

**GAZIT-GLOBE (1982) LTD.**

**INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**AS OF JUNE 30, 2004**

**UNAUDITED**

**INDEX**

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The Board of Directors  
Gazit-Globe (1982) Ltd.

Re: Review report of unaudited interim consolidated financial statements  
as of and for the six and three months periods ended June 30, 2004

At your request, we have reviewed the interim consolidated balance sheet of Gazit-Globe (1982) Ltd. as of June 30, 2004, and the related interim consolidated statements of income, changes in shareholders' equity and cash flows for the six and three months periods then ended. Our review was made in accordance with procedures established by the Institute of Certified Public Accountants in Israel. These procedures included reading the above mentioned financial statements, reading minutes of meetings of the shareholders and of the board of directors and its committees, and making inquiries of persons responsible for financial and accounting matters.

We have been furnished with reports of other accountants in respect of the review of the interim financial statements of certain subsidiaries, whose assets constitute approximately 97.4% of total consolidated assets as of June 30, 2004, and whose revenues constitute approximately 97.8% and 97.8% of total consolidated revenues for the six and three months then ended, respectively. In addition, we have been furnished with reports of other accountants in respect of the review of certain affiliates, the investment in which on the equity basis of accounting as of June 30, 2004 totaled NIS 391,141 thousand and the Company's share in the earnings of the above companies for the three months then ended totaled NIS 11,782 thousand.

A review is substantially less in scope than an audit in accordance with generally accepted auditing standards in Israel, and accordingly, we do not express an opinion on the interim consolidated financial statements.

Based on our review and the reports of other accountants, we are not aware of any material modifications that should be made to the interim consolidated financial statements in order for them to be in conformity with generally accepted accounting principles in Israel and with the Securities Regulations (Periodic and Immediate Reports), 1970.

Tel-Aviv, Israel  
August 31, 2004

**KOST FORER GABBAY & KASIERER**  
A Member of Ernst & Young Global

**CONSOLIDATED BALANCE SHEETS**

	<u>June 30,</u>		<u>December 31,</u>
	<u>2004</u>	<u>2003</u>	<u>2003</u>
	<u>Unaudited</u>		<u>Audited</u>
	<u>NIS in thousands</u>		
	<u>Reported <sup>(1)</sup></u>	<u>Adjusted <sup>(2)</sup></u>	<u>Adjusted <sup>(2)</sup></u>
<b>ASSETS</b>			
<b>CURRENT ASSETS:</b>			
Cash and cash equivalents	20,590	167,675	53,651
Short-term investments	73,695	63,594	67,709
Tenants	77,230	72,234	84,911
Accounts receivable	94,441	83,354	66,194
Loans to partners in property under development	58,356	59,637	57,522
Rental property held for sale	199,127	5,491	63,649
	<u>523,439</u>	<u>451,985</u>	<u>393,636</u>
<b>LONG-TERM INVESTMENTS AND LOANS:</b>			
Investments in affiliates	407,051	27,646	15,706
Long-term investments	146,647	65,859	40,353
Long-term loans	58,871	58,843	58,517
	<u>612,569</u>	<u>152,348</u>	<u>114,576</u>
<b>FIXED ASSETS:</b>			
Cost	14,303,725	10,203,249	12,608,688
Less - accumulated depreciation	652,764	408,321	530,276
	<u>13,650,961</u>	<u>9,794,928</u>	<u>12,078,412</u>
<b>OTHER ASSETS AND DEFERRED CHARGES, NET</b>			
	<u>280,599</u>	<u>260,023</u>	<u>228,823</u>
	<u><u>15,067,568</u></u>	<u><u>10,659,284</u></u>	<u><u>12,815,447</u></u>

(1) See Note 2.

(2) Adjusted to the NIS of December 2003.

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

**CONSOLIDATED BALANCE SHEETS**

	<u>June 30,</u>		<u>December 31,</u>
	<u>2004</u>	<u>2003</u>	<u>2003</u>
	<u>Unaudited</u>		<u>Audited</u>
<b>NIS in thousands</b>			
	<u>Reported <sup>(1)</sup></u>	<u>Adjusted <sup>(2)</sup></u>	<u>Adjusted <sup>(2)</sup></u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>CURRENT LIABILITIES:</b>			
Short-term credit from banks and others	576,163	295,812	378,944
Trade payables	79,297	60,100	129,921
Other accounts payable	273,143	182,952	187,094
	<u>928,603</u>	<u>538,864</u>	<u>695,959</u>
<b>LONG-TERM LIABILITIES:</b>			
Debentures	2,304,845	961,692	1,084,222
Liabilities to financial institutions and others	6,425,430	4,987,506	6,143,093
Tenants' security deposits	272,187	136,656	146,260
Accrued severance pay, net	1,043	905	846
Deferred taxes	-	731	-
	<u>9,003,505</u>	<u>6,087,490</u>	<u>7,374,421</u>
CONVERTIBLE DEBENTURES REDEEMABLE FOR SUBSIDIARY'S SHARES	<u>638,627</u>	<u>742,690</u>	<u>649,463</u>
MINORITY INTEREST	<u>3,284,552</u>	<u>2,344,605</u>	<u>2,954,392</u>
SHAREHOLDERS' EQUITY	<u>1,212,281</u>	<u>945,635</u>	<u>1,141,212</u>
	<u>15,067,568</u>	<u>10,659,284</u>	<u>12,815,447</u>

(1) See Note 2.

