

## **GAZIT-GLOBE LTD.**

### **Directors' Report to Shareholders** **For the year ended March 31, 2006**

**The Board of Directors of Gazit-Globe Ltd. (hereinafter – “the Company”) is honored to present the financial statements of the Company and its consolidated subsidiaries for the period ended March 31, 2006:**

#### **1. A. General**

The Company – directly and through subsidiaries and an affiliate – is engaged in the acquisition, development, and management of income-producing properties in North America, Europe and Israel and focuses mainly on supermarket-anchored shopping centers. In addition, the Company is active in the senior housing communities and the medical office buildings sectors in the U.S.A., and also continues to seek out and realize opportunities in its business and/or in synergetic businesses, both in regions where it operates and also in other regions.

#### **B. Properties of the Company and its Subsidiaries (hereinafter – “the Group”)**

As of the date of the financial statements, the Group owns and manages, by itself and through an affiliate, 516 properties, as follows:

- 485 shopping centers and shops
- 20 shopping centers under development
- 7 senior housing communities (encompassing some 860 units)
- 2 senior housing communities under development
- 1 medical office building with a multi-story parking garage
- 1 office building in Tel-Aviv

The above properties have a Gross Leasable Area (“G.L.A.”) of approximately 4.2 million square meters. These properties are recorded in the Company’s books at a value of NIS 27 billion and generate annual rental revenue of NIS 3.2 billion. (Annual rental revenue data are based on the gross annual rent from the properties currently owned at the exchange rate).

In the U.S.A., the Company operates mainly through Equity One Inc. (hereinafter – “EQY”), a public company listed on the NYSE (NYSE: EQY). EQY is a self-administrated, self-managed REIT (Real Estate Investment Trust) for tax purposes. As of the date of the financial statements, the Company owns, directly and indirectly (including through the subsidiary of First Capital Realty Inc., as described below), 41% of EQY. EQY located primarily in growing metropolitan areas in the southeastern United States (mainly in Florida, Texas and Georgia) and in the Boston, Massachusetts metropolitan area. EQY owns and has interests in 191 operating shopping centers, with a G.L.A. of 1.9 million square meters and 7 shopping centers under development (including 30 properties in unconsolidated joint venture – see section 2J below).

The Company is also active in the United States through Royal Senior Care (hereinafter – “RSC”) and ProMed Properties Inc. (hereinafter – “ProMed”). RSC, in which the Company holds a 50% interest, is active in the senior housing communities sector in the southeastern United States. RSC owns 7 senior housing communities, encompassing approximately 860 units, as well as two senior housing communities under development. ProMed, a wholly (100%) owned subsidiary, is engaged in the medical office buildings sector. ProMed owns a medical office building, with a G.L.A. of 24 thousand square meters, and an adjacent multi-story parking garage.

In Canada, the Company operates through First Capital Realty Inc. (“FCR”), a public company listed on the Toronto Stock Exchange (TSX: FCR). As of the date of the financial statements, the Company holds 53% of FCR. First Capital Realty Inc. located primarily in growing metropolitan areas in the provinces of Ontario, Quebec, Alberta and British Columbia in Canada. FCR owns 137 properties in Canada, with a G.L.A. of approximately 1.6 million square meters, and 6 shopping centers under development. In addition FCR owns 13.3 million shares of EQY.

In Israel, the Company owns 85% of the share capital of Gazit-Globe Israel (Development) Ltd. (hereinafter – “Gazit Development”), is an owner, developer and operator of shopping centers in Israel, owns 3 shopping centers and 5 plots of land for the future development of shopping centers. In addition, the Company owns an office building in Tel-Aviv.

In Europe, the Company operates mainly through Citycon Oyj. (hereinafter – Citycon), a Finnish public company, whose shares are traded on the Helsinki Stock Exchange (HEX). As of the date of the financial statements, the Company owns approximately 36.8% of Citycon’s share capital. Citycon is active in northern Europe (as of the date of the financial statements, in Finland, Sweden and Estonia) and owns 28 shopping centers and 127 stores, which are let primarily to supermarkets and other retail chains, with a G.L.A. of approximately 0.7 million square meters. European operations are also conducted through Gazit Europe, a wholly (100%) owned subsidiary, which is engaged in the European shopping centers sector and which owns a shopping center in Germany.

Other-publicly-accessible data concerning the Group, including up-to-date presentations, supplemental packages with information regarding assets and liabilities, and other information, can be found on the Group’s Internet website and the Internet websites of the Group’s companies:

