# Shikun & Binui Ltd.
# Directors' Report on the State of the Company's Affairs
# For the Period Ended September 30, 2010

***Translated from the Hebrew Original***

The Board of Directors of Shikun & Binui Ltd. ("the Company") is honored to present the financial statements of the Company for the period ended September 30, 2010:

## 1. The Corporation and its business environment

### A. General

The Company and its investees ("Shikun & Binui Ltd. Group") operates in Israel and overseas in the industries of roadwork and infrastructure contracting; construction contracting; different areas of the real estate field, including: purchase, design, improvement and development of property; sale of property, with and without buildings; holdings in and rental of income-producing properties; investment and operations in the renewable energy industry; water treatment in facilities to channel and desalinate water and in the concession sector in projects, mainly in the infrastructure contracting field, as well as other activities that are connected to or complement the Company's aforementioned areas of activity. In all of its areas of activity, the Company operates according to the concept of sustainability, which requires the integration of financial, environmental and social considerations in management and decision-making processes.

The Group's operations in Israel focus on residential and non-residential real estate development, contracted construction and infrastructure projects, as well as infrastructure and construction projects financed by the private sector instead of government financing, as well as renewable energy and water treatment projects. Outside of Israel, the Group operates mainly in western countries and in Eastern Africa, Central America and Central and Eastern Europe, engaged primarily in infrastructure contracting, holding and renting income-producing properties and in residential development. Additionally, the Company has investments in the solar industry in Spain.

### B. Company areas of activity

The Company's areas of activity are carried out based on the five areas of activity provided below (through seven operating segments, as provided in Par. 2 of this Report:

- **Infrastructure** – mainly through Shikun & Binui – S.B.I Infrastructures Ltd. and through its subsidiaries (outside of Israel) and Shikun & Binui – Solel Boneh (Building and Infrastructure) Ltd. (in Israel).

Shikun & Binui – S.B.I. Infrastructures Ltd. has more than 50 years of experience in infrastructure development overseas, mainly in Africa, Central America and Central Europe. Shikun & Binui – S.B.I. Infrastructures is presently operating in more than ten countries in the fields of construction, roadwork and infrastructure contracting, and is striving to strengthen and expand its operations in these countries. Likewise, based on the know how aggregated in the different countries, the abilities to manage projects it has developed and the long-standing reputation it has acquired, it is working to broaden its geographic dispersal into neighboring countries and new regions. At the end of 2009, an agreement took effect for a road construction project in Azerbaijan, a state in which the Company had not operated until then. In order to expand its geographic dispersal, it is adapting its organizational structure with the intention of creating additional geographic business units – and the appointment of managers of geographic regions accordingly.

Shikun & Binui – Solel Boneh (Building and Infrastructure) Ltd. ("Solel Boneh") has focused for 85 years on civil engineering initiatives, national transportation and infrastructure projects and large-scale construction projects. The Company closed year 2008 with its first net income in six years and Solel Boneh also maintained this profitability trend in 2009 and in the first nine months of 2010. In addition to its technical abilities, Solel Boneh also has the ability to independently produce temporary components, recycle building waste, produce asphalt, produce cement and build special bridge projects.

The Group's capabilities within and outside of Israel in the field of infrastructure and the management of large projects that constitute the basis for operating and expanding its concession projects segment, which are large scale projects, especially significant BOT and PFI infrastructure projects.

- **Real estate development in Israel and outside of Israel** – mainly through Shikun & Binui Real Estate Ltd. (in Israel) and Shikun & Binui Real Estate Development B.V. (outside of Israel).

  Shikun & Binui Real Estate Ltd., operating in Israel, combines more than 50 years of experience in the construction of residential housing, with the application of advanced architectural design, innovative work methods and stringent international standards, including green construction standards, to create a sustainable and progressive living environment. Shikun & Binui Real Estate provides a complete package of products and services that ensure quality of life and a comfortable residential environment. In the last year, it has positioned itself as a leader in the construction industry in Israel, and most of the buildings whose construction was begun since 2009 are being built under Israeli Standard for Green Design #5281. Shikun & Binui Real Estate is expanding its activities in the key areas of demand, while emphasizing green projects, such as the Pure residential project in eastern Netanya. Shikun & Binui Real Estate also engages in non-residential real estate activities (commercial, tourism, leisure and offices), intended, inter alia, to generate rental income, from the stage of development, design and performance using green construction methods, such as the student dormitory project at Tel-Aviv University and Seventh Avenue in Beer Sheba, an open shopping mall, and the Seas City mall in Netanya (construction is not yet complete), the design of which took into account the relevant social and environmental factors, from the design stage until completion and sale of the project.

Shikun & Binui Real Estate Development B.V. is engaged in Central and Eastern Europe, mainly in Germany, Hungary, Romania, Poland and Czech Republic, in the development of residential and non-residential projects for sale and the purchase and improvement of homes and commercial space designated to generate rental income. As part of the Company's preparations for financial conditions worldwide, and particularly in the countries in which it operates, the Company has reduced to a minimum the activity in those countries that have not yet recovered from the crisis. The Company regularly evaluates business opportunities in those countries that have recovered from the crisis.

- **Concession** – This area includes finance, construction and operation of "mega" projects, mainly in the fields of infrastructure and construction in Israel and overseas. The Company continues to expand its concession activity in Israel and overseas, which the Company's management believes has significant growth potential. The Company's management assesses (even if there is no certainty that this will be realized, especially in view of the present worldwide difficulties in obtaining financing) that the trend of bringing the private sector into large infrastructure projects will continue and grow in the coming years, and that the extensive experience of the Group companies in these fields could facilitate its winning additional tenders in this area. The Company's concession activities include construction and operation of the Trans-Israel Highway Project, including the main segment (which was opened to traffic in January 2004) and its expansions, and Segment 18 of the highway (which was opened to traffic in July 2009, about eight months ahead of schedule); construction of the Carmel Tunnels (the project has not yet been opened to traffic, with the opening planned before the end of the year), construction of the water treatment facility in Hadera, its expansion and operation (the water treatment facility opened on May 16, 2010), restoration and maintenance of roads in the North. The Company continues to participate in this type of tender in Israel and abroad.

- **Renewable energy**

  In the fields of renewable energy, the Company operates through the subsidiary Shikun & Binui Renewable Energy Ltd., as below:

  Production of photo voltaic solar electricity – initiation, financing, construction and operation of projects for the creation of photo voltaic solar electricity on roofs and properties in Israel and overseas. In Israel, the Company operates within an arrangement to build small, mid-sized and large facilities. In Spain, the Company has holdings in a company (50%) that owns a photo voltaic farm with capacity of 15 megawatts.

  Thermo solar industry – initiation and development of a thermo solar project with capacity of 120 megawatts within Kibbutz Tze'elim in the Negev, participation in tenders to finance and build thermo-solar projects with a total capacity of 220 mega watts in Ashelim and others. Moreover, the Company is working to acquire technological and engineering capabilities in the thermo-solar field.

  Energy production based on natural gas – initiation and development of projects to produce private electricity based on natural gas in the Ashdod industrial area, with capacity of 100 megawatts and in the Beer Tuviah industrial area with capacity of 400 megawatts.

  Electricity production based on conventional energy – production and sale of high voltage electricity to the Electric Corporation, at total capacity of 26 megawatts, through the power plant in Ashdod operating on the basis of mazut, which serves as the "picker" and operates on the basis of availability.

  Energy efficiency – The Company has holdings in PowerSines (21.05%), which is engaged within and outside Israel and overseas in reducing demand for electricity through smart electronic controllers.

- **Water**

  In the water and sewage segment, activities include the design, construction, operation and maintenance of facilities to improve Potable water, the operation of municipal and industrial sewage purification plants, recycling water and providing water and sewer infrastructure management services. In October 2010, the municipal and industrial sewage purification operations in Israel were sold via the sale of shares in the company Nitron Chemtech Ltd., to GES of the Granite Hacarmel Group. Furthermore, the Company is working to develop additional technological capabilities and expand the water treatment activities, by building facilities to improve residual water and desalinate sea water.

Until the end of 2009, the renewable energy and water operations had been conducted within a single business unit. At the beginning of this year, the water operations were split from the renewable energy operations, with a view to the company's strategy that the water operations will constitute a growth engine for the Group in the coming years, and the operations were classified as a separate business unit. The Company intends to develop the water segment mainly by acquiring companies operating in this segment, with the goal of creating the engineering capabilities that will enable the initiation and carrying out of projects in this field in Israel and overseas.

