

## Directors' Report to Shareholders | For the period ended September 30, 2004

**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 September 30, 2004:**

### 1. A. General

The Company is a property investment company engaged – directly and through its subsidiaries – in the acquisition, development, and management of properties in the USA, Canada, and Israel (hereinafter – “the Group”). The Group focuses mainly on supermarket-anchored shopping centers. In addition, the Group is active in the senior living sector in the USA and Israel, and pursues business opportunities through the acquisition of properties and/ or the acquisition of companies engaged in its areas of activity and/or in synergetic businesses, both in regions where it is already active and also in other regions.

### B. The Group's Properties

As of the date of the financial statements, the Group owns 297 properties with a Gross Leasable Area (“G.L.A.”) of some 3.1 million square meters. These properties comprise 282 operational shopping centers, 7 shopping centers that are under development, 7 senior living facilities (which comprise some 1,250 residential units in Israel and the USA) and an office building in Tel-Aviv. In addition, the Group is a partner in two partnerships, each of which owns a property. These properties have a book value of NIS 15.6 billion and generate annual rental income of NIS 2 billion (gross annual rent calculated for the properties currently owned at the exchange rate on the date of the financial statements). In addition, as of the date of the financial statements, the Company is the largest shareholder (36%) of the Finnish public company, Citycon Oyj. (hereinafter – “Citycon”), whose shares are traded on the Helsinki Stock Exchange (HEX).

In the USA, the Group operates mainly through Equity One Inc. (“EQY”), a public company traded on the NYSE. 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, 40% of EQY. EQY operates in growth regions in the southeastern part of the USA, mainly in Florida, Texas and Georgia, and owns 183 operational shopping centers, with a G.L.A. of 1.9 million square meters, 3 shopping centers that are under development, and is a partner in 2 jointly owned properties. In addition, the Group - through Royal Senior Care (“RSC”), in which it has a 50% interest - is active in the US senior living sector, where it owns 4 senior living facilities containing some 450 residential units.

Operations in Canada are carried out through First Capital Reality (“FCR”), a public company traded on the Toronto Stock Exchange (TSX). As of the date of the financial statements, the Company owns 57% of FCR. FCR operates in growth regions in the Canadian provinces of Ontario, Quebec and Alberta, owning 99 operational shopping centers, with a total G.L.A. of approximately 1.2 million square meters, as well as 4 additional shopping centers under development. In addition, FCR is a stockholder in EQY, holding 17.5% of the latter's stock.

In Israel, the Company owns 50% of the share capital of Mishkenot Clal (1982) Ltd. (hereinafter – “Mishkenot Clal”). Mishkenot Clal is engaged in the construction, maintenance, operation and management of senior living facilities in Israel and owns 3 senior living facilities, containing some 800 residential units. In addition, the Company owns an office building in Tel-Aviv.

In Finland, the Company owns approximately 36% of Citycon's share capital. As of September 30, 2004, Citycon owned 16 shopping centers and approximately 130 stores, which are let primarily to supermarkets and other retail chains. Citycon's properties have a total G.L.A. of approximately 500 thousand square meters.

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\* The Company's name was changed from Gazit Globe (1982) Ltd. in October 2004.

### C. The Company's Holdings

The following table presents a summary of the Company's holdings as of September 30, 2004, as described above:

Name of investee company	Type of security	Quantity (units in millions)	Holding percentage	Book value (NIS in millions)	Market value as of September 30, 2004 (NIS in millions)	Market value as of the date of the financial statements (NIS in millions)
EQY <sup>(1)</sup>	Shares	16.4	22.5%	980	1,440	1,597
FCR	Shares	29.2	56.9%	1,380	1,733	1,895
FCR	Convertible debentures	125.2	48.0%	381	447	468
Citycon	Shares	40.1	35.9%	439	477	545
Investments in other companies (non-traded) and other assets <sup>(2)</sup>	-	-	-	128	<sup>(3)</sup> 128	<sup>(3)</sup> 128
<b>Total</b>				<b>3,308</b>	<b>4,225</b>	<b>4,633</b>

The Company's net liabilities<sup>(4)</sup> (including those of its wholly owned subsidiaries) amounted to NIS 2,022 million as of September 30, 2004.