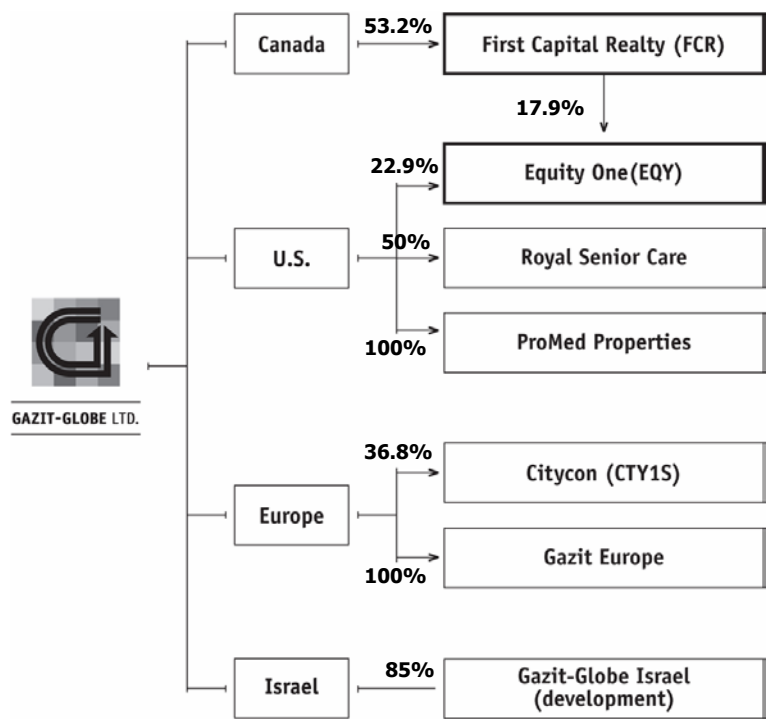
[www.gazit-globe.com](http://www.gazit-globe.com)

[www.equityone.net](http://www.equityone.net)

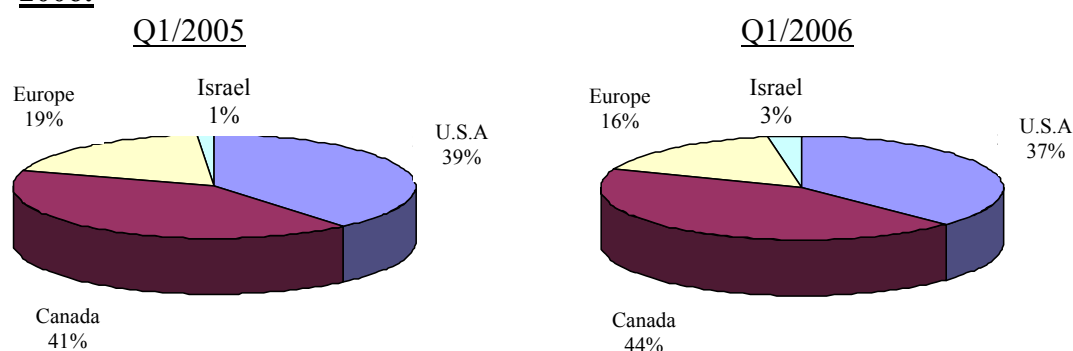
[www.firstcapitalrealty.ca](http://www.firstcapitalrealty.ca)

[www.citycon.fi](http://www.citycon.fi)

**C. The Company’s Major Holdings are Shown Below (Ownership Percentages are as of the Date of the Financial Statements):**



**D. The Following Chart Illustrates the Breakdown of Net Operating Income (“N.O.I.”)<sup>(1)</sup>, According to the Company’s Operating Regions, to March 31, 2006:**



**E. The Company’s Holdings**

- The following table presents a summary of the Company’s holdings as of March 31, 2006, as shown above:

Name of company	Type of security/ property	Holding (millions)	Holding percentage (%)	Book value (NIS in millions)	Market value as of March 31, 2006 (NIS in millions)
EQY <sup>(2)</sup>	Shares (NYSE)	17.1	22.6	1,097	1,960
FCR	Shares (TSX)	38.5	53.8	2,098	3,948
FCR	Convertible debentures (TSX)	11.7	11.7	45	48
Citycon	Shares (HEX)	50.7	36.9	756	1,179
RSC	Income-producing property	-	-	193	-
Gazit Europe	Income-producing property	-	-	184	-
ProMed	Income-producing property	-	-	409	-
Properties in Israel	Income-producing property	-	-	490	-
Other assets, net <sup>(3)</sup>		-	-	18	-
<b>Total</b>		-	-	<b>5,290</b>	-

The Company’s net liabilities <sup>(4)</sup> (including those of its wholly owned subsidiaries) amounted to NIS 3,191 million as of March 31, 2006.

<sup>(1)</sup> The Company’s share (by proportionate consolidation) of the Group’s properties.

<sup>(2)</sup> Represents only the Company’s direct holding in EQY. (In addition, FCR holds 13.3 million shares of EQY).

<sup>(3)</sup> Mainly represents the book-value of the Gazit House and other assets, net of provision for deferred taxes.

<sup>(4)</sup> Net of financial assets.

2. Additional information is presented below concerning the Company's share in the income-producing property owned by the Group as of March 31, 2006, based on capitalized net operating income ("N.O.I.") methodology. The presentation of this information is intended to provide investors with a further means of pricing the Company's worth, using a methodology that is generally accepted in the regions in which it operates.

The sensitivity table below presents the value of the income-producing properties owned by the Group according to the range of different cap rates generally accepted in the regions in which the Group operates, as of the date of publishing the financial statements. It should be noted that this presentation does not take into account existing construction rights in respect of the Company's properties.

In calculating the N.O.I., the following assumptions were made:

- a. The annual N.O.I. for each of the Group companies based on its quarterly results for the first quarter of 2006.
- b. The Company's proportionate share in the N.O.I. of the Group companies.

