWEEN ISRAELI GAAP AND IFRS (Cont.)

According to IAS 21, "The Effects of Changes in Foreign Exchange Rates", the Company is required to determine its functional currency and the functional currency of each Group entity based on the currency of the primary economic environment in which each entity operates, according to criteria prescribed by IAS 21. Management has concluded that the functional currency of the Company and of its subsidiaries in Israel is the NIS. There is no change in the functional currency of a subsidiaries which are located around the world.

Management has also elected the NIS as the presentation currency for the Group's consolidated financial statements.

Upon the transition to IFRS, as of January 1, 2007, an associate of the Company decided that according to the provisions of IAS 21, its functional currency is the dollar. The effect of the translation of the associate's balances from the functional currency into the presentation currency of the Company on the balances presented in the Company's balance sheet as of January 1, 2007 is a decrease of NIS 8,820 in investments with recognition of NIS 8,820 thousand in retained earnings.

The Company has elected to present the cumulative translation differences as of January 1, 2007 at zero, pursuant to the provisions of IFRS 1.

During the third quarter of 2008, the Company changed its policy with respect to current accounts with foreign subsidiaries. Consequently, translation differences from these current accounts in 2007 and for the periods ended September 30, 2007 which had accrued in equity were recorded in the statement of income as financial expenses.

7. Financial income and expenses:

According to Israeli GAAP, financial income and expenses are presented net in the statement of income. According to IFRS, financial income should be disclosed separately from financial expenses in the statement of income and, accordingly, the Company separately presented financial expenses of approximately NIS 22,139 thousand and financial income of approximately NIS 2,722 thousand for the year ended December 31, 2007.

8. Financial instruments:

According to Israeli GAAP, securities were classified into two categories: "permanent investment" presented at cost and "current investment" presented at fair value with changes in fair value being recorded in the statement of operations.

Pursuant to IAS 39, "Financial Instruments - Recognition and Measurement", the accounting treatment of financial instruments is based on their classification into one of the following four categories:

- financial asset or financial liability at fair value through profit or loss;
- held-to-maturity investments;
- loans and receivables; and
- available-for-sale financial assets.

NOTE 25:- RECONCILIATIONS BETWEEN ISRAELI GAAP AND IFRS (Cont.)

a) Investments in marketable securities:

According to Israeli GAAP, the Company classified its investment in marketable securities as "permanent investment". Accordingly, these investments were presented at their historical cost.

Upon the transition to IFRS, pursuant to the provisions of IAS 39, "Financial Instruments - Recognition and Measurement", the Company classified its investments in these securities as "available-for-sale financial assets". Accordingly, these securities are presented at their fair value at each balance sheet date with changes in fair value being recognized in a capital reserve, except for permanent impairment losses that are recognized in the statement of income.

As of January 1, 2007, the balance of these investments increased by approximately NIS 166 thousand, due to the difference between the fair value of these securities and their cost in the Company's accounts as presented according to Israeli GAAP (net of income taxes of approximately NIS 48 thousand recorded as a decrease in deferred taxes) with a corresponding increase in equity under "capital reserve from available-for-sale financial assets".

b) Investments in other companies:

According to Israeli GAAP, investments in other companies in which the Company does not exercise control or significant influence are presented in the balance sheet at cost less impairment losses that are other than temporary.

Upon the transition to IFRS and based on the provisions of IAS 39, "Financial Instruments - Recognition and Measurement", these investments are classified as available-for-sale securities and measured at fair value. Changes in fair value are recorded in a capital reserve. As of January 1, 2007, the investment in another company and the capital reserve increased by NIS 1,229 thousand and as of December 31, 2007 by NIS 1,029 thousand.

9. Liability to the Chief Scientist in respect of Government grants:

According to Israeli GAAP, grants from the Scientist were recorded as income when received. Royalties representing the refund of the grant were recorded in cost of sales when actually paid.

Upon the transition to IFRS and based on IAS 37, "Provisions, Contingent Liabilities and Contingent Assets", grants from the Chief Scientist are recognized as a liability to the extent that the amount is expected to be refunded. This liability is recognized at its present value. The amount of the liability is evaluated at the end of each reporting period and changes in the amount are recorded in the statement of income. Accordingly, as of January 1, 2007 and December 31, 2007, the liability to the Chief Scientist increased with a corresponding decrease in retained earnings of approximately NIS 148 thousand and NIS 50 thousand, respectively.

NOTE 25:- RECONCILIATIONS BETWEEN ISRAELI GAAP AND IFRS (Cont.)

10. Deferred gain from issuances to third party:

According to Israeli GAAP, the Company recognizes revenues from gain arising on the issuance of an associate in the research and development stage that has not yet made significant sales to a third party. The revenue is recognized in the statement of income on a straight-line basis over a period of three years or to the extent of the Company's share in the losses of this associate during the above period.