### D. Third Quarter 2004 - Highlights

- The Group's investments amounted to NIS 338 million, compared to NIS 1.1 billion in the same period last year.
- Rental income amounted to NIS 469 million, an increase of 22% compared to the same period last year, mainly as a result of the acquisition of properties, developed properties coming online, increases in property rental fees and a higher occupancy rate.
- Gross profit amounted to NIS 247 million (52.6% of revenues), compared to NIS 205 million (53.2% of revenues) for the same period last year, an increase of 21%.
- Cash flow from operating activities amounted to NIS 129 million, compared to NIS 103 million for the same period last year, an increase of 25%.
- F.F.O. (see section 3.C) amounted to NIS 44.7 million, NIS 0.53 per share, compared to the (pro forma<sup>(1)</sup>) F.F.O. of NIS 32.5 million, NIS 0.47 per share, for the same period last year.

<sup>(1)</sup> Represents the Company's direct holding in EQY. (In addition, FCR holds 17.5% in EQY).

<sup>(2)</sup> Mainly represents the Company's holdings in Mishkenot Clal, Royal Senior Care and the office building in Tel Aviv.

<sup>(3)</sup> Represents carrying cost.

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

- Net income amounted to NIS 31.2 million, compared to (pro forma<sup>(1)</sup>) net income of NIS 29.6 million for the same period last year (the inflation-adjusted net income for the same period last year amounted to NIS 49.3 million).
- Shareholders' equity and minority interests as of the date of the financial statements amounted to NIS 4.8 billion, representing 30.5% of the total assets, compared to NIS 4 billion at the same date in 2003, which represented 32.5% of the total assets.

**E. First Nine Months of 2004 ("the reporting period") - Highlights**

- The Group's investments amounted to NIS 2.5 billion, compared to NIS 4.8 billion in the same period last year.
- Rental income amounted to NIS 1,346 million, an increase of 35% compared to the same period last year, mainly as a result of the acquisition of properties, developed properties coming online, increases in property rental fees and a higher occupancy rate.
- Gross profit amounted to NIS 714 million (53% of revenues), compared to NIS 530 million (53.2% of revenues) for the same period last year, an increase of 35%.
- Cash flow from operating activities amounted to NIS 382 million, compared to NIS 231 million for the same period last year, an increase of 65%.
- F.F.O. amounted to NIS 118.6 million, NIS 1.42 per share, compared to the (pro forma<sup>(1)</sup>) F.F.O. of NIS 89.7 million, NIS 1.10 per share, for the same period last year.
- Net income amounted to NIS 67 million, compared to (pro forma<sup>(1)</sup>) net income of NIS 57.6 million for the same period last year (the inflation-adjusted net income for the same period last year amounted to NIS 125.1 million).

**F. Change in reported profit Due to Changes in Accounting Standards**

As of January 1, 2004, the Company ceased to adjust its financial statements for changes in the purchasing power of currencies in those countries in which the Company operates. This is in accordance with Israel Accounting Standards No. 12 and No. 13 that have come into effect.

The principal effect of the change in the aforementioned accounting standards is in the manner of presenting the financing expenses item, which - under the new reporting method - no longer includes the erosion of the Company's loans at the rate of the change in the Consumer Price Index ("CPI").

As a result of this change, and despite the fact that there has been no alterations to the Company's actual interest payments, the financing expenses reported for the first nine months of the year are approximately NIS 192 million higher than the financing expenses that would have been reported for the same period had it not been for the change in accounting standards.

The change in reported financing expenses for the first nine months of the year, after netting off the effect of minority interests, resulted in a decline in the reported net income of NIS 82 million, compared to the net income that would have been reported under the reporting method, which was the generally accepted accounting practice in Israel until December 31, 2003.

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<sup>(1)</sup> Assuming implementation of Accounting Standards No. 12 and No. 13, as of January 1, 2003.