<b><u>Cap Rate:</u></b>	<b><u>6.25%</u></b>	<b><u>6.50%</u></b>	<b><u>6.75%</u></b>	<b><u>7.00%</u></b>
Value of proportionately consolidated income-producing property (NIS in millions)	<b><u>14,998</u></b>	<b><u>14,421</u></b>	<b><u>13,887</u></b>	<b><u>13,391</u></b>

The Group's liabilities, net of monetary assets, new properties and properties under development, which have not yet begun to produce income and which are presented at their carrying values in the Company's books (by the proportionate consolidation method) as of March 31, 2006, amounted to NIS 8,881 million.

3. As of March 31, 2006, the Company's issued share capital comprises 101.7 million shares (excluding treasury stock held by the Company).

**F. Highlights - First Quarter 2006 (hereinafter – "the reporting period")**

- **The Group's investments amounted to NIS 2 billion, compared to NIS 0.5 billion in the same quarter last year.**

**In addition, during the reporting period Citycon invested NIS 475 million in acquiring and developing properties, compared to NIS 6 million in the same quarter last year.**

- **Property rental revenue amounted to NIS 661 million, an increase of 31% compared to the same quarter last year. The increase was due to the acquisition of properties, the coming online of properties whose development had been completed and the increase in the average rent per square meter received on the Group's properties.**

- **N.O.I.<sup>(1)</sup> amounted to NIS 435 million, compared to NIS 340 million in the same quarter last year, an increase of 28%.**
- **Gross profit amounted to NIS 322 million, compared to NIS 259 million for the same quarter last year, an increase of 24%.**
- **Cash inflows from operating activities amounted to NIS 155 million, compared to NIS 140 million for the same quarter last year, an increase of 10%.**
- **F.F.O.<sup>(2)</sup> amounted to NIS 70 million, NIS 0.70 per share on a fully diluted basis, compared to NIS 54 million, NIS 0.64 per share on a fully diluted basis, for the same quarter last year, an increase of 29%.**
- **The Company, EQY and FCR raised NIS 184 million in share capital from the public in the reporting period, compared to NIS 210 million in the same quarter last year.**
- **The income amounted to NIS 40 million, NIS 0.38 per share on a fully diluted basis, compared to NIS 45 million (which included unusually large capital gains), NIS 0.51 per share on a fully diluted basis, in the same quarter last year<sup>(3)</sup>.**
- **Capital surpluses<sup>(4)</sup> (included within the line item “shareholders’ equity”) increased by NIS 44 million (NIS 0.44 per share), compared to a rise of NIS 5 million (NIS 0.06 per share) in the same quarter last year. The increase in the capital surpluses is due to the strengthening of the Canadian dollar, the euro and the U.S. dollar against the shekel (a “devaluation” of the shekel) in the aforesaid periods.**
- **The ratio of debt to total market capitalization stood at 52% as of March 31, 2006, compared to 54.4% as of March 31, 2005.**

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<sup>(1)</sup> N.O.I. – Property rental revenue, net of property operating expenses.

<sup>(2)</sup> See section 3E.

<sup>(3)</sup> After neutralizing the cumulative effect at the beginning of the year of a change in accounting principle, net (Israel Accounting Standard No. 19) in the amount of NIS 56.5 million (see section G below).

<sup>(4)</sup> Capital surpluses deriving from translation of the financial statements of overseas investee companies operating independently.

## **G. Change in Accounting Income Due to Changes in Accounting Standards**

Israel Accounting Standard No. 19 – “Taxes on Income”, published by the Israel Accounting Standards Board (hereinafter – “the Standard”), was approved in July 2004. The Standard prescribes criteria for the recognition, measurement, presentation and disclosure for taxes on income in financial statements. ~~In the first~~ In the first quarter of 2005, the Company included in its statement of income (by means of a non-recurring charge) an expense of NIS 56.5 million in respect of the cumulative effect at the beginning of the year of adopting this Standard. Other than as stated above, the Company does not expect the application of the new Standard to have any further effect on its operating results, its financial position and/or its cash flows.

## **2. The Group and its Business Environment – Key Events and Changes During the Reporting Period**

### **General**

During the reporting period, the Group’s investments in the acquisition and development of new properties and in the redevelopment, expansion and construction of various other properties totaled NIS 2 billion. The effect of these investments on the operating results will be reflected in full during the remainder of the year.

### **A. Property Transactions**

1. During the reporting period, the Group acquired 11 income-producing properties, with a total G.L.A. of approximately 141 thousand square meters, and 7 plots of land for future development. The total consideration for these acquisitions amounted to 1.8 billion.
2. During the reporting period, the Group invested a total of NIS 0.2 billion in developing new properties and in the redevelopment of existing properties.
3. As of March 31, 2006, EQY has properties being developed that include land for the development of 6 properties on an area of approximately 904 thousand square meters. In addition, EQY is engaged in the redevelopment of 9 properties.

As of March 31, 2006, FCR has properties being developed that include land for the development of 11 properties on an area of approximately 619 thousand square meters. In addition, FCR is engaged in the development and redevelopment of 9 properties.

As of March 31, 2006, Gazit Development has 3 plots of land for the development of shopping centers.

The total cost of the properties and land as described above, which are being developed, amounts to approximately NIS 1.1 billion. These properties and land did not generate any property rental revenue during the reporting period.

4. As of the end of the first quarter of 2006, EQY's average basic monthly rental revenue was US\$ 9.56 per square meter. During the reporting period, EQY renewed leases on 38 thousand square meters, while increasing the average basic monthly rent on these leases by 5.2% to an average monthly rent of US\$ 10.07 per square meter, as well as signing new leases on 25 thousand square meters at an average basic monthly rent of US\$ 10.51 per square meter. During the reporting period, leases on 20 thousand square meters expired, on which the average monthly rent was US\$ 9.93 per square meter. The net operating income from the same properties increased by 2.3%, compared to the same period last year.