Upon the transition to IFRS, gain from issuance to third party derived as above, is recorded in the statement of income when earned and is not deferred. Accordingly, the deferred gain as of January 1, 2007 and December 31, 2007 amounting to approximately NIS 1,656 thousand and NIS 1,006 thousand, respectively, will be reversed.

11. Investment in associate:

Upon the transition to IFRS, the Company's share in the equity of an associate increased as of January 1, 2007 and December 31, 2007 by NIS 3,382 thousand and NIS 4,396 thousand, respectively, as a result of the adoption of IFRS by the associate.

12. Minority interests:

According to Israeli GAAP, minority interests are presented in the Company's balance sheet after the liabilities items and before the shareholders' equity items and in the consolidated statement of income as an expense in determining the Group's consolidated net income. According to the provisions of IAS 1, "Presentation of Financial Statements", the Company presents minority interest in the consolidated balance sheet within equity and minority interest is not deducted from the Group's net income.

13. Other income:

According to Israeli GAAP, other income, net is presented in the statement of income before income before taxes. According to IFRS, other income, net should be disclosed in the statement of income as part of operating income and, accordingly, for the year ended December 31, 2007, other income amounting to NIS 16 thousand has been reclassified.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 26:- CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY ("SOLO")

Balance sheets:

	December 31,	
	2007	2008
	NIS in thousands	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	317	115
Short-term investments	8,395	698
Accounts receivable	56,768	1,572
	<u>65,480</u>	<u>2,385</u>
NON-CURRENT ASSETS:		
Investments in investees	150,827	201,991
Current accounts with investees	-	110,704
Available-for-sale financial assets	1,264	2,348
Fixed assets, net	43	421
Deferred taxes	-	3,829
Employee benefit assets	358	-
	<u>152,492</u>	<u>319,293</u>
	<u>217,972</u>	<u>321,678</u>
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Credit from banks and others	17,416	20,470
Trade payables	5	48
Other accounts payable	250	2,095
	<u>17,671</u>	<u>22,613</u>
LONG-TERM LIABILITIES:		
Debentures	45,674	25,240
Loans from banks	-	235
Stock options	20	-
Employee benefit liabilities, net	-	4,293
	<u>45,694</u>	<u>29,768</u>
EQUITY:		
Share capital	14,538	14,538
Share premium	51,693	51,693
Treasury shares	(7,401)	(8,192)
Retained earnings	97,748	211,068
Capital reserve from share-based payment	-	704
Capital reserve from available-for-sale financial assets	1,029	(514)
	<u>154,607</u>	<u>269,297</u>
	<u>217,972</u>	<u>321,678</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 26:- CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY ("SOLO") (Cont.)

Statements of income:

	December 31,	
	2007	2008
	NIS in thousands	
Revenues from sales	47	3,528
Cost of sales	26	787
Gross profit	21	2,741
General and administrative expenses	317	12,843
Income (mainly dividends)	-	117,532
Operating income (loss)	(296)	107,430
Financial income	-	5,151
Financial expenses	2,654	-
Income (loss) before taxes on income	(2,950)	112,581
Taxes on income	-	3,739
Net income (loss)	(2,950)	116,320

Statements of change in equity:

	Share capital	Share premium	Treasury shares	Retained earnings	Capital reserve from share- based payment	Capital reserve from available- for-sale financial assets	Total equity
	NIS in thousands						
Balance as of January 1, 2007	14,538	51,693	(7,401)	97,698	-	1,347	157,875
Loss from available-for-sale financial assets, net	-	-	-	-	-	(318)	(318)
Total expenses recognized directly in equity	-	-	-	-	-	(318)	(318)
Loss	-	-	-	(2,950)	-	-	(2,950)
Total recognized expenses	-	-	-	(2,950)	-	(318)	(3,268)
Balance as of December 31, 2007	14,538	51,693	(7,401)	94,748	-	1,029	154,607
Loss from available-for-sale financial assets, net	-	-	-	-	-	(1,543)	(1,543)
Total expenses recognized directly in equity	-	-	-	-	-	(1,543)	(1,543)
Net income	-	-	-	116,320	-	-	116,320
Total recognized income (expenses)	-	-	-	116,352	-	(1,543)	114,777
Cost of share-based payment	-	-	-	-	704	-	704
Repurchase of shares	-	-	(791)	-	-	-	(791)
Balance as of December 31, 2008	14,538	51,693	(8,192)	211,068	704	(514)	269,297

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 26:- CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY ("SOLO") (Cont.)