(2) Adjusted to the NIS of December 2003.

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

<u>August 31, 2004</u>			
Date of approval of the financial statements	Chaim Katzmann Chairman of the Board of Directors	Dori Segal President and Director	Gil Kotler Chief Financial Officer

**CONSOLIDATED STATEMENTS OF INCOME**

	Six months ended June 30,		Three months ended June 30,		Year ended December 31,
	2004	2003	2004	2003	2003
	Unaudited				Audited
	NIS in thousands (except per share amounts)				
	Reported <sup>(1)</sup>	Adjusted <sup>(2)</sup>	Reported <sup>(1)</sup>	Adjusted <sup>(2)</sup>	Adjusted <sup>(2)</sup>
Rental income	877,350	610,750	456,930	317,760	1,401,186
Rental property operating expenses	280,397	201,846	145,305	102,724	457,790
Rental property depreciation	129,793	83,389	67,807	44,978	197,489
Gross profit	467,160	325,515	243,818	170,058	745,907
General and administrative expenses	73,533	52,728	38,012	25,222	115,805
Operating income	393,627	272,787	205,806	144,836	630,102
Financial expenses, net	254,253	105,439	132,718	122,155	300,163
Other income, net	139,374	167,348	73,088	22,681	329,939
	27,126	18,245	1,366	23,589	56,492
Income before taxes on income	166,500	185,593	74,454	46,270	386,431
Taxes on income	24,667	15,335	13,594	8,686	43,629
Income after taxes on income	141,833	170,258	60,860	37,584	342,802
Equity in earnings of affiliates	11,676	3,647	11,680	1,360	3,613
Minority interest in earnings of subsidiaries	(117,781)	(98,160)	(58,164)	(25,137)	(209,839)
Net income	35,728	75,745	14,376	13,807	136,576
Net earning per NIS 1 par value of Ordinary shares (in NIS)					
Basic earning	0.43	0.89	0.16	0.11	1.69
Diluted earning	0.39	-	0.13	-	-

(1) See Note 2.

(2) Adjusted to the NIS of December 2003.

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

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Six months ended June 30, 2004 (unaudited)								
	Share capital	Share premium	Capital reserve	Foreign currency translation adjustments for autonomous entities	Retained earnings	Dividend declared subsequent to the balance sheet date	Less - shares held by the Company	Less - loans for purchase of shares	Total
	Reported NIS in thousands (1)								
Balance at beginning of period (audited)	137,916	841,647	1,702	86,175	175,171	14,583	(106,604)	(9,378)	1,141,212
Exercise of stock options into shares	4,193	51,563	-	-	-	-	(9,400)	-	46,356
Foreign currency translation adjustments for autonomous entities	-	-	-	9,697	-	-	-	-	9,697
Revaluation of derivatives in affiliate to market value (3)	-	-	9,521	-	-	-	-	-	9,521
Revaluation of loans for purchase of shares	-	-	-	-	64	-	-	(64)	-
Net income	-	-	-	-	35,728	-	-	-	35,728
Dividend paid	-	-	-	-	(15,650)	(14,583)	-	-	(30,233)
Dividend declared (4)	-	-	-	-	(16,007)	16,007	-	-	-
Balance at end of period	<u>142,109</u>	<u>893,210</u>	<u>11,223</u>	<u>95,872</u>	<u>179,306</u>	<u>16,007</u>	<u>(116,004)</u>	<u>(9,442)</u>	<u>1,212,281</u>
	Six months ended June 30, 2003 (unaudited)								
	Share capital	Share premium	Capital reserve	Foreign currency translation adjustments for autonomous entities	Retained earnings	Dividend declared subsequent to the balance sheet date	Less - shares held by the Company	Less - loans for purchase of shares	Total
	Adjusted NIS in thousands (2)								
Balance at beginning of period (audited)	127,211	710,206	1,702	61,957	93,982	11,374	(106,544)	(10,176)	889,712
Exercise of stock options into shares	2,917	30,935	-	-	-	-	-	-	33,852
Repurchase of shares	-	-	-	-	-	-	(63)	63	-
Foreign currency translation adjustments for autonomous entities	-	-	-	(30,285)	-	-	-	-	(30,285)
Repayment of loans for purchase of shares	-	-	-	-	-	-	-	493	493
Net income	-	-	-	-	75,745	-	-	-	75,745
Dividend paid	-	-	-	-	(12,508)	(11,374)	-	-	(23,882)
Balance at end of period	<u>130,128</u>	<u>741,141</u>	<u>1,702</u>	<u>31,672</u>	<u>157,219</u>	<u>-</u>	<u>(106,607)</u>	<u>(9,620)</u>	<u>945,635</u>

(1) See Note 2.