**In the third quarter of the year, inflation in the USA, Canada and Israel was negligible and, thus, there was almost no difference between the reported financing expenses and the financing expenses that would have been reported, had it not been for the change in accounting standards.**

**The Company's management is of the opinion that the discontinuation of adjusting the financial statements for the effects of inflation has no effect on the Company's operations, revenues, gross profit, operating profit or 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 totaled NIS 2.5 billion - NIS 2.1 billion was invested in the acquisition of new properties and in the redevelopment, expansion and construction of various other properties. The effect of these investments on the operating results will be reflected in full in future quarters. Additionally, NIS 411 million was invested in acquiring the holding in Citycon.**

### **A. Property Transactions**

1. During the reporting period, EQY, FCR and RSC acquired 28 properties, with a total G.L.A. of some 300 thousand square meters, and 15 plots of land for future development. The total consideration for these acquisitions amounted to NIS 1.8 billion.
2. During the reporting period, EQY and FCR invested in excess of NIS 200 million in developing new properties and in the redevelopment of existing properties.
3. During the reporting period, EQY and FCR sold 11 properties (with a total G.L.A. of some 137 thousand square meters) and also a plot of land. The total proceeds from these sales amounted to NIS 313 million. The net gain recognized by the Company from these sales amounted to NIS 12.6 million, compared to a net gain of NIS 4.5 million from the sale of properties in the same period last year.

(In the third quarter of this year, the net gain recognized by the Company from the sale of properties amounted to NIS 10.6 million, compared to a net gain of NIS 1.7 million from the sale of properties in the same period last year.)

4. As of September 30, 2004, the Group had properties being developed and being redeveloped, as well as land for future development, at a cost of NIS 435 million. These properties and land did not generate any rental income during the reporting period.
5. As of the end of the third quarter of 2004, EQY's average basic monthly rental income was US\$ 8.85 per square meter. During the third quarter of the year, EQY renewed leases on 19 thousand square meters, while increasing the average basic monthly rental on these leases by 3.9% to an average monthly rental of US\$ 13.01 per square meter, as well as signing new leases on 27 thousand square meters at an average basic monthly rental of US\$ 11.04 per square meter. During the third quarter of the year, leases on 19 thousand square meters expired, on which the average monthly rental was US\$ 10.68 per square meter. The net cash inflows from the same properties increased by 3.3%, compared to the same quarter last year.

EQY's properties had an average occupancy rate of 92.9% as of September 30, 2004 (September 30, 2003 – 90.1%).

6. As of the end of the third quarter of 2004, FCR's average basic monthly rental income was C\$ 11.74 per square meter. During the third quarter of the year, FCR renewed leases on 6.5 thousand square meters, while increasing the average basic monthly rental on these leases by 1.9% to an average monthly rental of C\$ 15.27 per square meter, as well as signing new leases on 8 thousand square meters at an average basic monthly rental of C\$ 14.13 per square meter. During the reporting period, leases on 9 thousand square meters expired, on which the average monthly rental was C\$ 13.54 per square meter. The net cash inflows from the same properties increased by 1.7%, compared to the same quarter last year.

FCR's properties had an average occupancy rate of 93.7% as of September 30, 2004 (September 30, 2003 – 92.3%).

## **B. Acquisition of Citycon and Issue of Citycon Shares**

1. In February 2004, the Company's Board of Directors authorized Company management to investigate opportunities for expanding its shopping center operations into Europe, on the basis of the experience and skills the Group had accumulated in the North American shopping center sector.
2. During the reporting period, the Company acquired approximately 40.1 million shares in Citycon, at a cost of NIS 411 million. The reported cost of the investment is net of the Company's share in the dividend distributed by Citycon in March 2004, amounting to NIS 22 million.  
Citycon's Board of Directors consists of 8 directors, three of whom – including the Company's president - were appointed on the Company's recommendation.
3. Citycon is a publicly traded Finnish company that focuses on the commercial property sector in Finland. Its property portfolio, as of September 30, 2004, comprised 146 properties – some of which are supermarket-anchored shopping centers, while others are stores, which are let primarily to supermarkets and other retail chains. Citycon's properties have a total G.L.A. of approximately 500 thousand square meters.
4. In September 2004, Citycon issued 10 million shares to institutional investors in Finland and in other countries, for a consideration of € 20.3 million. As a result of this issue, the Company recognized a NIS 1 million gain due to the dilution of its holding in Citycon.
5. As of September 30, 2004, the Company owns 34.7% of Citycon's issued share capital (35.9% of the share capital, after deducting Citycon's treasury stock).
6. Commencing from the second quarter of this year, the Company presents its investment in Citycon according to the equity method, on the basis of Citycon's financial statements, which are drawn up in conformity with international accounting principles.