Statements of cash flows:

	Year ended December 31,	
	2007	2008
	NIS in thousands	
<u>Cash flows from operating activities:</u>		
Net income (loss)	(2,950)	116,320
Adjustments to reconcile net income (loss) to net cash provided by operating activities (a)	45,541	(49,517)
Net cash provided by operating activities	42,591	66,803
<u>Cash flows from investing activities:</u>		
Purchase of fixed assets	-	(432)
Purchase of investees	(24,974)	(50,233)
Purchase of available-for-sale financial assets	-	(2,918)
Proceeds from sale of securities at fair value through profit or loss, net	514	8,186
Grant of long-term loans and other credit, net	(440)	(1,888)
Net cash used in investing activities	(24,900)	(47,285)
<u>Cash flows from financing activities:</u>		
Repurchase of shares	-	(791)
Repayment/redemption of debentures	(17,644)	(22,433)
Receipt of long-term loans and other liabilities	-	235
Short-term credit from banks and others, net	-	3,269
Net cash used in financing activities	(17,644)	(19,720)
Increase (decrease) in cash and cash equivalents	47	(202)
Cash and cash equivalents at the beginning of the year	270	317
Cash and cash equivalents at the end of the year	317	115

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 26:- CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY ("SOLO") (Cont.)

	Year ended December 31,	
	2007	2008
	NIS in thousands	
(a) <u>Adjustments to reconcile net income (loss) to net cash provided by operating activities:</u>		
Income and expenses not involving cash flows:		
Dividend recorded for increase in current balances	-	(98,698)
Depreciation and impairment of fixed assets	15	54
Revaluation (erosion) of long-term liabilities to banks and liabilities	1,614	(3,154)
Change in employee benefit liabilities, net	344	668
Decrease (increase) in value of securities at fair value through profit or loss	505	(488)
Decrease in value of available-for-sale securities	36	100
Share-based payment	-	704
Amortization of discount and expenses relating to issuance of debentures	1,517	2,099
Deferred taxes, net	-	(3,639)
Changes in asset and liability items:		
Decrease in trade and unbilled receivables	136	-
Decrease in other accounts receivable	44,117	50,948
Increase (decrease) in trade payables	(149)	44
Increase (decrease) in other accounts payable	(2,594)	1,845
	<u>45,541</u>	<u>(49,517)</u>
(b) <u>Additional cash flow information:</u>		
Cash paid during the year for:		
Interest	<u>3,243</u>	<u>2,537</u>
(c) <u>Significant non-cash transactions:</u>		
Dividend income recorded against increase in current balance with investees	<u>-</u>	<u>98,698</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 26:- CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY ("SOLO") (Cont.)

The accounting policies applied in the above condensed data are identical to those applied in the consolidated financial statements as detailed in Note 2, except:

- Earlier adoption of IFRS:

The Company has early adopted IFRS 1 (Revised) - First-time Adoption of IFRS and IAS 27 (Revised) - Consolidated and Separate Financial Statements.

Pursuant to the amendments to these Standards, an exemption has been added with respect to the retrospective adoption of IFRS in the opening balance sheet pursuant to IFRS 1 on first-time adoption of IFRS reporting in the separate financial statements ("solo" financial statements). According to this exemption, in these financial statements, the cost of investment in shares of subsidiaries and associates may also be determined, other than at historical cost or fair value, at deemed cost based on the carrying amount of the investment under previous accounting principles namely, at equity. The election may be adopted for each investment individually. Furthermore, dividends in respect of investments in companies as above will be recognized in the separate financial statements as income irrespective whether they had been distributed in respect of earnings retained before or after the date of purchase of the investment. The Standard was adopted in the separate financial statements as above with the date of transition being on or after January 1, 2008. Earlier application is permitted. Accordingly, the Company elected to present in the opening balance sheet in the separate financial statements as of the date of transition its investments in the shares of subsidiaries, jointly controlled entities and associates at deemed cost which is the balance based on the equity method at the date of transition, as presented under previous accounting principles.

- The accounting treatment of investments in shares of investees pursuant to IAS 27:

When presenting the data from the separate financial statements of the parent company ("solo"), investments in shares of subsidiaries and associates are accounted for at cost or at fair value in accordance with IAS 39 and not at equity. The Company has elected to account for said investments at cost (deemed cost) and, accordingly, the investments in shares of subsidiaries and associates are presented at deemed cost.

- Impairment losses are assessed for each investment, according to Note 2o.
- Dividends from investees are recorded as income in the statement of income.