EQY's core properties had an occupancy rate of 94.4% as of March 31, 2006 (the rate was 94.8% as of March 31, 2005).

5. As of the end of the first quarter of 2006, FCR's average basic monthly rental revenue was C\$ 12.30 per square meter. During the reporting period, FCR renewed leases on 26 thousand square meters, while increasing the average basic monthly rent on these leases by 5.5% to an average monthly rent of C\$ 11.58 per square meter, as well as signing new leases on 6 thousand square meters at an average basic monthly rent of C\$ 16.03 per square meter. During the reporting period, leases on 5 thousand square meters expired, on which the average monthly rent was C\$ 13.49 per square meter. Net operating income from same properties increased by 2.3%, compared to the same period last year.

FCR's properties had an occupancy rate of 94.7% as of March 31, 2006 (the rate was 93.9% as of March 31, 2005).

6. As of March 31, 2006, RSC's properties had an occupancy rate of 93.2% (the rate was 92.9% as of March 31, 2005).

During the reporting period, RSC acquired 2 plots of land for the construction of additional senior housing communities for a total investment of US\$ 8 million.

In addition, RSC has completed the process of refinancing two mortgages on properties in South Carolina, on which RSC has taken a new, non-recourse loan secured by a mortgage on these properties from a leading institutional provider of mortgages to the senior housing communities sector. The new loan, which is for a 5-year period, is in an amount of US\$ 13.5 million. This is close to the amount paid by the Company for the acquisition of these two properties in 2004 and is at the same level of leverage.

7. In the reporting period, Citycon invested € 85 million (approximately NIS 475 million) in the acquisition of income-producing properties, in increasing its stake in existing shopping centers, and in the redevelopment of income-producing properties.

As of March 31, 2006, Citycon's properties had an occupancy rate of 96.7% (the rate was 96.4% as of March 31, 2005).

- B.** As to the closing of ProMed's acquisition of a medical office building, with a multi-story parking garage, located in the state of New Jersey in the United States – see note 3A to the financial statements.
- C.** As to the exercise of stock options into shares of the Company by Clal Insurance – see note 3B to the financial statements.
- D.** As to the agreement with Clal Finance Underwriting Ltd. for the receipt of services in relation to raising capital, marketing securities, banking and other areas, in consideration for the grant of non-listed stock options – see note 3C to the financial statements.
- E.** In January 2006, based on the capabilities and the experience accumulated by the Company in North America and Europe, the Company's Board of Directors authorized the Company's management to broaden the scope of operations in Europe and to examine the possibility of extending operations into Asia. To this end, the Board of Directors approved an investment budget of US\$ 1.5 billion over the next two years. The investments will be made while maintaining the proper ratios of financial strength that have characterized the Group over the years and will be financed from the Company's own resources, as well as by raising capital and debt on the Israeli and overseas financial markets.

Pursuant to the Board of Directors' decision, the broadening of the scope of operations in Europe and the examination of the possibility of extending operations into Asia will include the Company's existing areas of activity, viz.: mainly shopping centers, as well as sheltered living facilities and medical office buildings. Within this framework, the Company is currently assessing – in several geographical regions of Europe and Asia – various types of arrangements, including: the acquisition, development and construction of individual buildings, the acquisition of property portfolios and the acquisition of property companies – either by itself or through alliances and joint ventures with appropriate partners.

- F.** As to the replacement of EQY's credit facility – see note 3D to the financial statements.
- G.** As to the raising of debt and the sale of treasury stock by the Company – see note 3E to the financial statements.

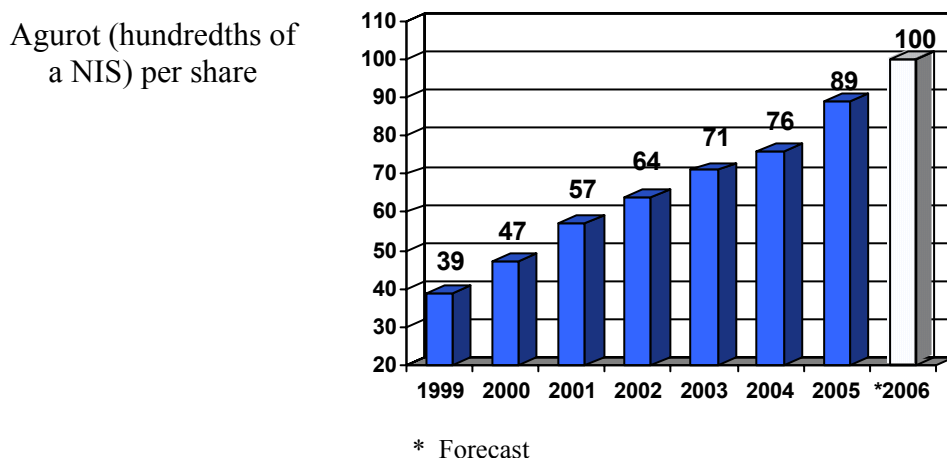
- H. As to the issue of debentures by EQY – see note 3F to the financial statements.
- I. As to the issue of debentures by FCR – see note 3G to the financial statements.
- J. As to the agreement that EQY entered into to establish a joint venture with Investcorp, with regard to 29 properties in Texas – see note 3H to the financial statements.
- K. As to the closing of an acquisition of a shopping center in Hamburg, Germany – see note 3I to the financial statements.