## C. Global economy

Based on data of the International Monetary Fund (IMF), the global economic recovery is continuing, however there is variability: in a number of economies, the recovery is modest and in others is stronger.

The global growth that accelerated in early 2010 is expected to slow, due to the stabilization of the high public debt and the end of incentive programs in European countries.

The IMF forecast for 2010 is for global growth of 4.8%, growth in the U.S. of 2.6%, growth in the Euro bloc of 1.67%, growth of 3.7% in Central and Eastern Europe and growth of 4.2% in Israel.

The IMF forecast is similar to the forecast of the Bank of Israel – 4.0%, and of the Israeli Central Bureau of Statistics – 4.5%.

Global macro data indicate non-recurrence of the global recession scenario. Nonetheless, the forecast is conservative, due to the fact that the private sector, which includes businesses and households, is in the process of reducing the debts created by the pre-crisis leverage and furthermore, the unemployment rates in developed nations remain at high levels.

### U.S.

In Q3 2010, the U.S. economy had growth at the annual rate of 2.0%, following growth of 1.7% in Q2. In the third quarter, private consumption increased by 2.6% and corporate investment grew by 10%, although part of the growth stemmed from changes in inventories of companies.

The official U.S. unemployment rate remained at 9.6%.

The U.S. has a growing, constant deficit in the current account of its balance of payments, due mainly to trade with China, which for years has purchased trillions of dollars in order to maintain a competitive exchange rate.

## Euro bloc

The crisis that plagued the PIGS countries – Portugal, Ireland, Greece and Spain caused the European Union to create a system of economic laws that will make it possible to deal with economic crises in the European bloc such as permanent emergency fund of hundreds of millions of euro, establishment of control mechanisms for warning about the creation of real estate or assets bubbles and from exceeding budgets. Furthermore, the European bloc may impose penalties and sanctions on countries that do not comply with the regulations.

According to IMF data, the Euro bloc had Q3 growth at the annual rate of 1.6%. The slowing of growth was due to the slump in exports, mainly the result of the appreciation of the euro and in response to the weakness of global demand.

## Israeli economy

According to the Bank of Israel's survey of companies, the business sector continued its growth in the third quarter of 2010, at a rate similar to the previous three quarters.

This indicator is contrary to the industrial production data and export and import of goods data of the Central Bureau of Statistics (CBS), which point to a slowdown in the growth rate in the third quarter. Due to this data, the CBS updated its estimated growth data in 2010 to the annual rate of 4.5% (instead of the 4.6% in its previous estimate).

The slowdown stands out especially in the foreign trade data – in exports and imports, slowing domestic demand expressed in stable revenues of the trade and services sectors.

The unemployment rate, which peaked at 10.7% in 2003, fell to 6.3% in 2008. In the wake of the crisis in 2009, the unemployment rate resumed its climb, but halted once again this year, a fact supported by updated data on the labor market, which indicate continuation of the expansion trend.

The unemployment rate estimate for 2010 of the Finance Ministry and the CBS is in the range below 6.5%.

In October 2010, the Research Division of the Bank of Israel issued an updated inflation and interest forecast: the forecast projects that inflation in the next 12 months will be 2.5%, with a gradual increase in the interest rate to 2.9% at the end of 2011.

## Construction industry

The improved economic growth rate, the lower level of uncertainty that prevailed in the economy immediately after the global economic crisis, the improvement in the labor market and the falling unemployment levels combined with expansionary monetary policy, expressed in low interest rates in the economy and in the mortgage market – impacted the growth in demand for housing, for purchase or for investment. The growth in demand against the backdrop of undersupply of appropriate residential units throughout the country, especially in the central region, led to an especially high increase in housing prices and rental fees in most regions, following years of real declines in housing prices. The growth in housing demand and the increase in housing prices contributed to an especially high increase in the number of mortgages issued in the economy.

## Residential construction

In October 2010, the Supervisor of Banks issued a directive to the banks instructing them to increase the capital allocated to highly-leverage housing loans issued at variable interest. According to the Bank of Israel, this step was driven by the need to assure financial stability against the backdrop of continually rising housing prices and expansion of credit for home purchases.

This measure could in the future cause interest on highly-leveraged mortgages to rise, thereby influencing the purchase of homes and their prices.

In November 2010, the Prime Minister, Finance Minister and Minister of Construction and Housing published a new reform, with the goal of making home purchases easier and to prevent a continuation of the housing price increases.

The reform, drafted together with the Governor of the Bank of Israel, Stanley Fischer, will include three stages, with the objective of bringing about an increase in housing supply in the near term:

1. 15% discount in the purchase of land in tenders of the Israel Lands Administration, to contractors that will complete construction of at least 80% of the number of units in the project within a period not to exceed 30 months.

2. Reducing betterment tax on land purchased before 2001 from 45% to 20%. This reduction will be given only in 2011 and is conditioned on the construction being completed within 30 months.

3. Giving local authorities the possibility of directly collecting development assessments from contractors for the purpose of building public institutions and

areas (this barrier has made it difficult until now for the authorities to issue building permits, thereby delaying residential projects).

CBS data regarding the last 12 months indicate an increase in the housing sector, which is measured through rental fees and housing prices, at the rate of 5.6% and 22%, respectively.

The Bank of Israel forecast points to an expected slowing for the rate of increase in housing prices in the coming year.

CBS data on housing starts for the months January-August 2010 indicate stability compared with last year, while the CBS usually has a tendency to update these data upward during the year.

The rental index of the CBS has increased cumulatively in the years 2008 – 9/2010 by 18% in nominal terms and 7% in real terms.

In new and renewed contracts, the rental index rose at a higher cumulative rate: 27% in nominal terms and 15% in real terms. The increase characterized all regions of the country and different sized homes, especially prominent in the central region and the Dan region.

According to Ministry of Construction and Housing data, there was a 15% increase in 2009 in the purchase of new homes in the economy, and in January-September 2010, the growth rate, in annual terms, was the same for purchases from contractors and independent construction.

Ministry of Construction and Housing estimates for building starts is 36,000 building starts in 2010.

**Non-residential construction**

Indicators of the CBS and the Ministry of Construction and Housing for the months January-September 2010 point to a continuation of the decrease in investments in non-residential construction, compared with the same period last year. The improvement indicated in the state of the economy could lead to a gradual improvement in the future in the price levels and in reducing supply.

**Investments in infrastructure and roads**

Central Bureau of Statistics' estimates for the first nine months of 2010 indicate a continuation of the decline in investments in infrastructure and roads, which was driven by factors including the delay of large projects, such as: the Tel Aviv light railway project, the tunnels to Jerusalem, Highway 531 and the City of IDF Training Bases.

Advanced transportation infrastructures constitute an essential element for advancing economic growth, for reasons including that they constitute a condition for a fast, reliable and inexpensive connection between the different means of production in the economy. The cost to the economy of traffic jams on the transportation infrastructure, expressed mainly in loss of time, is estimated at NIS 14 billion annually.

The Government earmarks road and infrastructure development budgets as part of economic growth:

The governmental transportation policy is expressed in the allocation of resources for investment in transportation infrastructures according to the objectives:

1. Response to the growth in demand for traveling by upgrading and widening existing roads (intra and intercity).
2. Development of advanced public transportation systems such as light railways and BRT (planned mass transit system called Bus Rapid Transit – using road infrastructure instead of iron tracks, providing a solution for a large number of commuters) and improving the public transportation system.
3. Improved efficiency in the allocation of the road system and vehicles by building and widening toll highways and express lanes.
4. Bringing the periphery closer to the country's center through highways and railways.

The budget for 2011-2012 includes the Israel Highway Program. This program was allocated an earmarked budget of NIS 27.5 billion, in order to enable implementation of the Government's goals for development of the Galilee and Negev.

The Israel Highways Program includes:

1. Development of a system of roads in the north (continuation of the Trans-Israel Highway in the direction of Somekh Junction and building a high-speed eastern branch from Yokne'am to Amiad Junction).
2. Building railway tracks to Carmiel, Afula and Beit She'an.
3. Electrification of the national railway system, purchase of mobile railway equipment and continuation of the Trans-Israel Highway southward.
4. Advancement of additional planning projects.

The budgets and programs described above could change the volume of activity in the coming years, provided that the budgets are actually allocated.

## D. Significant events during report period and subsequent to balance sheet date

### Options to managers

Under the terms of the option plan from 2009, on March 24, 2010 and on May 16, 2010, a total of 750,000 and 250,000 options, respectively, were granted to three senior officers, representing 0.24% of the Company's shares on a fully diluted basis. The fair value of the benefit in the said grants is NIS 3,997 thousand. For additional information, see Note 4.C to the Company's financial statements.