(2) Adjusted to the NIS of December 2003.

(3) See Note 3f.

(4) See Note 4d.

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

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Three months ended June 30, 2004 (unaudited)								
	Share capital	Share premium	Capital reserve	Foreign currency translation adjustments for autonomous entities	Retained earnings	Dividend declared subsequent to the balance sheet date	Less - shares held by the Company	Less - loans for purchase of shares	Total
	Reported NIS in thousands (1)								
Balance at beginning of period	140,769	872,409	1,702	120,983	181,207	15,393	(116,004)	(9,434)	1,207,025
Exercise of stock options into shares	1,340	20,801	-	-	-	-	-	-	22,141
Foreign currency translation adjustments for autonomous entities	-	-	-	(25,111)	-	-	-	-	(25,111)
Revaluation of derivatives in affiliate to market value (3)	-	-	9,521	-	-	-	-	-	9,521
Revaluation of loans for purchase of shares	-	-	-	-	8	-	-	(8)	-
Net income	-	-	-	-	14,376	-	-	-	14,376
Dividend paid	-	-	-	-	(278)	(15,393)	-	-	(15,671)
Dividend declared (4)	-	-	-	-	(16,007)	16,007	-	-	-
Balance at end of period	<u>142,109</u>	<u>893,210</u>	<u>11,223</u>	<u>95,872</u>	<u>179,306</u>	<u>16,007</u>	<u>(116,004)</u>	<u>(9,442)</u>	<u>1,212,281</u>
	Three months ended June 30, 2003 (unaudited)								
	Share capital	Share premium	Capital reserve	Foreign currency translation adjustments for autonomous entities	Retained earnings		Less - shares held by the Company	Less - loans for purchase of shares	Total
	Adjusted NIS in thousands (2)								
Balance at beginning of period	127,211	710,206	1,702	76,644	156,002		(106,544)	(10,176)	955,045
Exercise of stock options into shares	2,917	30,935	-	-	-		-	-	33,852
Repurchase of shares	-	-	-	-	-		(63)	63	-
Foreign currency translation adjustments for autonomous entities	-	-	-	(44,972)	-		-	-	(44,972)
Repayment of loans for purchase of shares	-	-	-	-	-		-	493	493
Net income	-	-	-	-	13,807		-	-	13,807
Dividend paid	-	-	-	-	(12,590)		-	-	(12,590)
Balance at end of period	<u>130,128</u>	<u>741,141</u>	<u>1,702</u>	<u>31,672</u>	<u>157,219</u>		<u>(106,607)</u>	<u>(9,620)</u>	<u>945,635</u>

(1) See Note 2.

(2) Adjusted to the NIS of December 2003.

(3) See Note 3f.

(4) See Note 4d.

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

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Year ended December 31, 2003 (audited)								
	Share capital	Share premium	Capital reserve	Foreign currency translation adjustments for autonomous entities	Retained earnings	Dividend declared subsequent to the balance sheet date	Less - shares held by the Company	Less - loans for purchase of shares	Total
	Adjusted NIS in thousands (1)								
Balance at the beginning of the year	127,211	710,206	1,702	61,957	93,982	11,374	(106,544)	(10,176)	889,712
Issuance of share capital, net	3,987	59,758	-	-	-	-	-	-	63,745
Exercise of stock options into shares	6,718	71,683	-	-	-	-	-	-	78,401
Repayment of loans for purchase of shares	-	-	-	-	-	-	-	738	738
Repurchase of shares	-	-	-	-	-	-	(60)	60	-
Foreign currency translation adjustments for autonomous entities	-	-	-	24,218	-	-	-	-	24,218
Net income	-	-	-	-	136,576	-	-	-	136,576
Dividend paid	-	-	-	-	(40,804)	(11,374)	-	-	(52,178)
Dividend declared	-	-	-	-	(14,583)	14,583	-	-	-
Balance at the end of the year	<u>137,916</u>	<u>841,647</u>	<u>1,702</u>	<u>86,175</u>	<u>175,171</u>	<u>14,583</u>	<u>(106,604)</u>	<u>(9,378)</u>	<u>1,141,212</u>

(1) Adjusted to the NIS of December 2003.