## **C. Option Warrants Exercised for Company Shares**

1. During the reporting period, 1.6 million of the Company's option warrants (Series 4) were exercised for 2 million Company shares for a total consideration of NIS 23.9 million. In addition, the Company exercised 0.6 million options warrants it held, for 0.8 million shares. Some three thousand options warrants (Series 4) that had not been exercised until February 20, 2004, the last exercise date, expired.
2. During the reporting period, 3.2 million shares were issued in respect of the exercise of 3.2 million of the Company's option warrants (Series 7), which had been granted to Company shareholders by way of a rights issue in May 2004. As the exercise price in respect of these options was approximately NIS 17 per option warrant, the aggregate proceeds received by the Company from the exercise of these options totaled NIS 53.9 million. Some six thousand options warrants (Series 7) that had not been exercised until July 22, 2004, the last exercise date, expired.

**D. Public Offering of Shares and Conversion of Convertible Debentures into Shares in Subsidiaries**

1. In March 2004, FCR issued 3.4 million shares to institutional investors and others (including 0.8 million shares to the Company), for a total consideration of C\$ 54 million (NIS 190 million). In addition, 7 million options warrants were exercised for FCR shares, for an additional investment of C\$ 86 million (NIS 303 million). Of the above, 3.9 million options warrants were exercised by the Company, for a consideration of C\$ 46 million (NIS 162 million).
2. In March and April 2004, FCR's Compensation Committee approved the issue of 120,000 restricted shares to FCR's Chief Executive Officer (who is also the Company's president) for no consideration. 80,000 of the above shares were issued in May 2004 (half in respect of 2003 and half in respect of 2004), while the remaining shares will be issued through May 2005. The restricted shares have a vesting period of 3 years, which commences on December 15 of the year in respect of which the shares were issued.
3. At the end of August 2004 and prior to redemption date, FCR redeemed in cash the balance of its 7.875% convertible debentures (Series B) for a total net amount of C\$ 35 million. Immediately prior to this redemption, convertible debentures in the principal amount of C\$ 42 million and C\$ 20 million, which were held by a wholly owned subsidiary of the Company and by others, respectively, were converted into 3.8 million FCR shares.

As part of FCR's arrangements to finance the above redemption of its debentures, FCR made a private placement of 2 million shares to the Company (through a wholly owned subsidiary) and to an interested party. The shares were issued at a price of C\$ 16 per share and the total proceeds amounted to C\$ 32 million. 1.56 million of the above shares were issued to the Company.

4. As of September 30, 2004, the Company owns 56.9% of FCR's share capital. During the reporting period, as a result of changes in its percentage holding in FCR, the Company recognized an accounting gain of NIS 11.3 million.
5. During the reporting period, EQY issued 3.1 million shares to the public, within the framework of its Dividend Reinvestment Plan ("DRIP") and resulting from the exercise of option warrants for EQY shares held by employees and others, for a total consideration of US\$ 55 million (NIS 248 million) (of which 0.6 million shares were issued to the Company and its subsidiaries for a consideration of US\$ 10 million). Consequently, the Company's holding in EQY was diluted from 40.5% to 40.0%, and the Company recognized an accounting gain of NIS 10.9 million.

**E. Debt Raised by the Company and Subsidiaries**

1. On January 27, 2004, the Company issued to institutional investors:
  - 1.1 A series of debentures (that are not registered for trading on the Stock Exchange) with a total par value of NIS 120 million. The debentures were issued against payment of their par value. The aforesaid debentures are linked to the CPI, and bear fixed annual interest at the rate of 5.55%. The principal amount of the debentures is to be redeemed in a single payment in February 2010.
  - 1.2 Debentures (Series A) with a total par value of NIS 90 million, at a price of NIS 101 per NIS 100 par value of debentures, for a total consideration of NIS 91 million. The above issue was made by way of enlarging the series of debentures (Series A) that was first offered to the public pursuant to the Company's prospectus dated May 2, 2002.