Additionally, on August 22, 2010, a total of 250,000 options were allotted to officers in a subsidiary, representing 0.06% of the company's share capital on a fully-diluted basis.

The fair value of the benefit is NIS 1,061 thousand. For additional details, see Note 4.D. to the Company's financial statements.

### Dividend distribution to shareholders

On May 9, 2010, the Company's board of directors resolved to distribute a dividend totaling NIS 110 million, which represents a dividend of NIS 0.27425 per NIS 1 par value share. The date of record is May 23, 2010 and the ex-date is May 24, 2010. The dividend was paid on June 6, 2010.

### Opening of desalination facility in Hadera

On May 16, 2010, the inauguration ceremony for the desalination facility in Hadera was held. The desalination facility in Hadera, in which the Company holds 50% of the rights, successfully completed the State's acceptance tests and began production and to sell water as planned. Construction of the facility, including its expansion, ended earlier than the dates prescribed in the concession agreement.

### Shelf prospectus

The Company published a shelf prospectus dated May 26, 2010, for the issue of the securities included in the shelf prospectus as provided in the prospectus published. The securities offering that will be held within the framework of the shelf prospectus, if and to the extent held, will be according to the shelf prospectus in which special details of that offering will be completed.

### Negotiations for allotment of shares in Carmelton

Carmelton, a jointly-held company of the Group with a 50% stake, is negotiating to allot 10% of its share capital to a party not related to the Company or to the other shareholders of Carmelton. The conclusion of the negotiations and execution of the transaction are also subject to various due diligence processes by the said third party and there is no certainty that the shares will be allotted and what the terms of the allotment will be. The Company's management assesses that if and to the extent the allotment will be completed, the Company is expected to recognize a gain in its financial statements in respect of a revaluation of its holdings in Carmelton.

### Renewal of directors' insurance

On June 23, 2010, the Company's board of directors, after obtaining approval of the audit committee, resolved that the Company would enter into an ongoing policy for directors' and officers' liability insurance for a one-year period. The insurance coverage is limited to liability of 70 million dollars.

### Financial closing of the Northern Highway project

On June 30, 2010, the financial closing of the project awarded to the Company, to rehabilitate, operate and maintain roads by the P.F.I. method, published by MA'ATZ – the Israel National Roads Company, pursuant to which a series of agreements related to this project and its financing took effect. For additional details, see Note 4.G to the Company's financial statements.

### Ibadin-Ilorin Highway project in Nigeria

On July 7, 2010, a subsidiary undertook with the Nigerian government to build a contracted project, paving a segment of the Ibadan-Ilorin Highway in Nigeria. The duration of the rehabilitation and paving project is expected to last for 4 years, with the proceeds for building the project totaling $290 million.

### Issuance of debentures

During August 2010, the Company issued (an expansion) of Series 3 and 4 debentures totaling NIS 250 million – for additional details, see Par. 6 of this Report.

**Holdings in Derech Eretz**

Derech Eretz Highways (1997) Ltd. (an affiliate – "Derech Eretz")is a company engaged in the financing, construction and operation of a toll highway known as "Trans-Israel Highway" or "Highway 6", including the collection of payments from those using the highway, under the terms of its concession contract with the State.

For additional details, also see Note 18.A(6) to the annual financial statements as of December 31, 2009.

In July 2010, Canadian Highways Investment Corporation, a Canadian company that is not related to the Company ("CHIC") entered into an agreement for the sale of its holdings in Derech Eretz and its rights in shareholder loans to an Israeli partnership that is not related to the Company or its controlling shareholders ("the Fund"), in consideration for a sum equivalent to NIS 300 million ("CHIC transaction").

Immediately before execution of the CHIC transaction, Shikun & Binui holds 37.5% of the share capital of Derech Eretz, with the balance held by third parties that are not related to the Company: Africa Israel Investments Ltd. (which holds 37.5% of Derech Eretz) ("Africa Israel") and CHIC (which holds 25% of Derech Eretz).

On August 19, 2010, the Company informed CHIC and Africa Israel that it wishes to exercise it right of first refusal, given to it under the terms of the agreements among the shareholders in Derech Eretz, and to acquire CHIC's holdings in Derech Eretz and the said shareholder loans, under the terms of the CHIC transaction. The said acquisition of holdings is subject to obtaining the consent of those financing the project, the State and relevant regulatory approvals, which were not received as of the date of these financial statements.

On August 19, 2010, the Fund informed the Company that it had entered into an agreement to acquire Africa Israel's holdings in Derech Eretz (37.5%).

On September 22, 2010, the Company entered into an agreement with the Fund, which prescribed, inter alia, provisions related to the holdings in Derech Eretz, including provisions regarding the right of refusal to acquire shares and tag along rights in the sale of shares if sold by the shareholders in Derech Eretz, so that the Company and the Fund will each hold 50% in Derech Eretz. It was further provided that the management of Derech Eretz and its decision making, including decisions by the organs of Derech Eretz, would be reached jointly by Shikun & Binui and the Fund. The agreement's taking effect is subject to several suspending conditions, including the taking effect of the agreements regarding the purchase of the Derech Eretz shares by the Fund, obtaining consent of the project's financers, the State and approval of the relevant regulators, which were not received as of the date of these financial statements.

As of the report date, based on its holdings structure in Derech Eretz, the Company exerts significant influence in Derech Eretz. Upon and subject to the closing of the aforementioned transactions, the Company and the Fund will jointly control Derech Eretz (joint control). In accordance with International Financial Reporting Standards IFRS (also see Note 3.A.1 to the Company's financial statements), upon the change from a holding that gave significant influence in Derech Eretz to a holding in which there is joint control in Derech Eretz, the Company will revalue the existing holdings in the shares of Derech Eretz to fair value, based on the price reflected by the transactions described above. Consequently, and subject to the closing of the said transactions and the execution of the agreement with the Fund, the Company is expected, according to a preliminary calculation to recognize a gain in its financial statements of NIS 200-250 million.

## 2. Business results

**Operating segments of Shikun & Binui are:**

- Infrastructure and construction outside of Israel – includes construction, roadwork and infrastructure contracting outside of Israel; is carried out through Shikun & Binui S.B.I. Infrastructures Ltd.
- Infrastructure and construction in Israel – includes construction, roadwork and infrastructure contracting in Israel; is carried out through Shikun & Binui Solel Boneh (Building and Infrastructure) Ltd.
- Real estate development in Israel – carried out through Shikun & Binui Real Estate Ltd.
- Real estate development outside of Israel – carried out through Shikun & Binui Real Estate Development B.V.
- Renewable energy – carried out mainly through Shikun & Binui Renewable Energy Ltd.
- Water – This activity was split from the renewable energy operations, in order to develop the activity as a growth engine. This activity is carried out through Orlev Industries Construction and Projects 2000 Ltd.
- Concessions – includes concession activities in Israel; carried out directly and through affiliates: Derech Eretz Highways (1997) Ltd., Carmelton Group Ltd. and H2ID Ltd.
- Other – includes the Company's holdings in operations that are not its core activities; most were sold as part of the process of focusing on core operations.

For additional information, see Note 6 to the financial statements of the Company.

## A. Revenues from projects and sales

| | For the nine-month period ended September 30 | | For the three-month period ended September 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | NIS millions | | NIS millions | |
| Infrastructure and construction outside of Israel | 1,919 | 1,700 | 637 | 492 |
| Infrastructure and construction in Israel | 1,089 | 1,089 | 417 | 391 |
| Real estate development in Israel | 595 | 572 | 285 | 146 |
| Real estate development outside of Israel | 5 | 4 | 2 | - |
| Renewable energy | 50 | 48 | 13 | 22 |
| Water | 44 | 39 | 17 | 13 |
| Concessions | 72 | - | 72 | - |
| Adjustments | (148) | (92) | (88) | (43) |
| Total consolidated | 3,626 | 3,360 | 1,355 | 1,021 |

Revenues from projects and sales in the first nine months of 2010 totaled NIS 3,626 million, compared with NIS 3,360 million in the same period last year. The principal changes that occurred in the first nine months of the year, compared with the same period in 2009, are as follows: revenues from the infrastructure and construction segment outside of Israel segment increased by NIS 219 million, driven by revenues from the expansionary activity in countries in which the Company operates, as well as the start of activity in Azerbaijan. It should be noted that changes in the shekel/ dollar exchange rate have an offsetting effect against the growth in revenues, and had the dollar rate not decreased in comparison with last year, a further increase in revenues of NIS 112 million would have been posted in this segment. Furthermore, there was an increase of NIS 23 million in the real estate development in Israel segment and an increase of NIS 72 million in the concessions segment, driven by the start of work on a BOT project – restoration and maintenance of roads in the north.