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

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Six months ended June 30,		Three months ended June 30,		Year ended December 31,
	2004	2003	2004	2003	2003
	Unaudited				Audited
	NIS in thousands				
	Reported <sup>(1)</sup>	Adjusted <sup>(2)</sup>	Reported <sup>(1)</sup>	Adjusted <sup>(2)</sup>	Adjusted <sup>(2)</sup>
<b>Cash flows from operating activities:</b>					
Net income	35,728	75,745	14,376	13,807	136,576
Adjustments to reconcile net income to net cash provided by operating activities (a)	217,561	52,439	144,299	83,491	225,208
Net cash provided by operating activities	253,289	128,184	158,675	97,298	361,784
<b>Cash flows from investing activities:</b>					
Investment in newly consolidated companies (b)	(8,861)	(800,858)	-	-	(827,451)
Investment in subsidiary and jointly controlled entity	(10,824)	(15,026)	-	(15,026)	(57,988)
Investments in fixed assets	(1,705,005)	(394,995)	(829,600)	(197,766)	(2,310,376)
Repayment (grant) of loans to partners in property under development, net	(1,945)	(14,564)	1,783	(9,004)	(3,744)
Proceeds from sale of real estate	70,583	66,638	31,245	23,193	145,523
Long-term loans granted	(20,755)	(3,500)	-	-	(214)
Repayment of long-term loans granted	23,231	34,995	20,631	32,494	17,452
Short-term investments, net	3,609	73,565	463	60,993	108,964
Purchase of marketable securities and long-term investments	(120,377)	(45,356)	(91,731)	(42,092)	(76,269)
Investment in affiliate	(374,748)	-	(68,295)	-	-
Proceeds from realization of long-term investments	10,409	34,491	-	13,133	74,938
Net cash used in investing activities	(2,134,683)	(1,064,610)	(935,504)	(134,075)	(2,929,165)
<b>Cash flows from financing activities:</b>					
Repayment of loans for the purchase of Company and subsidiary's shares	13,476	493	-	493	16,058
Issuance of share capital, net	-	-	-	-	63,745
Exercise of stock options into shares	46,356	33,852	22,141	33,852	78,401
Issuance of shares to minorities in subsidiary, net	321,273	515,422	93,037	377,391	1,002,175
Deferred charges in respect of raising loans and debentures	(14,995)	(10,585)	(510)	(779)	(19,672)
Dividend paid	(30,233)	(23,882)	(30,233)	(23,882)	(52,178)
Dividend paid to minorities in subsidiaries	(138,456)	(90,526)	(53,912)	(38,097)	(211,918)
Receipt of long-term loans	1,179,271	1,031,657	633,931	32,662	2,245,899
Repayment of long-term loans	(811,232)	(598,576)	(93,152)	(341,200)	(788,186)
Redemption and early redemption of debentures and convertible debentures	(19,586)	(22,916)	(18,741)	(13,014)	(123,379)
Issuance of debentures	1,206,974	-	107,630	-	-
Sale of Company's debentures by subsidiaries	2,772	1,767	-	638	117,632
Short-term bank credit, net	83,933	145	57,166	57	313
Increase in tenants' security deposits	12,336	845	4,696	1,791	1,111
Net cash provided by financing activities	1,851,889	837,696	722,053	29,912	2,330,001
Effect of exchange rate differences from cash balances of foreign autonomous entities	(3,556)	(17,291)	(3,823)	(26,788)	7,335
Decrease in cash and cash equivalents	(33,061)	(116,021)	(58,599)	(33,653)	(230,045)
Cash and cash equivalents at beginning of period	53,651	283,696	79,189	201,328	283,696
Cash and cash equivalents at end of period	20,590	167,675	20,590	167,675	53,651

(1) See Note 2.

(2) Adjusted to the NIS of December 2003.

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

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Six months ended June 30,		Three months ended June 30,		Year ended December 31,
	2004	2003	2004	2003	2003
	Unaudited				Audited
NIS in thousands					
	Reported <sup>(1)</sup>	Adjusted <sup>(2)</sup>	Reported <sup>(1)</sup>	Adjusted <sup>(2)</sup>	Adjusted <sup>(2)</sup>
(a) <u>Adjustments to reconcile net income to net cash provided by operating activities:</u>					
Income and expenses not involving cash flows:					
Loss (gain) from realization and revaluation of marketable securities, net	(4,736)	1,241	(421)	(6,985)	(11,334)
Minority interest in earnings of subsidiaries	117,781	98,160	58,164	25,137	209,839
Equity in earnings of affiliates, net of dividend received	(11,676)	(2,337)	(11,680)	(787)	(1,232)
Depreciation	129,903	83,592	70,285	45,063	199,406
Deferred taxes, net	10,897	834	7,323	(790)	17,081
Loss from early redemption of debentures and convertible debentures	30	160	7	145	288
Adjustment differences on monetary assets and long-term monetary liabilities, net	(24,977)	(99,466)	(19,802)	32,639	(159,356)
Write-down of long-term investments	-	-	-	-	250
Amortization of other assets and deferred charges	9,669	10,733	2,524	2,564	23,848
loss (gain) from sale of real estate	(6,322)	(6,921)	2,030	(4,646)	(11,070)
Increase in accrued severance pay, net	26	65	10	49	6
Gain from issuance to third party	(15,524)	(13,619)	(212)	(18,403)	(44,627)
Changes in asset and liability items:					
Increase in tenants and other accounts receivable	(22,198)	(26,496)	(17,440)	(26,429)	(35,225)
Increase in trade payables and other accounts payable	30,117	5,323	52,101	36,378	29,259
Increase (decrease) in tenants' security deposits, net	4,571	1,170	1,410	(444)	8,075
	<u>217,561</u>	<u>52,439</u>	<u>144,299</u>	<u>83,491</u>	<u>225,208</u>