2. On March 26, 2004, EQY completed the issue of a series of debentures with a total par value of US\$ 200 million. The debentures are to be redeemed in a single payment on April 15, 2009, and bear fixed annual interest at the rate of 3.875%. The debentures were issued at a yield to maturity of 3.902% (a margin of 1.25% above the yield for U.S. government bonds for the above period at the time of issuance). Additionally, EQY entered into an interest swap transaction with a banking institution, whereby a fixed interest rate was swapped for a floating interest rate on a sum of US\$ 100 million; as a result of the interest swap, the interest rate on the exchanged sum is the 6-month LIBOR with an additional margin of 0.4375%.
3. On May 24, 2004, the Company issued – pursuant to a prospectus – a new series of debentures (Series B), which are linked to the euro and bear interest at EUROBOR with an additional margin of 2%. Of the total principal amount of NIS 347.5 million, NIS 66.5 million was issued to institutional investors and the public, while NIS 281 million was issued to wholly owned subsidiaries of the Company.

Within the framework of the issue, the Company enlarged its series of marketable debentures (Series A) by NIS 155 million, issuing NIS 25 million and NIS 130 million to the public and to wholly owned subsidiaries of the Company, respectively. Through to the date of the financial statements, the aforesaid subsidiaries had sold NIS 64 million of these debentures to the public.

Additionally, within the framework of the prospectus, the Company distributed option warrants (Series 8) to the purchasers of the above debentures. The option warrants are convertible into Company shares, through October 13, 2005, at an exercise price of NIS 24 per option; the exercise price is linked to the exchange rate of the US dollar. Furthermore, a rights issue of two series of option warrants (Series 7 and Series 8) was also made, for no consideration, to the shareholders.

#### **F. The Acquisition of Hatsrot Hadar Ltd. By Mishkenot Clal**

On January 31, 2004, Mishkenot Clal signed an agreement with Polar Investments Ltd. and Nidoran Ltd. to purchase 91.2% of the shares in Hatsrot Hadar Ltd., Mishkenot Clal's partner in the senior housing facilities, Mediterranean Towers Kfar Saba (50%), and Mediterranean Towers Nordiya (33%), which are managed by Mishkenot Clal.

The transaction was completed on March 1, 2004, after being approved by the Anti-Trust Commissioner. After completion of the transaction, Mishkenot Clal holds - through its subsidiaries – all the ownership rights in Mediterranean Towers Kfar Saba and 66.67% of the ownership rights in Mediterranean Towers Nordiya.

#### **G. Long-Term Investments**

During the reporting period, EQY acquired 1.5 million shares in the property company, Cedar Shopping Centers Inc. ("CDR"), through trades on the New York Stock Exchange, constituting 9% of CDR's issued capital. EQY also acquired 220 thousand preferred (Series A) shares in CDR, constituting 9.4% of its issued preferred (Series A) shares.

CDR is a self-administrated, self-managed REIT (Real Estate Investment Trust) for tax purposes. It owns 29 neighborhood shopping centers with a G.L.A. of some 420 thousand square meters. These shopping Centers are located in 4 states in the eastern United States and are mainly supermarket-anchored.

As of September 30, 2004, CDR has a market value of US\$ 230 million (NIS 1 billion).

#### H. Purchase of EQY Shares from Interested Parties of the Company

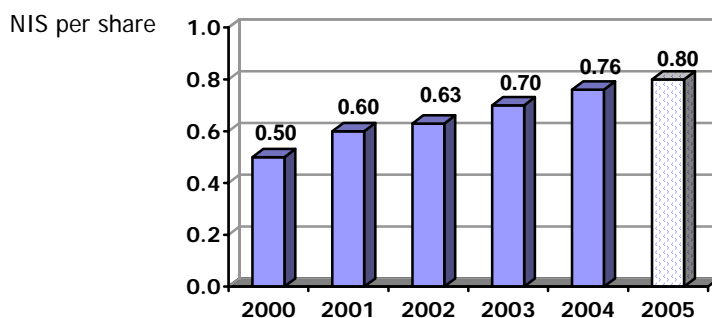
During August 2004, within the framework of acquisitions of EQY shares that the Company transacts from time to time and as part of its ordinary course of business, the Company acquired 130,000 EQY shares from the Chairman of its Board of Directors and 1,250 EQY shares from the Company's CEO, at a price of US\$ 19.08 per share (1% below their market price at that time). The acquisition price was identical to the price at which 137,000 EQY shares were acquired – on the same date - from a third party (who is one of EQY's senior executives, but is not an officer or interested party of the Company). The Company has applied the provisions of the Securities Regulations (Presentation in Financial Statements of Transactions Between a corporation and its Controlling Member), 1996 in its accounting treatment of this transaction.