Revenues from projects and sales in the third quarter of the year increased by NIS 334 million compared with Q3 2009, totaling NIS 1,355 million. The principal changes compared with the same period last year are as follows: an increase of NIS 145 million in the infrastructure and construction outside of Israel segment, driven by the start of activity in Azerbaijan, an increase of NIS139 million originating in the real estate development in Israel segment, stemming from the fact that the Company may recognize revenues from home sales when conveyed to the customer – and not when sold, and in Q3 of 2010, the Company actually recognized a higher number of units that were populated than last year (210 units compared with 147 units for which revenues were recognized last year), mainly in the "Kfar Sava Dreams" Project. an increase of NIS 26 million in the infrastructure and construction in Israel segment, and an increase of NIS 72 million was posted in the concessions segment, driven by the start of work on a BOT project, restoration and maintenance of roads in the north.

**B. Gross profit**

| | For the nine-month period ended September 30 | | For the three-month period ended September 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | NIS millions | | NIS millions | |
| Infrastructure and construction outside of Israel | 405 | 407 | 129 | 99 |
| Infrastructure and construction in Israel | 64 | 66 | 26 | 32 |
| Real estate development in Israel | 233 | 195 | 105 | 57 |
| Real estate development outside of Israel | - | - | - | (1) |
| Renewable energy | 11 | 4 | 4 | 3 |
| Water | 12 | 6 | 6 | 2 |
| Concessions | 1 | - | - | - |
| Adjustments | (3) | (5) | (1) | (2) |
| Total consolidated | 723 | 673 | 269 | 190 |

Gross profit in the first nine months of the year totaled NIS 723 million, compared with NIS 673 million in the same period last year. Gross margin was 20%, unchanged from Q3 last year. The increase in gross profit (NIS 50 million) was driven mainly by the real estate development in Israel segment, due mainly to the growth in turnover in this segment compared with the same period last year. Gross profit in the infrastructure and construction outside of Israel segment remained without significant change compared with Q3 last year. However, it should be noted that had the exchange rate of the dollar not declined, compared with last year, further growth in gross profit of NIS 26 million would have been posted.

Gross profit in the third quarter of the year increased by NIS 79 million compared with Q3 2009, amounting to NIS 269 million. Most of the change in gross profit was driven by the infrastructure and construction outside of Israel segment (NIS 30 million) and by the real estate development in Israel segment (NIS 48 million).

## C. General and administrative expenses

General and administrative expenses totaled NIS 220 million in the first nine months of the year, an increase of NIS 32 million compared with the same period last year (NIS 188 million). Most of the change was driven by the increase in salaries, which originated in the recognition of the value of the benefit for employee and manager options (NIS 10 million) and to the further expansion of the renewable energy segment and the adapting of the organizational structure to the expanding volumes of activity outside of Israel, including the entry into new countries. Additional growth originated in the expenses of a marketing campaign (NIS 3 million).

General and administrative expenses rose in the third quarter of the year by NIS 11 million compared with Q3 2009, totaling NIS 75 million. The increase was due mainly to the adapting of the organizational structure to the expanding volumes of activity in the renewable energy segment and in the infrastructure and construction outside of Israel segment.

## D. Other operating income (expenses), net

These expenses totaled NIS 15 million in the first nine months of the year, compared with net expenses of NIS 1 million in the same period last year. Presented below are details of the key income and expenses included in this item:

| | For the nine-month period ended September 30 | | For the three-month period ended September 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | NIS millions | | NIS millions | |
| Capital gain from realization of fixed assets | 1.6 | 0.8 | 1.9 | 0.3 |
| Provisions for loss expected from sale of shares in subsidiary | (5.6) | - | - | - |
| Capital gain from the realization of investments in consolidated companies | 1.1 | 0.8 | 1.1 | - |
| Impairment loss on assets, net | (1.6) | - | - | - |
| Provisions for balances, realization of which is doubtful | (2.0) | - | - | - |
| Expenses of the efficiency plan | (2.7) | (1.9) | (2.1) | (0.3) |
| Other, net | (5.8) | (0.7) | (1.3) | - |
| | (15.0) | (1.0) | (0.4) | - |

## E. Operating income

| | For the nine-month period ended September 30 | | For the three-month period ended September 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | NIS millions | | NIS millions | |
| Infrastructure and construction outside of Israel | 314 | 329 | 98 | 74 |
| Infrastructure and construction in Israel | 17 | 17 | 11 | 15 |
| Real estate development in Israel | 187 | 152 | 91 | 40 |
| Real estate development outside of Israel | (9) | (10) | (3) | (4) |
| Renewable energy | (6) | (6) | (2) | (2) |
| Water | (5) | 2 | 2 | 1 |
| Concessions | 1 | - | 1 | - |
| Other | (4) | (5) | (1) | - |
| Adjustments | 88 | 63 | 32 | 17 |
| Total according to operating segments | 583 | 542 | 229 | 141 |
| Expenses of all segments | (99) | (68) | (34) | (22) |
| Total operating income | 484 | 474 | 195 | 119 |

Operating income in the first nine months of 2010 totaled NIS 484 million, an increase of NIS 10 million, compared with the same period last year, driven mainly by the increase in the operating income in the real estate development in Israel segment (NIS 35 million), which was offset by a decrease of NIS 15 million in operating income expressed in the infrastructure and construction outside of Israel segment, mainly due to the expansion of volumes of activity outside of Israel, including the entry into new countries (which entails lower profitability in the early stages), which involved an increase in general and administrative expenses.

Operating income in Q3 2010 rose by NIS 76 million compared with the same quarter last year, amounting to NIS 195 million. Most of the increase was driven by the real estate development in Israel segment (NIS 51 million – due to the growth in gross profit in this segment) and by the infrastructure and construction outside of Israel segment (NIS 24 million – due to the increase in gross profit in this segment).

## F. Net financing costs

Net financing costs totaled NIS 124 million in the first nine months of 2010, compared with NIS 224 million in the same period last year. NIS 60 million of the decrease in net financing expenses (which totaled NIS 100 million) was driven by the hedging of foreign currency transactions. The Company executes transactions to hedge part of its foreign currency exposure in its financial statements. In the first nine months of the year, there was an offsetting effect – offsetting almost the entire effect of the change in exchange rates included in financing expenses. Contrarily, in the same period last year, the hedge transactions only partially offset the currency exposure. Furthermore, there was a NIS 56 million decrease in financing expenses related to long-term credit (mainly CPI-linked), due primarily to the fact that there was a 1.6% increase in the CPI in the first nine months of the year, compared with an increase of 3.6% in the same period last year.

Net financing costs in the third quarter of the year fell by NIS 33 million compared with Q3 2009, amounting to NIS 64 million. NIS 30 million of the decrease relates to long-term credit.

## G. Taxes on income

Tax expenses totaled NIS 104 million in the first nine months of 2010, similar to the same period last year. Tax expenses overseas fell by NIS 30 million, compared with the same period last year, due to the fact that last year, a foreign subsidiary declared a dividend which generated a tax liability at the rate of 5% (NIS 32 million). Contrarily, tax expenses in Israel increased, compared with the same period last year, due to the fact that in the same period last year, a tax asset of NIS 20 million was recognized for the accrued losses of a subsidiary, the utilization of which is expected in the coming years, and to the increase in tax expenses stemming from increased income.

Tax expenses in the third quarter of the year totaled NIS 39 million, compared with NIS 28 million in Q3 2009.

## H. Income of investees, net

The Company's equity in results of affiliates in the first nine months of 2010 amounted to a loss of NIS 5 million, compared with a loss of NIS 47 million in the same period last year. The change of NIS 42 million was due mainly to the decrease in losses attributed to the effect of the revaluation of the State's option on the results of Derech Eretz (Company's share of NIS 39 million, and in the report period – NIS 13 million) last year, and to the results of an affiliate engaged as a concessionaire, which recognized financing income in the first quarter of the year as a result of the erosion of the euro exchange rate (Company's share is NIS 20 million).

The Company's equity in the results of affiliates in the third quarter of the year amounted to a loss of NIS 14 million, compared with a loss of NIS 23 million in Q3 2009.

**I. Net income for the period**

Net income in the first nine months of 2010 rose by 250%, compared with the same period last year, amounting to NIS 250 million, compared with NIS 99 million in the same period last year.