(1) See Note 2.

(2) Adjusted to the NIS of December 2003.

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

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Six months ended June 30,		Three months ended June 30,		Year ended December 31,
	2004	2003	2004	2003	2003
	Unaudited				Audited
	NIS in thousands				
	Reported <sup>(1)</sup>	Adjusted <sup>(2)</sup>	Reported <sup>(1)</sup>	Adjusted <sup>(2)</sup>	Adjusted <sup>(2)</sup>
(b) <u>Investment in newly consolidated companies: (3)</u>					
Subsidiaries' assets and liabilities at date of acquisition:					
Working capital (excluding cash and cash equivalents):					
Current assets	(1,381)	(51,118)	-	-	(52,815)
Current liabilities	5,932	57,085	-	-	58,979
	4,551	5,967	-	-	6,164
Fixed assets, long-term investments and loans (mainly real estate)	(123,804)	(3,117,878)	-	-	(3,221,407)
Other assets (including goodwill)	(3,653)	(87,421)	-	-	(90,323)
Long-term liabilities	115,512	1,357,659	-	-	1,402,741
Minority interest	(1,467)	51,677	-	-	53,394
	(13,412)	(1,795,963)	-	-	(1,855,595)
Increase in minority interest in respect of consideration paid in subsidiary's shares	-	989,138	-	-	1,021,980
	(8,861)	(800,858)	-	-	(827,451)
(c) <u>Significant non-cash operations:</u>					
Conversion of convertible debentures into subsidiary's shares	-	-	-	-	127,934
Purchase of fixed assets against liabilities	-	-	-	-	11,788
Purchase of fixed assets in consideration for subsidiary's shares	-	7,754	-	-	8,432
Conversion of debentures into convertible debentures	-	564	-	-	593
Realization of investment in affiliate	-	9,656	-	9,656	-

(1) See Note 2.

(2) Adjusted to the NIS of December 2003.

(3) See Note 3g.

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

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 1:- GENERAL**

These financial statements have been prepared in a condensed format as of June 30, 2004, and for the six and three months periods then ended ("interim financial statements"). These financial statements should be read in conjunction with the Company's audited annual financial statements and accompanying notes as of December 31, 2003 and for the year then ended.

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES**

- a. The interim financial statements have been prepared in accordance with generally accepted accounting principles for the preparation of financial statements for interim periods, as prescribed in Accounting Standard No. 14 of the Israel Accounting Standards Board.

The significant accounting policies and methods of computation followed in the preparation of the interim financial statements are identical to those followed in the preparation of the latest annual financial statements, except as described below.

- b. Discontinuance of the adjustment of financial statements and financial reporting in reported amounts:

In 2001, the Israel Accounting Standards Board published Accounting Standard No. 12 with respect to the discontinuance of the adjustment of financial statements. According to this Standard (as amended by Accounting Standard No. 17), the adjustment of financial statements for the effects of inflation should be discontinued beginning January 1, 2004. The Company applied the provisions of the Standard, and accordingly, the adjustment for the effects of inflation was discontinued as from January 1, 2004.

1. Starting point for the preparation of financial statements:

- a) In the past, the Company prepared its financial statements on the basis of the historical cost convention, adjusted for the changes in the general purchasing power of the Israeli currency based on the changes in the Israeli Consumer Price Index ("Israeli CPI"). These adjusted amounts, as included in the financial statements as of December 31, 2003 (the transition date), served as a starting point for nominal financial reporting beginning January 1, 2004. Additions made after the transition date are included at nominal values.
- b) The amounts for non-monetary assets do not necessarily represent realizable value or current economic value, but only the reported amounts for those assets.
- c) In the financial statements "cost" represents cost in the reported amount (see 2 below).
- d) All comparative data for previous periods are presented after adjustment for the Israeli CPI as of the transition date (the Israeli CPI for December 2003).

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (cont.)**

## 2. Financial statements in reported amounts:

## a) Definitions:

*Adjusted amount* - historical nominal amount adjusted for the Israeli CPI as of December 2003, according to the provisions of Opinions No. 23 and No. 36 of the Institute of Certified Public Accountants in Israel.