**L. Dividend Distribution Policy**

Pursuant to the Company’s dividend policy, the Company announces at the end of each year the anticipated dividend for the subsequent year. In November 2005, the Company decided that the dividend to be declared in 2006 will not be less than NIS 0.25 per share per quarter (NIS 1.00 per share on an annualized basis).

The aforesaid is subject to the existence of adequate amounts of distributable income at the relevant dates, and is subject to the provisions of any law relating to dividend distributions and to decisions that the Company is permitted to take, including the appropriation of its income for other purposes and the revision of this policy.

**The Company’s dividend growth in the years 1999-2006 is shown in the graph below:**



### 3. A. Results of Operations

	For the 3 months ended March 31		For the year ended December 31,
	<u>2006</u>	<u>2005</u>	<u>2005</u>
	Unaudited		Audited
<b>Reported NIS in thousands (other than net earnings (loss) per share data)</b>			
Property rental revenue	661,285	503,601	2,195,821
Rental property operating expenses	226,025	163,792	717,762
Rental property depreciation	112,931	80,689	360,800
<b>Gross profit</b>	<b>322,329</b>	<b>259,120</b>	<b>1,117,259</b>
General and administrative expenses	54,820	42,147	(*)189,102
<b>Operating income</b>	<b>267,509</b>	<b>216,973</b>	<b>928,157</b>
Financing expenses, net	171,087	142,951	622,058
	96,422	74,022	306,099
Other income, net	7,726	43,342	122,353
<b>Income before taxes on income</b>	<b>104,148</b>	<b>117,364</b>	<b>428,452</b>
Taxes on income	24,274	22,373	74,545
<b>Income after taxes on income</b>	<b>79,874</b>	<b>94,991</b>	<b>353,907</b>
Equity in earnings of affiliates	37,672	11,419	129,960
Minority interest in earnings of subsidiaries	(77,258)	(61,576)	(*)(295,965)
<b>Net income before cumulative effect</b>	<b>40,288</b>	<b>44,834</b>	<b>187,902</b>
Cumulative effect as of the beginning of the period of change in accounting principle (see section 1G above)	-	(56,525)	(56,525)
<b>Net income</b>	<b>40,288</b>	<b>(11,691)</b>	<b>131,377</b>
<b><u>Net earnings (loss) per share of NIS 1 par value (in reported NIS)(**)</u></b>			
<b><u>Fully diluted earnings per share</u></b>			
Before cumulative effect	0.38	0.51	2.05
Cumulative effect as of the beginning of the period of change in accounting principle	-	(0.66)	(0.63)
<b>Net earnings (loss)</b>	<b>0.38</b>	<b>(0.15)</b>	<b>1.42</b>
<b>Number of shares on a fully diluted basis used in computing fully diluted earnings per share</b>			
	<b>100,722</b>	<b>85,479</b>	<b>89,791</b>

(\*) Reclassified in accordance with Israel Accounting Standard No. 24 – see note 2D(4) to the financial statements.

(\*\*) Reclassified in accordance with Israel Accounting Standard No. 21 – see note 2D(2) to the financial statements.

## **B. Analysis of Results of Operations for the First Quarter of 2006**

### **Property rental revenue**

The 31% increase compared with the same period last year resulted from the acquisition of new properties, the coming online of properties whose development had been completed, and from the higher average rent per square meter for the Group's properties.

### **Rental property operating expenses**

The increase in rental operating expenses, compared to the same period last year, stems from the increased number of properties, as referred to above. Rental property operating expenses as a percentage of property rental revenue rose to 34.2% from 32.5% for the same period last year. This is mainly due to the relatively greater share in these items that now relates to FCR and RSC, whose operating expenses represent a higher percentage of revenue than EQY's.

### **Rental property depreciation**

The increase in rental property depreciation expenses compared to the same period last year stems from the increased number of properties, as referred to above, as well as from the allocation of certain property costs to the term of the tenants' leases, which is shorter than the lifespan of the properties. Depreciation expenses as a percentage of property rental revenue rose to 17% from 16% for the same period last year.

### **Gross profit**

Gross profit amounted to NIS 322 million (48.7% of property rental revenue); this compares to NIS 259 million (51.5% of property rental revenue) for the same period last year – an increase of 24%. The reduction in gross profit as a percentage of property rental revenue is attributable to the increase in rental property depreciation as a percentage of property rental revenue, and FCR's and RSC's relatively greater share in this item, as explained above.

### **General and administrative expenses**

The increase in general and administrative expenses compared to the same period last year stems from the growth in the Company's and the Group's activities, as referred to above. General and administrative expenses as a percentage of property rental revenue amount to 8.3%, compared to 8.4% in the same period last year.

### **Financing expenses, net**

The change in financing expenses stems from the following factors:

1. An increase in the Group's loans from an average balance of NIS 10.7 billion in the first quarter of 2005 to an average balance of NIS 14.4 billion in the first quarter of 2006. Interest expenses for the quarter reflect an average nominal interest rate of approximately 5.9% per annum on the Group's indebtedness.
2. The financing expenses are after taking into account income of NIS 20 million received by EQY as a result of a dividend distributed by DIM; the financing expenses are also net of income of NIS 12 million from other Group investments, compared to the income of NIS 6.7 million received in the same period last year.