Net income in Q3 2010 amounted to NIS 78 million, compared with a loss of NIS 29 million in the same period last year.

## 3. Orders backlog

The Company's orders backlog in construction and infrastructure contracting totals NIS 9.1 billion as at September 30, 2010 of which NIS 6.6 billion ($1.8 billion) is for overseas activity. At the end of last year, the Company's orders backlog in this area totaled NIS 7.8 billion, of which NIS 6.1 billion ($1.6 billion) is for activity outside of Israel. The orders backlog has increased by 17% since the beginning of the year.

## 4. Liquidity and financing sources

- Cash flows from operating activities in the first nine months of 2010 increased by 43% compared with the same period last year, and totaled NIS 408 million, compared with NIS 285 million in the same period last year. Cash flows from operating activities were provided mainly by current income, after neutralizing depreciation expenses.
- Cash flows from investing activities were used by the Company mainly in investments in fixed assets, which totaled NIS 222 million, principally to support the expansion of infrastructure activities outside Israel. Cash flows used in investing activities in the first nine months of 2010 totaled NIS 279 million, compared with NIS 173 million used by the Company in the same period last year. The change was driven mainly by the proceeds from settlement of derivatives (execution of hedge transactions) totaling NIS 51 million, which were received during the first nine months of 2010, and from the increase in investment in fixed assets of NIS 57 million.
- Cash flows used by the Company in financing activities totaled NIS 4 million in the first nine months of 2010, compared with NIS 174 million in the same period last year. In the first nine months of 2010, the Company repaid credit totaling NIS 489 million and paid a total of NIS 129 million in interest. The Company also paid a dividend to shareholders totaling NIS 108 million (see Par. 1.D of the Report). Contrarily, the Company received credit totaling NIS 765 million, whereas in the

same period last year, the Company repaid NIS 463 million in credit and paid interest totaling NIS 137 million. In contrast, the Company received credit totaling NIS 524 million.

The Company's working capital totaled NIS 827 million as of September 31, 2010, compared with NIS 488 million at the end of 2009.

The Company has balances of cash and cash equivalents of NIS 1,283 million and unutilized credit facilities totaling NIS 672 million.

| | Debentures and bank credit | Cash and cash equivalents | Pledged deposits | Net |
|---|---|---|---|---|
| | NIS millions | | | |
| Infrastructure and construction outside of Israel | 11 | 717 | 7 | (713) |
| Infrastructure and construction in Israel | 6 | 118 | 36 | (148) |
| Real estate development in Israel | 670 | 273 | 27 | 370 |
| Real estate development outside of Israel | 548 | 22 | - | 526 |
| Renewable energy | 48 | 13 | 5 | 30 |
| Water | 21 | 2 | 4 | 15 |
| Concessions | 73 | 1 | - | 72 |
| Company headquarters | 2,754 | 137 | **(1)** 463 | 2,154 |
| Total consolidated | 4,131 | 1,283 | 542 | 2,306 |

(1) NIS 330 million of the deposits secures the credit of real estate ventures outside of Israel.

## 5. Financial position

### A. Shareholders' equity

Shareholders' equity as of September 30, 2010 stands at NIS 599 million, compared with NIS 508 million as at December 31, 2009. The increase in equity is driven mainly by the income of the first nine months of 2010 (NIS 250 million), the recognition of the benefit from issuance of options to employees and officers totaling NIS 16 million, which are offset by translation adjustments of the financial statements of foreign subsidiaries (totaling NIS 19 million), which are prepared mainly in the dollar and euro, a dividend paid to shareholders of NIS 108 million, a dividend paid to the minority interest of NIS 43 million and by a reserve for hedge transactions of NIS 7 million.

## B. Current assets

The balance of the Company's current assets totaled NIS 4,545 million as of September 30, 2010.

The balance of current assets increased by NIS 456 million in the first nine months of 2010, compared with the end of last year. The main changes derive from an increase of NIS 319 million in the inventory of buildings for sale, due to the recognition of consideration to landowners from combination transactions in the Dairies Project totaling NIS 157 million, resulting from properties placed in service totaling NIS 75 million (mainly properties in Kiryat Ono of NIS 30 million and in eastern Netanya of NIS 23 million), in the wake of investments of NIS 63 million in the period in commercial centers, such as the Netanya City of the Seas mall and "Seventh Avenue" (a shopping and entertainment center in Beer Sheba). Cash balances increased by NIS 103 million, of which NIS 88 million is from outside of Israel and NIS 17 million originating in activities in Israel. An increase was posted in deposits and of NIS 129 million in banks, from a deposit intended for the purchase of additional holdings in Derech Eretz. An increase was also posted in accounts receivable and other debit balances of NIS 119 million. Most of this increase stems from several hedge transactions for the purchase of raw materials earmarked for projects awarded to the Company in the construction and infrastructure in Israel segment – this policy is intended to help reduce the exposure to risks due to rising commodity prices. Inventory increased by NIS 30 million. Contrarily, a decrease of NIS 154 million was posted in short-term loans given to affiliates (NIS 136 million of the loans given to an affiliate in Spain were repaid in the first quarter of the year) and a further decrease of NIS 18 million originating in the decrease in the euro exchange rate, which eroded the value of the said loan, since the Company had executed a hedge payable in the euro currency. Against this, there was a change in other investments and derivatives, of which an increase of NIS 18 million was due to the hedge transactions on the euro and a decrease of NIS 82 million in trade receivables (NIS 37 million outside of Israel).

## C. Non-current assets

The Company's non-current investments total NIS 3,506 million, an increase of NIS 224 million compared with the end of 2009. Most of the change occurred in loans to investees, due to the NIS 130 million in loans given to an affiliate in the water desalination field.

In the report period, fixed assets increased by NIS 90 million compared with the end of last year, stemming mainly from the purchase of machinery and equipment overseas, to support the Company's infrastructure activities outside of Israel. Likewise, there was an increase in receivables for concession agreements of NIS 90 million, following the start of the Northern Highway Project (NIS 67 million) and as a result of the progress in the student dormitory project in Tel-Aviv, and in the project to build a pneumatic refuse clearings system in Yavneh (together – NIS 23 million). Contrarily, a decrease of NIS 56 million was posted in inventory of properties – NIS 43 million in Israel and NIS 13 million overseas (overseas, the entire decrease was due to the eroding euro exchange rate). The decrease in properties in Israel was due mainly to the placing in service (transfer of property to current inventory – homes under construction) of properties totaling NIS 75 million for the project in Kiryat Ono (NIS 30 million) and for the eastern Netanya project (NIS 23 million), and due to the fact that properties with a cost of NIS 14 million were sold in the City of Seas project in Netanya, against which investments of NIS 46 million were posted, of which payments of NIS 34 were for the purchase of property in Pardes Chana. Likewise, a decrease of NIS 48 million was posted in long-term loans, receivables and deposits, due to the posting that led to a decrease of NIS 33 million in loans given to property owners in the Dairies Project, and due to erosion from changes in the euro exchange rate and a further decrease stemming from euro deposits that eroded as a result of the falling euro exchange rate.

## D. Current liabilities

Current liabilities increased by NIS 116 million in the first nine months of 2010 compared with the end of 2009, totaling NIS 3,717 million. The principal changes are: a decrease of NIS 202 million in short-term credit from banks and others due to the repayment of NIS 200 million, a decrease of NIS 112 million in the balance of payables – customers who ordered projects, due to the progress in projects and utilization of the advances received in the projects in overseas (NIS 159 million). In Israel, an increase of NIS 47 million was posted in advances received from a BOT project – Hall of Justice in Tel-Aviv. Posted against this was an increase of NIS 169 million in the balance of customer advances, mainly home buyers in Israel – of which NIS 40 million is for advances for lots sold in Kiryat Ono and Mount Catron. Furthermore, an increase of NIS 65 million was posted in the balance of provisions (mainly due to projects outside of Israel) as well as an increase of NIS 168 million in other payables and credit balances, of which NIS 144 million derives from the posting of a liability to provide construction services in a combination transaction in the Dairies Project.

## E. Non-current liabilities

The main element of this item is debentures that were issued to institutional investors and loans from banks and other lenders, which totaled NIS 3,513 million as of September 30, 2010, an increase of NIS 471 million compared with the end of 2009. Most of the net increase is due to the raising of additional credit (NIS 746 million), which was offset by the current repayment of the aforementioned liabilities (a total of NIS 386 million).