*Reported amount* - adjusted amount as of the transition date (December 31, 2003), plus additions in nominal values after the transition date and less amounts deducted after the transition date.

## b) Balance sheet:

- 1) Non-monetary items are presented in reported amounts.
- 2) Monetary items are presented in nominal values as of the balance sheet date.
- 3) The carrying value of investments in investees is determined based on the financial statements of these companies in reported amounts.

## c) Statement of income:

- 1) Income and expenses relating to non-monetary items are derived from the change in the reported amount between the opening balance and the closing balance.
- 2) Other items in the statement of income are presented in nominal values.
- 3) Equity in the results of operations of investees is determined based on the financial statements of these companies in reported amounts.

## d) Statement of changes in shareholders' equity:

Dividends declared in the reported period are presented in nominal values.

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**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**


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**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (cont.)**

3. The following are details of the changes in the index in Israel, U.S. and Canada and in the exchange rates of the U.S. dollar, the Canadian dollar and the Euro:

	Six months ended June 30,		Three months ended June 30,		Year ended December 31,
	2004	2003	2004	2003	2003
	%				
Index in Israel	1.4	(0.5)	1.5	(1.3)	(1.9)
Index in U.S.	2.9	1.6	1.2	(0.3)	1.9
Index in Canada	1.9	1.4	1.2	(0.6)	2.0
Exchange rate of one U.S. dollar	2.7	(9.0)	(0.7)	(8.0)	(7.6)
Exchange rate of one Canadian dollar	(1.9)	5.9	(3.5)	(0.5)	13.5
Exchange rate of one Euro	(1.2)	(0.8)	(1.3)	(3.5)	11.3

4. Translation of financial statements of foreign operations:

- a) On January 1, 2004, Accounting Standard No. 13 with respect to the effect of changes in foreign exchange rates became effective ("Standard No. 13"). Standard No. 13 replaces Interpretations No. 8 and No. 9 of Opinion No. 36 of the Institute of Certified Public Accountants in Israel, which were superseded when Accounting Standard No. 12, as described above, became effective.

Standard No. 13 deals with the translation of foreign currency transactions and with the translation of financial statements of foreign operations for incorporation into the financial statements of the Company.

- b) Foreign operation that is classified as a foreign autonomous entity ("the entity"):

In accordance with Standard No. 13, assets and liabilities, both monetary and non-monetary of the entity are translated at the closing rate. The components of the statement of operations and of the statement of cash flows of the entity are translated at the exchange rates at the dates of the transactions or at average exchange rates for the period if such exchange rates approximate the actual exchange rates. All exchange rate differences resulting from the translation, as above, are classified as a separate item in shareholders' equity ("foreign currency translation adjustments for autonomous entities") until the disposal of the investment.

As a result of the adoption of Standard No. 13, goodwill arising on the acquisition of the entity is accounted for as an asset of the entity and translated at the closing rate and not at the rate as of the date of the transaction, which was the rate used until December 31, 2003. In addition, the components of the statement of operations and of the statement of cash flows are no longer translated at the closing rate but are translated as described above, and the financial statements of the entity are no longer adjusted for the changes in the foreign index before their translation into NIS.

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (cont.)**

## c. Change in the amortization period of goodwill:

In March 2004, the Israel Accounting Standards Board published Accounting Standard No. 20 with respect to the amortization period of goodwill. According to this Standard, goodwill should be amortized on a systematic basis over its useful life, which reflects the best estimate of the period during which the Company is expected to generate future economic benefits from the goodwill. The amortization period should not exceed 20 years from the date of initial recognition. The Standard is effective with respect to financial statements for periods beginning on or after January 1, 2004 and the related accounting effect is treated as change in estimate ("prospective").

As a result of the publication of the new Standard and after its evaluation, the Company's management decided to extend the amortization period of goodwill up to 20 years in view of the following circumstances and special characteristics of the markets in which the Company operates which justify amortization period of goodwill of up to 20 years:

1. Markets which are characterized by long-term engagements and tenants' loyalty.
2. Leading companies in their business segments.

The change in the amortization period resulted in a decrease of approximately NIS 2 million in the amortization of goodwill in the consolidated financial statements during the six months period ended June 30, 2004 (the effect on the Company's net income is approximately NIS 1 million).

## d. The effect of a new accounting standard prior to its adoption:

In July 2004, Accounting Standard No. 19, "Taxes on Income" ("the Standard") of the Israel Accounting Standards Board was approved. The Standard prescribes the principles for recognition, measurement, presentation and disclosures of taxes on income in the financial statements.

The major changes in the principles determined by the Standard compared to the principles applied to date are: recognition of deferred taxes for temporary differences which are created if the measurement currency for accounting is other than the measurement currency for tax and recognition of deferred taxes for temporary differences relating to land.