APPENDIX TO CONSOLIDATED FINANCIAL STATEMENTS

LIST OF INVESTEEES

a. Subsidiaries:	<u>Holding rate</u>
Mer Services Group Ltd.	100%
M.M. Satellite and Communication Ltd. (held by Mer Services) ("M.M. Satellite and Communication")	100%
Rotal.com Ltd. ("Rotal.com")	86%
Rotal Cable Infrastructures Ltd. (held by Rotal.com)	86%
Netlincom Ltd. (held by Rotal.com) *)	64.5%
TMCS Communication Ltd. (held by Rotal.com)	86%
Misgav Industrial Park Ltd.	72%
S.T.S. Electronic Systems Ltd. ("STS Electronic Systems") *)	100%
Anywhere Technologies Ltd. (held by STS Electronic Systems)	98%
Leros International B.V. - registered in the Netherlands *)	100%
Mer Security & Communication Systems Ltd. ("Mer Systems")	100%
TechMer Ltd. (held by Mer Security & Communication Systems)	100%
Athena G.S. 3 Security Implementation Ltd. (held by Mer Security & Communication Systems) ("Athena")	80%
Athena G.S. 3 Mexico, S.A. de CV - registered in Mexico (held by Athena)	100%
Mer Inc. - registered in the US (held by Mer Systems)	100%
Mer and Co. (1982) Ltd. ("Mer and Co.")	100%
Mer and Co. Exports Ltd. (held by Mer and Co.) (in voluntary liquidation)	100%
Mer Metal Works (held by Mer and Co.)	100%
Truparu B.V. - registered in the Netherlands (held by Mer and Co.) ("Truparu")	100%
TMV Wireless - registered in the Netherlands (held by Truparu)	100%
Terence Technologies V.O.F. (partnership, 99% held by Truparu and 1% by TMV Wireless) ("Terence Technologies")	100%
Regard Interactive B.V. - registered in the Netherlands (held by Mer Systems)	100%
Regard Ltd. (held by Regard Interactive B.V.)	100%
Cellular B.V. - registered in the Netherlands (held by Terence Technologies) ("Cellular")	100%
Mer Engenharia de Seguranca E Instalacoes Ltda. - registered in Brazil (held by Cellular)	100%
Mer Infraestructura Colombia Ltd. - registered in Colombia (held by Cellular)	100%
Mer Infraestructura Venezuela CA - registered in Venezuela (held by Cellular)	100%
Mer Infraestructura Chile SA (formerly: Belmerix SA) - registered in Chile (held by Cellular)	100%
Mer Hellas A.E - registered in Greece (held by Cellular) *)	100%
Mer Cellular Cyprus Ltd. - registered in Cyprus (held by Cellular) ("Mer Cellular Cyprus")	100%
Mer Infraestructura Ltd. - registered in Mauritius (held by Cellular)	100%
MER Guinea SARL - registered in Guinea (held by Cellular)	100%
Mer Telecom Senegal SARL - registered in Senegal (held by Cellular)	100%
Abernet Holdings Ltd. - registered in the Cyprus (held by Mer Cellular Cyprus) *)	100%
Mer Infraestructura Peru S.C.R. L. S.A. de CV - registered in Peru (held by Cellular)	100%
Mer Security Mexico - registered in Mexico (held by Cellular)	100%
Infracomex S.A. de CV - registered in Mexico (held by Cellular)	100%
Mexmerco S.A. de CV - registered in Mexico (held by Infracomex) *)	100%
Servcel S.A. de CV - registered in Mexico (held by Infracomex)	100%
Mer Honduras S.A. de CV - registered in Honduras (held by Cellular)	100%
Mer Infraestructura S.A. - registered in Guatemala (held by Infracomex)	100%
Mer Telecom Ghana Limited - registered in Ghana (held by Cellular)	100%
Mer Telecom Tanzania Limited - registered in Tanzania (held by Cellular)	100%
Mer Panama Limited - registered in Panama (held by Cellular)	100%
Mer Jamaica Limited - registered in Jamaica (held by Cellular)	100%
Mer DRC SARL - registered in Congo (held by Cellular)	100%
Mer Infraestructura Argentina S.A. - registered in Argentina (held by Cellular)	100%

*) Inactive.

LIST OF INVESTEEES (Cont.)

	<u>Holding rate</u>
b. Associates:	
Omarim Yielding Investments (2005) Ltd.	50%
Novacom Technologies Ltd.	37.5%
Silvermind Ltd.	50%
P.L.H Lighting Engineering Ltd. (held by Mer and Co.)	25%
Afik Hatzafof Investments Ltd. (held by Mer and Co.)	33.3%
Arcus Technologies Ltd. (held by Rotal.com)	13.12%
Rotal Digital - registered in Turkey (held by Rotal.com)	50%
Crystal clear Limited Partnership	20.5%
SUBE BV - registered in the Netherlands (held by Leros)	20%

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