The credit raised in the first nine months of the year includes NIS 250 million from debentures issued by the Company in August, in which two previous debenture series were expanded (also see Par. 6 of this Report).

Other liabilities (due to employee benefits, deferred taxes, long-term provisions and surplus losses accrued in affiliates) total NIS 223 million, an increase of NIS 3 million compared with the end of 2009.

## Information on debentures

Series 2 - debentures

| | |
|---|---|
| Issue date | April 18, 2008 |
| Trustee: | Union Bank Trust Company Ltd.<br>6 Ahuzat Bayit, Tel Aviv<br>The Company was given notices by the Union Bank Trust Company, whereby it had undertaken with Clal Trust Finance 2007 Ltd. in an agreement, whereby Clal Trust 2007 Ltd. assumed the role of trustee of this series. |
| Par value on issue date: | NIS 1,000,000,000 |
| Balance of par value outstanding: | NIS 600,000,000 (in March 2010, the series was replaced by Series 4) |
| Balance of par value outstanding, revalued according to linkage terms: | NIS 681,609,100 |
| Linked interest 5.2%, accrued interest amount as of 30/09/2010 | NIS 15,949,653 |
| Market value of NIS 1 par value as of 30/09/2010: | 1.275 |

Principal payments in 4 equal installments on April 18th of each of the years 2012 through 2015 (inclusive).

Interest is paid twice a year, on April 18th and October 18th of each year, until the final repayment of the debentures (18.4.2015).

Debentures (Series 2) were rated A2 by Midroog and were classified as long-term.

Interest and principal are linked to the consumer price index of March 2007, which was published on 15.4.2007 (98.9).

According to the terms of the debentures, several instances were specified in which the trustee will be able to call the unsettled balance of the debentures for immediate repayment. These include: non-payment of any amount within 7 business days after its payment date, the appointment of a liquidator for the Company, which will not be cancelled within 30 business days, the downgrading of the debentures below an A3 rating by Midroog (a debenture rating company), the Company's becoming a private company, an instance in which the Company will cease to be the controlling shareholder in Shikun & Binui Real Estate or the Arison Group will cease being the controlling shareholder in the Company and filing of a motion to freeze proceedings against the Company, which was not cancelled within 45 days.

As of the balance sheet date and as of the approval date of this Report, none of the aforementioned events occurred.

Series 3 - debentures

| | |
|---|---|
| Issue date | September 29, 2009 (the series was expanded according to the shelf offering dated August 4, 2010) |
| Trustee: | Clal Finance Trust (2007) Ltd.<br>37 Menachem Begin Street,<br>Tel Aviv |
| Par value on issue date: | NIS 200,000,000 |
| Balance of par value outstanding as of 30/09/2010: | NIS 289,206,000 |
| Unlinked interest 7.9%, accrued interest amount as of 30/9/2010 | NIS 1,840,475 |
| Market value of NIS 1 par value as of 30/09/2010 | 1.1147 |

On September 29, 2009, the Company held a private placement offering to institutional investors of 200 million debentures, NIS 1 par value each (Series 3). The offering proceeds totaled NIS 200 million (net proceeds after issue costs – NIS 197 million).

In August 2010, the Company issued (an expansion) additional debentures (Series 3) totaling NIS 89,206 thousand par value of debentures, NIS 1 par value each (expansion of Series 3). The offering proceeds totaled NIS 101 million (net proceeds after issue costs total NIS 100 million). The expansion of the series (Series 3) was executed according to a shelf offering report issued on August 4, 2010, based on the shelf prospectus issued by the Company on May 26, 2010.

The debentures (Series 3) will be repaid in 8 equal semi-annual installments, in each of the years 2013 through 2016. The debentures are unlinked and bear interest at the effective annual rate of 8.4% (stated interest is 7.9%). The interest will be paid every six months. The said debentures were issued pursuant to a shelf offering report published on September 23, 2009, based on a shelf prospectus published by the Company on May 19, 2008 (including an amendment published on July 23, 2009).

The said debentures were rated "A2" by Midroog and were classified as long-term.

Pursuant to the terms of the debentures, several instances were prescribed for which the trustee is allowed to call the unsettled balance of the debentures for immediate payment. These instances include: non-payment of any amount within 60 business days after its due date, the appointment of a liquidator for the Company, the appointment of which will not be cancelled within 60 business days, the imposition of a material attachment on the Company or on its material assets that was not removed within 60 days, issuance of an execution against material assets of the Company that will not be cancelled within 60 days, the appointment of a permanent receiver for the Company, the Company's announcement that it was halting payment of its debentures, discontinuation of the Company's operations, the calling of another series of the Company's debentures for immediate payment, the delisting of the Company or the occurrence of any other event that constitutes a material impairment of the rights of the debenture holders.

As of the balance sheet date and the report approval date, none of the above events have occurred.

Series 4 - debentures

| | |
|---|---|
| Issue date | March 4, 2010 (the series was expanded according to the shelf offering dated August 4, 2010) |
| Trustee: | Hermetic Trust (1975) Ltd.<br>113 Hayarkon Street, Tel Aviv |
| Par value on issue date: | NIS 492,000,000 |
| Balance of par value outstanding as of 30/09/2010: | NIS 629,868,000 |
| Balance of par value outstanding, revalued according to linkage terms: | NIS 644,333,868 |
| Linked interest 4.8%, accrued interest amount as of 30/09/2010 | NIS 1,779,421 |
| Market value of NIS 1 par value as of 30/9/2010 | 1.1067 |

On March 3, 2010, the Company executed an exchange tender offer for NIS 400 million par value (NIS 447 million of the balance of the debentures (Series 2) as of December 31, 2009) against an allotment of NIS 492 million par value of debentures (Series 4), at an exchange ratio of 1.23, in other words, NIS 100 par value of debentures (Series 2) for NIS 123 par value of debentures (Series 4).

In August 2010, the Company issued additional debentures (Series 4) totaling NIS 137,868 thousand par value of debentures, NIS 1 each (expansion of Series 4). The offering proceeds totaled NIS 150 million (net proceeds after issue costs total NIS 149 million). The expansion of the series (Series 4) was executed according to a shelf offering report issued on August 4, 2010, based on the shelf prospectus issued by the Company on May 26, 2010.

The debentures (Series 4) are CPI-linked for January 2010 (principal and interest) and bear interest at the effective annual rate of 6.46% (stated interest is 4.8%). The debentures (Series 4) are to be repaid (principal) in 5 annual installments, to be paid on March 10 of each of the years 2015-2019 (inclusive). The interest is paid in two equal semi-annual installments, on September 10 and March 10 of each year through March 2019, inclusive. Midroog rated the debentures (Series 4) at A2.

## 7. First-time application of accounting standards

A. As from January 1, 2010, the Group applies IFRS 3 (2008) Business Combinations and IAS 27 (2008) Consolidated and Separate Financial Statements. For additional information, see Note 3.A.1 to the Company's financial statements.

B. As from January 1, 2010, the Group applies the Amendment to IAS 17, Leases, Classification of Leases of Land and Buildings ("the Amendment"). Adoption of the Amendment was retroactive. For additional information, see Note 3.A.2 to the Company's financial statements.

## 8. Reporting on market exposure and risks and their management

### Corporate official responsible for management of market risks

The official responsible for risks management in the Company is Doron Blachar, the CFO, a senior executive in the corporation (see Regulation 26A in the Periodic Report).

The Company maintains controls over the exposure to market risks. No material change has occurred in these risks and in the report according to linkage basis in the first nine months of 2010, compared with that provided in the annual report as of December 2009 (also see Note 33 to the annual financial statements).

## 9. Sensitivity tests

### Sensitivity analyses as of 30.9.10 constituting a material change compared with sensitivity analysis as of 31.12.09

Presented below is a sensitivity table for sensitive instruments based on the changes in market factors as of June 30, 2010 relevant for the Company, based on the risks to which it is exposed. The sensitivity analyses were performed for financial instruments whose sensitivity to changes in the different risk factors is material, relative to the sensitivity analyses performed as of December 31, 2009.