The Standard will apply to financial statements for periods beginning on or after January 1, 2005.

The adoption of the Standard will be recognized by the cumulative effect on the beginning of the period in which the Standard will be adopted.

The Company reviews the new Standard however, at this time, it is unable to estimate the effect of the Standard on the financial statements.

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 3:- ADDITIONAL INFORMATION**

- a. On January 27, 2004, once Maalot - the Israeli Rating Company, raised the rating for the Company's debentures to AA-, the Company made the following securities offerings to institutional investors as follows:
1. A series of debentures (not to be listed) at the total par value of NIS 120 million in consideration of their par value. Said debentures are linked to the increase in the Israeli CPI and bear fixed annual interest at the rate of 5.55%, payable annually. The principal of the debentures is payable in one sum in February 2010.
  2. Debentures (series A) of NIS 90 million par value at a price of NIS 101 per NIS 100 par value of debentures and for the total consideration of approximately NIS 91 million. The above issuance was by the extension of the series of debentures (series A) which was first issued to the public according to the Company's prospectus from May 2, 2002.
- b. On May 24, 2004, the Company issued under a prospectus a new series of debentures (debentures B) that are linked to the Euro and bear interest of Eurobor plus a margin of 2% amounting to approximately NIS 347.5 million, of which NIS 66.5 million were issued to institutional holders and to the public and approximately NIS 281 million were issued to the Company's wholly owned subsidiaries.

In the context of the issuance, the Company extended the marketable series of debentures (debentures A) by approximately NIS 155 million, of which NIS 25 million were sold to the public and NIS 130 million were issued to the Company's wholly owned subsidiaries.

In addition, in the context of the prospectus, the Company distributed to the buyers of these debentures stock options (series 8) that are exercisable into the Company's shares until October 13, 2005 for the exercise increment of NIS 24 per stock option and distributed to its shareholders, by way of rights, without consideration, 2 series of stock options; stock options (series 7) that are exercisable into the Company's shares until July 22, 2004 for the exercise increment of NIS 17 per stock options and stock option (series 8) (the exercise increment for both series is linked to the change in the exchange rate of the U.S. dollar).

- c. During the reported period, 1.6 million stock options (series 4) of the Company were exercised into 2 million shares of the Company for the total consideration of approximately NIS 23.9 million. Further, the Company exercised additional 0.6 million stock options it held into 0.8 million shares. About 3 thousand stock options (series 4) which were not exercised by February 20, 2004, the last exercise day, expired.

Further to the above, during the reported period, 1.3 million stock options (series 7) of the Company were exercised into 1.3 million shares of the Company for the total consideration of approximately NIS 22.1 million. Subsequent to the balance sheet date, additional 1.9 million options were exercised into 1.9 million shares for the total consideration of approximately NIS 32 million. About 6 thousand stock options (series 7) which were not exercised by July 22, 2004, the last exercise day, expired.

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 3:- ADDITIONAL INFORMATION (cont.)**

- d. In March 2004, FCR issued to institutional investors and others about 3.4 million shares (including 0.8 million shares to the Company) for the total consideration of approximately C\$ 54 million (NIS 180 million). As a result of the issuance of shares, as above, the exercise of stock options into FCR shares and the issuance of FCR shares in return for interest on FCR convertible debentures, the Company recorded in the reported period a gain amounting to approximately NIS 10.5 million from decrease in its holding.
- e. In March and April 2004, FCR's remuneration committee approved the issuance of 120,000 restricted shares to FRC's CEO (who acts also as the Company's President) without consideration. Of the above, 80,000 shares were issued in May 2004 (half of the amount in respect of 2003 and the other half in respect of 2004) and the remainder amount will be issued until May 2005. The restricted shares have a vesting period of 3 years beginning December 15 of the year in respect of which the shares are granted.
- f. During the reported period, the Company acquired 37 million shares of Citycon Oyj. ("Citycon") thereby conferring a holding of 35% of the share capital of Citycon (about 36.3% of the share capital net of shares held by Citycon) in consideration of NIS 374.7 million. The cost of the reported investment is net of the Company's share in the dividend, which Citycon distributed during March 2004 in the amount of approximately NIS 22 million.

Citycon Board is comprised of eight members among which three members were based on the Company's recommendation, including the Company's President.

The financial statements of Citycon, which are attached to these statements, include financial statements prepared according to generally accepted accounting principles in Finland, as published on August 11, 2004, as well as an appendix, which includes financial statements prepared according to international accounting financial standards and the adjustments required in order to present the financial statements in accordance with these standards, as published on August 31, 2004.

Effective the second quarter of the year, the Company presents its investment in Citycon by the equity method of accounting based on the financial statements of Citycon, which were prepared in accordance with international accounting financial standards.

Citycon is a Finnish public company which focuses on the field of income producing properties in Finland. Its properties portfolio as of the balance sheet date consisted of about 146 properties, some of which are supermarket-anchored shopping centers and some are commercial buildings with a total area of approximately 500 thousand sq. which are principally leased to supermarket and retail chains.