### **Other income, net**

This item consists mainly of gains and losses in respect of capital transactions, such as the dilution of holdings in consolidated subsidiaries and real estate sales.

The gain resulting from the dilution of holdings in consolidated subsidiaries amounts to a total of NIS 3.3 million (the Company's share being NIS 3 million), compared to the gain of NIS 35.7 million (the Company's share being NIS 35.9 million) in the same period last year.

Additionally, the sale of an income-producing property and a plot of land by EQY produced a net gain for the Group of NIS 3.4 million (the Company's share being NIS 1.1 million), compared to the gain of NIS 7 million (the Company's share being NIS 2.2 million) from the sale of properties in the same period last year.

### **Equity in earnings of affiliates**

The increase in this item is attributable to the Company's equity in the earnings of Citycon in the amount of NIS 37.7 million, compared to NIS 11.4 million in the same period last year.

In the reporting period, Citycon revalued its investments in fixed assets to their fair value, in conformity with International Accounting Standard No. 40, resulting in an appreciation in their gross value of € 15.5 million (approximately NIS 87 million) (the Company's share, net of related taxes, being approximately NIS 24 million).

### **C. F.F.O.<sup>(1)</sup> and F.F.O. per share**

The Company's practice is to publish its F.F.O. results (which is the net reported income, after neutralizing non-recurring income and expenditure (including capital gains from the sale of properties and the gain from the dilution of its holdings in consolidated subsidiaries) and with the addition of the Company's share of depreciation of rental properties and amortization), and F.F.O. per share, as is already the accepted practice in those countries in which the Company operates, and in accordance with the position paper issued by the NAREIT – the U.S.-based National Association of Real Estate Investment Trusts.

In addition, beginning in 2006, Israel has adopted a REIT tax regime for companies that are real estate investment trusts, similar to that in effect in various other countries throughout the world. Such companies, under certain conditions, do not pay corporate tax. The Company thus considers that the presentation of F.F.O. and F.F.O. per share data, after neutralizing expenses and income in respect of deferred taxes (in other words, tax income and expenses that are not on a cash flows basis) provides a better comparison of the Company's operating results with those of other REIT companies in Israel and overseas.

The Company is of the opinion that F.F.O. and F.F.O. per share accurately reflect an additional aspect of the Company's operating results, providing a more appropriate basis for comparing the Company's operating results for a given period to those for previous periods, and for comparing the Company's operating results to those of other property companies.

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<sup>(1)</sup> According to the NAREIT position paper, the F.F.O. index does not represent cash flow from current operations according to accepted accounting principles, nor does it reflect the cash held by a company, or its ability to distribute that cash, and it is not a substitute for the reported net income. Furthermore, the F.F.O. is not part of the data audited by the Company's independent auditors.

The table below presents the computation of the Company's F.F.O. and F.F.O. per share for the periods stated:

	<b>For the 3 months ended March 31</b>		<b>For the year ended December 31,</b>
	<b>2006</b>	<b>2005</b>	<b>2005</b>
	<b>NIS in thousands (other than F.F.O. per share data)</b>		
<b>Net income</b>	<b>40,288</b>	<sup>(1)</sup> <b>44,834</b>	<sup>(1)</sup> <b>187,902</b>
<b>Adjustments to net income:</b>			
Depreciation and amortization <sup>(2)</sup>	51,239	33,202	153,685
Gains from dilution in holdings of consolidated subsidiaries	(3,017)	(38,798)	(75,264)
Gains from the sale of properties	(608)	(2,154)	(13,782)
Losses of Mishkenot Clal <sup>(2)</sup>	-	2,866	12,059
Deferred tax expenses	3,999	10,269	22,279
Equity in earnings of affiliates <sup>(3)</sup>	(37,672)	(11,419)	(129,960)
Equity in F.F.O. of affiliates	14,495	13,439	50,758
Other adjustments <sup>(4)</sup>	1,557	2,096	9,075
<b>Total adjustments to net income</b>	<b>29,993</b>	<b>9,501</b>	<b>28,850</b>
<b>F.F.O.</b>	<b>70,281</b>	<b>54,335</b>	<b>216,752</b>
<b>Primary F.F.O. per share<sup>(5)</sup></b>	<b>0.70</b>	<b>0.64</b>	<b>2.43</b>
<b>Fully diluted F.F.O. per share<sup>(5)</sup></b>	<b>0.70</b>	<b>0.64</b>	<b>2.41</b>

<sup>(1)</sup> After neutralizing the cumulative effect at the beginning of the year of a change in accounting principle, net (Israel Accounting Standard No. 19) (see section 1G above).

<sup>(2)</sup> After neutralizing the Company's equity in the results of Michkenot Clal (1982) Ltd., this operation having been sold at the end of the second quarter of 2005.

<sup>(3)</sup> Includes the Company's equity in the revaluation of Citycom's investment in fixed assets to their fair value, in conformity with International Accounting Standard No. 40.

<sup>(4)</sup> Expenses that are directly related to the income and expense items adjusted against the net income for the purpose of calculating F.F.O.

<sup>(5)</sup> In conformance with Israel Accounting Standard No. 21, which has been applied for the first time in the first quarter of 2006.