## Sensitivity to changes in NIS interest rate

| | Gain (loss) from changes | | Fair value | Gain (loss) from changes | |
|---|---|---|---|---|---|
| | Increase of 10% | Increase of 5% | | Decrease of 5% | Decrease of 10% |
| | in interest rate | | | in interest rate | |
| | NIS thousands | | | | |
| Long-term loans given to investees | (29,583) | (15,233) | 483,215 | 16,190 | 33,391 |
| Long-term loans received | 7,321 | 3,687 | (529,206) | (3,728) | (7,489) |
| Debentures | 34,981 | 17,603 | (2,682,801) | (17,831) | (35,893) |

## Sensitivity to changes in dollar/NIS exchange rate

| | Gain (loss) from changes | | Fair value | Gain (loss) from changes | |
|---|---|---|---|---|---|
| | Increase of 10% | Increase of 5% | | Decrease of 5% | Decrease of 10% |
| | In exchange rate | | | In exchange rate | |
| | NIS thousands | | | | |
| Dollar/NIS forward | 3,594 | 1,796 | (561) | (1,796) | (3,594) |
| Raw materials forward | 29 | 14 | 290 | (14) | (29) |

## Sensitivity to changes in NIS interest rate

| | Gain (loss) from changes | | | Fair value | Gain (loss) from changes | | |
|---|---|---|---|---|---|---|---|
| | Increase of 16% | Increase of 10% | Increase of 5% | | Decrease of 5% | Decrease of 10% | Decrease of 16% |
| | in interest rate | | | | in interest rate | | |
| | NIS thousands | | | | | | |
| Euro/NIS forward | 1 | 1 | - | (30) | - | (1) | (1) |
| Dollar/NIS forward | (9) | (4) | (2) | (561) | 2 | 4 | 9 |

The sensitivity analysis of shekel interest includes an additional scenario (16% higher and 16% lower), which tests the most extreme daily change that occurred in the last ten years.

## Sensitivity to changes in dollar interest rate

| | Gain (loss) from changes | | | Fair value | Gain (loss) from changes | | |
|---|---|---|---|---|---|---|---|
| | Increase of 26% | Increase of 10% | Increase of 5% | | Decrease of 5% | Decrease of 10% | Decrease of 26% |
| | in interest rate | | | | in interest rate | | |
| | NIS thousands | | | | | | |
| Dollar/NIS forward | 8 | 3 | 1 | (561) | (1) | (3) | (8) |

The sensitivity analysis of dollar interest includes an additional scenario (26% higher and 26% lower), which tests the most extreme daily change that occurred in the last ten years.

## Sensitivity to changes in euro/NIS exchange rate

| | Gain (loss) from changes | | Fair value | Gain (loss) from changes | |
|---|---|---|---|---|---|
| | Increase of 10% | Increase of 5% | | Decrease of 5% | Decrease of 10% |
| | In exchange rate | | | In exchange rate | |
| | NIS thousands | | | | |
| Euro/NIS forward | 597 | 299 | (30) | (299) | (597) |

## Sensitivity to changes in raw material prices

| | Gain (loss) from changes | | | Fair value | Gain (loss) from changes | | |
|---|---|---|---|---|---|---|---|
| | Increase of 14% | Increase of 10% | Increase of 5% | | Decrease of 5% | Decrease of 10% | Decrease of 14% |
| | in raw material prices | | | | in raw material prices | | |
| | NIS thousands | | | | NIS thousands | | |
| Forward | 1,292 | 923 | 461 | 290 | (461) | (923) | (1,292) |

On 31.12.2008, there was a daily change of 14% in raw material prices – the most extreme daily change occurring in the last 10 years.

**Additional data:**

1. For the purpose of sensitivity tests on dollar/NIS forwards, dollar interest rates of 0.303%-0.93% were taken into account and NIS interest rates of 0.878%-1.796%.
2. For the purpose of sensitivity tests on euro/NIS forwards, euro interest rates of 0.462%-0.884% were taken into account and NIS interest rates of 0.936%-1.468%.

# Instruments for hedges not recognized for accounting purposes

## Sensitivity to changes in euro/dollar exchange rate

| | Gain (loss) from changes | | Fair value | Gain (loss) from changes | |
|---|---|---|---|---|---|
| | Increase of 10% | Increase of 5% | | Decrease of 5% | Decrease of 10% |
| | In exchange rate | | | in exchange rate | |
| | NIS thousands | | | | |
| Euro/dollar forward | (20,903) | (10,452) | (10,110) | 10,452 | 20,903 |

## Sensitivity to changes in dollar interest rate

| | Gain (loss) from changes | | | Fair value | Gain (loss) from changes | | |
|---|---|---|---|---|---|---|---|
| | Increase of 26% | Increase of 10% | Increase of 5% | | Decrease of 5% | Decrease of 10% | Decrease of 26% |
| | in interest rate | | | | in interest rate | | |
| | NIS thousands | | | | | | |
| Euro/dollar forward | (543) | (209) | (104) | (10,110) | 104 | 209 | 542 |

The sensitivity analysis of dollar interest includes an additional scenario (26% higher and 26% lower), which tests the most extreme daily change that occurred in the last ten years.

## Sensitivity to changes in euro interest rate

| | Gain (loss) from changes | | Fair value | Gain (loss) from changes | |
|---|---|---|---|---|---|
| | Increase of 10% | Increase of 5% | | Decrease of 5% | Decrease of 10% |
| | in interest rate | | | in interest rate | |
| | NIS thousands | | | | |
| Euro/dollar forward | 291 | 145 | (10,110) | (146) | (291) |

## Sensitivity to changes in dollar/NIS exchange rate

| | Gain (loss) from changes | | Fair value | Gain (loss) from changes | |
|---|---|---|---|---|---|
| | Increase of 10% | Increase of 5% | | Decrease of 5% | Decrease of 10% |
| | In exchange rate | | | In exchange rate | |
| | NIS thousands | | | | |
| Dollar/NIS forward | 604 | 302 | (235) | (302) | (604) |

## Sensitivity to changes in nominal NIS interest rate

| | Gain (loss) from changes | | | Fair value | Gain (loss) from changes | | |
|---|---|---|---|---|---|---|---|
| | Increase of 16% | Increase of 10% | Increase of 5% | | Decrease of 5% | Decrease of 10% | Decrease of 16% |
| | in interest rate | | | | in interest rate | | |
| | NIS thousands | | | | | | |
| Euro/NIS forward | (264) | (164) | (83) | 638 | 83 | 165 | 264 |
| Dollar/NIS forward | - | - | - | (235) | - | - | - |
| Euro/NIS option | (59) | (37) | (19) | (1,893) | 18 | 37 | 58 |

The sensitivity analysis of dollar interest includes an additional scenario (16% higher and 16% lower), which tests the most extreme daily change that occurred in the last ten years.

## Sensitivity to changes in euro interest rate

| | Gain (loss) from changes in interest rate | | Fair value | Gain (loss) from changes in interest rate | |
|---|---|---|---|---|---|
| | Increase of 10% | Increase of 5% | | Decrease of 5% | Decrease of 10% |
| | NIS thousands | | | | |
| Euro/NIS forward | 100 | 51 | 638 | (51) | (101) |
| Euro/NIS option | 26 | 13 | 1,823 | (13) | (26) |

## Sensitivity to changes in euro/NIS exchange rate

| | Gain (loss) from changes in exchange rate | | Fair value | Gain (loss) from changes in exchange rate | |
|---|---|---|---|---|---|
| | Increase of 10% | Increase of 5% | | Decrease of 5% | Decrease of 10% |
| | NIS thousands | | | | |
| Euro/NIS forward | (45,316) | (22,657) | 638 | 22,657 | 45,316 |
| Euro/NIS option | (4,637) | (2,219) | (1,893) | 1,755 | 3,527 |

## Sensitivity to changes in the standard deviation

| | Gain (loss) from changes in standard deviation | | Fair value | Gain (loss) from changes in standard deviation | |
|---|---|---|---|---|---|
| | Increase of 10% | Increase of 5% | | Decrease of 5% | Decrease of 10% |
| | NIS thousands | | | | |
| Euro/NIS option | (117) | (60) | (1,893) | 63 | 128 |

**Additional data:**

1. The sensitivity analyses are based on the representative dollar exchange rate as of 30.9.10 – NIS 3.665.
2. The sensitivity analyses are based on the representative euro exchange rate as of 30.9.10 – NIS 4.9873.

## 10. Sustainability

The Group has championed the vision of creating a sustainable and progressive living environment within and outside Israel, and promotes it in the industries in which it is engaged worldwide and particularly in the Israeli economy. Sustainability is a concept that requires the integration of economic, environmental and social considerations in the management and decision-making processes. The basic assumption is that conduct according to the sustainability approach will assure the Company's long-term business sustainability, and will enable the Company to be more competitive, relevant and attractive to its customers than its competitors.

Conforming to the principles of sustainability assures that the Company will not only have thought-out risk management and monetary savings, but will also have the creation of economic value, deriving from the identification of new solutions for existing challenges.