- g. On January 31, 2004, Mishkenot Clal signed an agreement with Polar Investments Ltd. and Niduran Ltd. for the acquisition of 91.2% of Hazerot Hadar Ltd., which jointly holds with Mishkenot Clal in Mediterranean Towers Kfar Saba (50%) and Mediterranean Towers Nordia (33%) which are managed by Mishkenot Clal.

On March 1, 2004, after receiving the approval of the Anti Trust Commissioner, the transaction was closed. Subsequent to the closing, Mishkenot Clal holds, through its subsidiaries, full ownership of Mediterranean Towers Kfar Saba and 66.7% of Mediterranean Towers Nordia.

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 3:- ADDITIONAL INFORMATION (cont.)**

- h. On March 26, 2004, EQY completed an issuance of debentures in the scope of \$ 200 million. The debentures are redeemable in one sum on April 15, 2009 and bear fixed interest of 3.875%. The debentures were issued with yield to maturity of 3.902% (at the time of issuance, 1.25% margin above the return on U.S. Government bonds for same period). Additionally, EQY entered into an interest swap transaction with a bank in order to exchange fixed interest for variable interest in the amount of \$ 100 million, so that after the swap transaction, the interest on the exchanged amount is 6-month Libor plus a margin of 0.4375%.

**NOTE 4:- SUBSEQUENT EVENTS**

- a. At the end of August 2004, FCR effected an early redemption of the remainder of the series of convertible debentures (7.875%) (series B) for the total consideration of approximately C\$ 35 million, in cash and that after the eve of the early redemption convertible debentures of C\$ 42 million and of C\$ 20 million, which were held by the Company's wholly owned subsidiary and by others, respectively, were converted into 3.8 million of FCR shares.

In the context of FCR preparation to finance the redemption of above debentures, FCR effected a private placement to the Company (through its wholly owned subsidiary) and to another related party in FCR 2 million shares (of which 1.56 million shares to the Company) at the price of C\$ 16 per share, for the total consideration of approximately C\$ 32 million.

- b. In August 2004, the Company's wholly owned subsidiary exercised the remaining stock options it owned into 1.3 million shares of FCR with an investment of approximately C\$ 16 million.
- c. In August 2004, in the context of purchase of EQY shares which the Company performs from time to time and in the ordinary course of its operation, the Company purchased 130,000 of EQY shares from its chairman of the Board and 1,250 of EQY shares from the Company's President at the price of \$ 19.08 per share, which was 1% lower than the then share market price. The purchase price was identical to the price paid on that day for 137 thousand of EQY shares which were purchased from a third party (who holds senior position at EQY, however he does not hold a position in the Company and he is not a related party). The Company will apply the Securities Regulations (Presentation of Activities Between a Corporation and a Controlling Interest Therein in the Financial Statements), 1996 in the accounting for this transaction.
- d. In August 2004, the Company declared a dividend of NIS 0.19 per share payable in September 2004. The record date for the entitlement to the dividend is September 13, 2004.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 5:- GEOGRAPHIC INFORMATION

	<b>Six months ended June 30, 2004 (unaudited)</b>			
	<b>U.S.</b>	<b>Canada</b>	<b>Israel</b>	<b>Total - consolidated</b>
	<b>Reported NIS in thousands</b>			
Rental income	521,986	340,178	15,186	877,350
Segment results	303,514	162,822	824	467,160
	<b>Six months ended June 30, 2003 (unaudited)</b>			
	<b>U.S.</b>	<b>Canada</b>	<b>Israel</b>	<b>Total - consolidated</b>
	<b>Adjusted NIS in thousands</b>			
Rental income	372,794	229,401	8,555	610,750
Segment results	215,199	109,792	524	325,515
	<b>Three months ended June 30, 2004 (unaudited)</b>			
	<b>U.S.</b>	<b>Canada</b>	<b>Israel</b>	<b>Total - consolidated</b>
	<b>Reported NIS in thousands</b>			
Rental income	273,183	176,085	7,662	456,930
Segment results	158,903	84,744	171	243,818
	<b>Three months ended June 30, 2003 (unaudited)</b>			
	<b>U.S.</b>	<b>Canada</b>	<b>Israel</b>	<b>Total - consolidated</b>
	<b>Adjusted NIS in thousands</b>			
Rental income	196,816	116,734	4,210	317,760
Segment results	113,767	56,117	174	170,058
	<b>Year ended December 31, 2003 (audited)</b>			
	<b>U.S.</b>	<b>Canada</b>	<b>Israel</b>	<b>Total - consolidated</b>
	<b>Adjusted NIS in thousands</b>			
Rental income	854,484	529,069	17,633	1,401,186
Segment results	482,063	262,415	1,429	745,907