#### **4. Financial Status**

##### **Liquidity**

The Group has a policy of maintaining a high level of liquidity that enables the pursuit of business opportunities in its areas of operations.

As of March 31, 2006, the liquid assets available to the Group, including short-term investments, totaled NIS 138 million, compared to NIS 351 million as of December 31, 2005. In addition, as of March 31, 2006, the Group had unutilized credit facilities available for immediate drawdown of NIS 1.9 billion, compared to NIS 2.1 billion as of December 31, 2005.

**In aggregate, the Group has cash reserves and unutilized credit facilities available for immediate drawdown amounting to NIS 2 billion.**

##### **Current Assets**

Current assets, as of March 31, 2006, totaled NIS 1.8 billion, compared to NIS 1.9 billion as of December 31, 2005 and mainly includes rental properties held for disposal in an amount of NIS 1.3 billion (see section 2J above).

##### **Investments in Affiliates**

Investments in affiliates, amounting to NIS 765 million as of March 31, 2006, relate primarily to the investment in 50.7 million shares of Citycon; investments in affiliates as of December 31, 2005 amounted to NIS 722 million. During the reporting period, the Company acquired additional Citycon shares at a cost of NIS 7 million.

##### **Long-Term Investments**

Long-term investments, as of March 31, 2006, totaled NIS 956 million, compared to NIS 650 million as of December 31, 2005.

The increase in this item is derived primarily from the acquisition of listed shares and debentures in companies active in the Group's areas of activity or in synergetic businesses, in regions where it is already active. Among the investments included in the balance as of March 31, 2006 are an investment in 3.6 million shares of DIM (see note 3K to the financial statements), an investment in the debentures and shares of Winn-Dixie Stores Inc., which is currently subject to a court-ordered stay of proceedings notice within the framework of Chapter 11 proceedings, and also an investment in an income-producing property company, which is listed on the NYSE (see note 4F to the financial statements).

### **Fixed Assets, Net**

Net fixed assets (that include rental properties held for disposal, which are presented among current assets – see section 2J above), as of March 31, 2006, totaled NIS 20.4 billion, compared to NIS 18.3 billion at the end of 2005.

In the reporting period, the Group acquired income-producing properties, developed new properties and redeveloped existing properties at a total cost of NIS 2 billion. In addition, the strengthening of the U.S. dollar and the Canadian dollar against the shekel contributed NIS 0.2 billion to the increase in this item. Depreciation expenses for the reporting period amounted to NIS 113 million.

### **Current Liabilities**

Current liabilities, as of March 31, 2006, mainly comprise the line item “credit from banks and other credit granting institutions”, which mainly consist of the current maturities of long-term liabilities in the amount of NIS 1 billion, compared to NIS 1.2 billion at the end of 2005.

The balance of current maturities includes the final settlement of loans, in the amount of NIS 0.4 billion (at the end of 2005 - NIS 0.5 billion), which are secured by a charge on the properties. Based on past experience, the Group usually renews most of these loans by taking new, long-term secured and unsecured loans.

### **Long-Term Liabilities**

Long-term liabilities, as of March 31, 2006 totaled NIS 14.7 billion, compared to NIS 12.3 billion at the end of 2005.

The increase in this item derives principally from the taking of new loans and the issuance of debentures, intended principally for financing investments in fixed assets and the acquisition of long-term investments.

### **Shareholders' Equity**

The change in shareholders' equity from NIS 1,908 million as of December 31, 2005 to NIS 2,099 million as of March 31, 2006 stems mainly from the sale of treasury stock to institutional investors amounting to NIS 49 million, from the exercise of stock options into shares amounting to NIS 72 million, from the income for the reporting period amounting to NIS 40 million, and from the increase due to “translation adjustments deriving from translation of the financial statements of FCR, EQY and Citycon” and other capital surpluses amounting to NIS 54 million. These were partly offset by the dividend of NIS 25.4 million declared by the Company.

Shareholders' equity per share as of March 31, 2006 amounted to NIS 20.6 per share, compared to NIS 19.4 per share as of December 31, 2005, this being after a dividend distribution of NIS 0.25 per share during the reporting period.

### **Ratio of Debt to Total Assets**

The ratio of the Group's interest-bearing debt to its gross assets (which includes the accumulated depreciation on the Group's assets) stood at 63.5% as of March 31, 2006, compared to 61.5% and 61.7% as of December 31, 2005 and March 31, 2005, respectively.

The ratio of the Group's interest-bearing debt to total market capitalization stood at 52% as of March 31, 2006, compared to 52.2% and 54.4% as of December 31, 2005 and March 31, 2005, respectively.

The Company considers that the fair value of its assets exceeds their carrying value in the Company's books, and accordingly, the ratio of debt to total assets more fairly reflects the Group's leverage ratios.

### **Cash Flows**

Cash inflows from operating activities for the reporting period totaled NIS 155 million, compared to NIS 140 million for the same period last year. The growth in cash inflows from operating activities in the reporting period was due to the continuing improvement in operating income.

In addition, in order to fund the Group's activities during the reporting period, the Company and its consolidated subsidiaries raised capital totaling NIS 184 million and took long-term loans and issued debentures in a net amount of NIS 1,808 million. The proceeds from the above sources were used primarily to finance investing activities for the purchase of fixed assets, which, net of proceeds from the disposal of fixed assets, totaled NIS 1,936 million in the reporting period, and for further investments in affiliates, listed shares and debentures and long-term investments, in an aggregate net amount of NIS 290 million.