The Group is in the ongoing process of implementation of new modes of operation, in accordance with the principles of sustainability, inter alia, in its approach to solving challenges in the management of human resources, in the sustained development of projects and challenges and in the treatment of construction waste. During the first nine months of 2010, the Company continues to implement many processes in its activities that reflect this approach, including:

- Implementation of Site Management standard according to sustainability principles – The subsidiaries implement the standard in the newly opened sites and in most of the existing sites.
- Prescribing policy documents – The Group formulated and management approved policy documents on sustainability, in the areas of purchasing and environmental policies. The Group is drafting internal policies appropriate for compliance with the policy documents in the above areas.
- Measurement of sustainability activities – Examining the activities of the Group companies as relates to implementation and integration of sustainability by using two main indices:
    - SAM Index – During the second quarter of 2010, the Group companies measured themselves according to the SAM measurement process (http://sam-group.com), the company that carries out the sustainability index of Dow Jones (Dow Jones Sustainability Index – DJSI). The measurement was done as part of the Company's decision to aspire to conform to international indices and adopt *best practices* as relates to sustainability. During the year, the Company is

instituting the actions necessary to improve the grades it will achieve in future measurements according to this index.

- Internal measurement – As from the second quarter of 2010, the Company's management has begun to evaluate the sustainability reporting according to internal standards in the activities of the Group companies. The reports enable the measurement of the activities of each of the Group companies, in different aspects of sustainability, such as: management of business partnerships, site management, collaboration with stakeholders, management of safety and hygiene, management of human resources and evaluation of vendors.

- Assimilation of sustainability principles in the Group
    - The Sustainability Department of Shikun & Binui completed its joint project with the Engineer of the Central District of the Ministry of Health regarding a gray water system in the Broshim dormitories. Shikun & Binui Real Estate is beginning to evaluate companies that provide gray water systems, which have already met with the Sustainability Department.
    - Collaboration of stakeholders – The Sustainability Department guides the Group companies in bringing stakeholders into its various projects. This basic process of collaboration with stakeholders was carried out in the Tzelim Project, according to the United Nations' requirements, in preparation for testing of the project for trading in carbon – CDM.

      In addition, the Sustainability Department is guiding the process of stakeholder collaboration in Shikun & Binui Renewable Energy and in Shikun & Binui Solel Boneh.
    - Out of a desire to promote the environmental dimension of the sustainability approach, the Roads Department of Solel Boneh is promoting the use of recycled asphalt. The Roads Department has also acquired a sustainable asphalt plant (an innovative plant, built as a single division, more efficient use of energy with the ability to produce recycled concrete).
    - In a similar trend, the concrete plants of Solel Boneh are evaluating developments in the field of green concrete and has purchased a cement-hauling tanker that will enable the reduction in air pollution, because of the filters they contain.
- In line with the Group's leadership values, the Sustainability Department promoted the involvement of Shikun & Binui in the process of revising the Israeli Standard for Green Design (5281) in the Standards Institute, and several representatives of the Group were staffed on the expert committees for this Standard.

- Sustainability instruction and training in the Group -
    - After all Group employees in Israel attended seminars in order to assimilate the sustainability and the Company's values, the Group continues to hold seminars for new employees hired by the Company.
    - At the beginning of the second quarter, the Sustainability Department was integrated in a course of Solel Boneh project managers, in order to strengthen the assimilation of sustainability among project managers, with emphasis on the sustainability goals in risk management, procurement management and collaboration of stakeholders.

## 11. Social involvement and contribution to the community

As part of the sustainability vision of Shikun & Binui, the Company works to advance activities on behalf of the community – mainly in activities with children and youth.

Correspondingly, the Company focuses on green environmental education, with the objective of creating environmental awareness and loyalty among the younger generation.

The Shikun & Binui Group strives to realize the power of the Group – its size, resiliency and broad national dispersal, in adopting projects having significant impact.

The Group has chosen a principle of action that includes strengthening the value of giving and channeling human capital to action in the wide range of the Group's unique fields of knowledge, thereby enabling its employees to take part in activities that give expression to the added professional value of the Group, in order to bring about change, facilitated by the added value of Shikun & Binui's employees and managers.

The Group is now engaged in several activities on behalf of the community, including:

- Collection and purchase of hundreds of parcels of food, clothing and various consumer goods for needy families and associations.
- Adoption of three schools in the central region to strengthen education in the field of sustainability, by financing activities/tours and professional content, which contribute to enriching the knowledge of the children and teachers about sustainability.
- Scholarships for students of environmental studies.
- Activities on behalf of IDF servicemen, including the adoption of a brigade as part of the "Adopt a Combat Soldier" project, and the contribution of equipment.

- Funding and carrying out activities to advance education, culture and health in specific communities, working with associations that promote values of environmental protection.
- Participation in "Good Deed Days", led by the Good Spirit Association, with the participation annually of employees in welfare activities with children from low socioeconomic backgrounds.

## 12. Directors with accounting and finance capabilities

In accordance with the instructions of the Securities Authority regarding reporting on directors with accounting and finance capabilities, the board of directors decided that the minimum number of such directors will be three directors.

In the opinion of the board of directors, this number of directors with accounting and finance capabilities will enable the board of directors to meet the obligations imposed on it, especially with respect to examining the financial position of the Company and preparing and approving the financial statements.

Below is a list of seven directors with accounting and finance capabilities, who are not employed in additional positions in the Company: Irit Izacson, Shmuel Berkovitz, Nir Zichlinskey, Efrat Peled, Moshe Luhmany, Israel (Izzy) Tapoohi and Joseph Alshech.

## 13. Board of directors and management of the Company

**Below are the changes in the composition of the Corporation's board of directors during the report period and subsequent to the report date**

On April 27, 2010, Mr. Amy Landau was appointed Director of Concessions Division in the Construction and Roadwork Sector. His tenure actually began on May 23, 2010.

On June 20, 2010, Mr. Moshe Luhmany was appointed a director of the Company.

On June 29, 2010, Mr. Dan Dankner ended his tenure as a director of the Company.

**Appointments among the Corporation's officers**

On April 27, 2010, Mr. Amit Segev, Vice CEO was appointed Deputy Chief Executive Officer.

On April 27, 2010, Mrs. Limor Shako, Director of Human Resources, was appointed Vice-CEO of Human Resources.

On August 4, 2010, a general meeting resolved to reappoint Mr. Israel Tapoohi an outside director in the Company.

## 14. Financial statement approval process

The Company organ responsible for financial statement approval is the board of directors. The Company's board of directors approves the financial statements after the finance and balance sheet committee of the board of directors recommends that it approve the financial statements before their approval in the board of directors.

Seven directors are members of the finance and balance sheet committee: Chairperson of the board of directors, Mrs. Ravit Barniv, Mrs. Irit Izacson, Mrs. Efrat Peled, Mr. Nir Zichlinskey, Mr. Shmuel Berkovitz, Mr. Israel (Izzy) Tapoohi and Mr. Joseph Alshech. Six members of the committee have accounting and finance capabilities.

A detailed presentation is made before the finance and balance sheet committee as well as before the board of directors (which discusses the subject after the detailed discussion held in the finance and balance sheet committee) by officers and others in the Company, including the Chief Executive Officer Ofer Kotler, Chief Financial Officer Doron Blachar and the Controller Ronit Rosenzweig regarding highlights of the financial statements, significant financial reporting issues, including with respect to transactions that are not in the ordinary course of business, if any, material assessments, critical estimates applied in the financial statements, a discussion on the reasonableness of the data, accounting principles and policies applied and changes in them, including changes deriving from the first time application of new standards, and application of the proper disclosure principles in the financial statements, and for all of these, a discussion was held in the committee and/or the board of directors.

Participating in meetings of the finance and balance sheet committee and of the board of directors that discuss approval of the financial statements is the independent auditor of the Company, who also refers to the issues arising in the finance and balance sheet committee meetings and in the board of directors meetings, and presents the key matters that arose during the audit or review of the financial statements.

Within the scope of the process of approving the Company's financial statements by the board of directors, several days before the meeting scheduled for financial statement approval, a draft of the Company's financial statements, including the report of the board of directors, is sent for the review of the members of the finance and balance sheet committee and the other members of the board of directors.

Approval of the financial statements involves one or a number of meetings, as necessary: in the finance and balance sheet committee, several days before the approval date of the financial statements, and later in the board of directors itself, for discussing and approving the financial statements.

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| Ravit Barniv | Ofer Kotler |
| Chairman of the Board of Directors | Chief Executive Officer |

**November 23, 2010**