## **5. Donations**

The Company customarily makes donations to charities and community welfare and education projects.

The Company makes donations to Tel-Aviv University, which has established and operates an institute focusing on research and studies of all manner of real estate related topics (The Chaim Katzman – Gazit-Globe Real Estate Institute). In this connection, the Company has pledged to make an annual donation of US\$ 150 thousand for a period of seven years.

The Company donates to the "College for All" charity – a not-for-profit organization working to close the gaps in education by means of creating equal opportunities for excellence. This vision is being realized through the provision of learning and other tools to students with ability and motivation, who come from underprivileged neighborhoods. The goal is to encourage such students into academic studies. In this connection, the Company has pledged to provide assistance to a group of students for a period of five years.

During the reporting period, the Group's donations amounted to NIS 855 thousand.

## **6. Additional Information and Subsequent Events**

- A. From balance sheet date through to the date of signing the financial statements, the Group invested a total of NIS 0.5 billion in acquiring new properties and land for future development.
- B. As to the closing of a sale of 29 of EQY's properties in Texas to a joint venture with Investcorp and the sale of 2 other properties in Texas to third parties - see notes 3H, 4I and 4J to the financial statements.
- C. As to the sale of Company shares and stock options for Company shares to institutional and foreign investors, interested parties and the parent company for a total consideration of NIS 325 million - see note 4A to the financial statements.
- D. As to the issue of 500 thousand Company stock options, together with a wholly owned subsidiary's debentures with a nominal value of NIS 50 million, to institutional investors – see note 4C to the financial statements.
- E. As to the raising of debt by the Company - see note 4B to the financial statements.
- F. As to the raising of debt by FCR - see note 4D to the financial statements.
- G. As to a rights issue made by Citycon – see note 4E to the financial statements.

## **7. Reporting of Exposures to Market Risks and their Management**

The individuals responsible for managing and reporting the Company's market risks are Mr. Dori Segal, the Company's president, and Mr. Gil Kotler, the Company's Chief Financial Officer. Since the publication of the Company's annual report for 2005 on March 20, 2006, there have been no significant changes in the market risks or the way in which they are managed.

Attached as Appendix I is the Company's primary linkage balance sheet as of March 31, 2006.

May 22, 2006		
_____ <b>Date of approval of the Directors' Report</b>	_____ <b>Chaim Katzman Chairman of the Board of Directors</b>	_____ <b>Dori Segal President and Director</b>

**Appendix I to Board of Directors' Report  
on the State of the Company's Affairs**

**Primary Linkage Balance Sheet  
as of March 31, 2006**

	<b>Linked to the consumer price index</b>	<b>In unlinked NIS</b>	<b>In US\$ or linked thereto</b>	<b>In C\$ or linked thereto</b>	<b>In euros</b>	<b>Unlinked</b>	<b>Total</b>
	<b>R e p o r t e d N I S i n t h o u s a n d s</b>						
<b>Monetary assets</b>							
Cash and cash equivalents	-	6,959	46,858	37,598	848	-	92,263
Short-term investments	-	-	40,647	1,568	-	3,840	46,055
Tenants, accounts receivable and other debit balances	15,885	1,668	116,828	135,735	-	77,120	347,236
Long-term investments	4,517	-	1,852	16,848	-	933,128	956,345
Long-term loans and debit balances	2,561	-	87,450	39,002	-	-	129,013
	22,963	8,627	293,635	230,751	848	1,014,088	1,570,912
<b>Non-monetary assets<sup>(1)</sup></b>	-	673,036	10,198,951	9,533,483	763,426	223,844	21,392,740
	<b>22,963</b>	<b>681,663</b>	<b>10,492,586</b>	<b>9,764,234</b>	<b>764,274</b>	<b>1,237,932</b>	<b>22,963,652</b>
<b>Liabilities</b>							
Short-term credit from banks and other credit granting institutions	-	355	83,206	-	43	-	83,604
Trade and other payables and other credit balances	1,170	42,925	186,548	279,730	2,046	31,316	543,735
Debentures	878,985	-	3,531,572	897,533	181,143	-	5,489,233
Convertible debentures redeemable in shares of a consolidated subsidiary	-	-	-	346,202	-	-	346,202
Liabilities to financial institutions and others	17,792	17,527	4,002,875	5,450,670	228,203	-	9,717,067
Deposits from tenants	1,283	-	48,829	19,191	-	-	69,303
Liabilities for employee rights upon retirement	-	164	-	-	-	-	164
Deferred taxes	-	-	-	-	-	97,552	97,552
	899,230	60,971	7,853,030	6,993,326	411,435	128,868	16,346,860
<b>Receipts in respect of conversion options in consolidated subsidiary</b>	-	-	-	10,757	-	-	10,757
<b>Minority interests</b>	-	-	-	-	-	4,507,514	4,507,514
<b>Shareholders' equity</b>	-	-	-	-	-	2,098,521	2,098,521
	<b>899,230</b>	<b>60,971</b>	<b>7,853,030</b>	<b>7,004,083</b>	<b>411,435</b>	<b>6,734,903</b>	<b>22,963,652</b>

<sup>(1)</sup> Mainly fixed assets, net.