#### I. 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. The Company has decided that the dividend to be announced in 2005 will be at least NIS 0.20 per share each quarter (NIS 0.80 per share on an annual 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 is illustrated by the following graph:**



#### J. Effect of New Accounting Standard in the Period Prior to its Implementation

In June 2004, the Israel Accounting Standards Board approved Israel Accounting Standard No. 19 – "Taxes on Income" (hereinafter – "the Standard"). The Standard provides rules for the recognition, measurement, presentation and disclosure of taxes on income in financial statements.

The principal changes contained in the rules stipulated by the Standard, as compared to the rules that are currently applied, affect the recognition of deferred taxes in respect of temporary differences relating to real estate.

The Standard will be applied to financial statements relating to periods commencing on January 1, 2005 or thereafter. The Standard will be applied by making a "cumulative effect" adjustment through to the beginning of the period in which the Standard is first adopted.

The Company is assessing the new Standard, but is currently unable to estimate what effect the Standard will have on the financial statements.

3. A. Results of Operations

	<u>For the 9 months ended September 30</u>		<u>For the 3 months ended September 30</u>		<u>For the year ended December 31,</u>
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>	<u>2003</u>
	<u>Unaudited</u>				<u>Audited</u>
	<u>NIS in thousands (except per share amounts)</u>				
	<u>Reported<sup>(1)</sup></u>	<u>Adjusted<sup>(2)</sup></u>	<u>Reported<sup>(1)</sup></u>	<u>Adjusted<sup>(2)</sup></u>	<u>Adjusted<sup>(2)</sup></u>
Rental income	1,346,431	996,252	469,081	385,502	1,401,186
Rental operating expenses	430,435	325,823	150,038	123,977	457,790
Depreciation of rental properties	201,918	140,016	72,125	56,628	197,489
Gross profit	714,078	530,413	246,918	204,897	745,907
General and administrative expenses	111,825	85,911	38,292	33,182	115,805
Income from ordinary operations	602,253	444,502	208,626	171,715	630,102
Financing expenses, net	390,804	165,823	136,551	60,385	300,163
	211,449	278,679	72,075	111,330	329,939
Other income, net	86,896	47,686	59,770	29,442	56,492
Income before taxes on income	298,345	326,365	131,845	140,772	386,431
Taxes on income	44,279	30,391	19,612	15,056	43,629
Income after taxes on income	254,066	295,974	112,233	125,716	342,802
Company's share in profits of associated companies	24,629	3,652	12,953	6	3,613
Minority interest in earnings of subsidiaries	(211,726)	(174,556)	(93,945)	(76,397)	(209,839)
<b>Net income for the period</b>	<b>66,969</b>	<b>125,070</b>	<b>31,241</b>	<b>49,325</b>	<b>136,576</b>
<b>Net earnings per share - basic</b>	<b>0.80</b>	<b>1.56</b>	<b>0.37</b>	<b>0.69</b>	<b>1.69</b>
<b>Net earnings per share - diluted</b>	<b>0.73</b>	<b>-</b>	<b>0.34</b>	<b>-</b>	<b>-</b>

(1) In accordance with Israel Accounting Standards No. 12 and No. 13.

(2) Adjusted to December 2003 NIS.

**B. Analysis of Results of Operations for the Third Quarter of 2004****Rental income**

The 22% increase compared with the same period last year resulted from the acquisition of new properties during the first nine months of the year, the coming online of properties whose development had been completed, the acquisition of properties during 2003, as well as from a higher average occupancy rate and from the increase in rental fees received in respect of the existing properties portfolio.

**Rental 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, as well as from the NIS 2 million provision created against the hurricanes that hit the southeastern United States during the third quarter of this year. Rental operating expenses as a percentage of rental income fell from 32.2% for the same period last year to 32.0%.

**Depreciation**

The Company's share in the depreciation of assets (depreciation of assets less the minority interest therein) was NIS 32.2 million, representing NIS 0.38 per share; this compares with NIS 25.6 million, representing NIS 0.34 per share, for the same period last year.

**Gross profit**

Gross profit amounted to NIS 247 million (52.6% of rental income); this compares to NIS 205 million (53.2% of rental income) for the same period last year – an increase of 21%.

**General and administrative expenses**

General and administrative expenses represent 8.2% of rental income, compared to 8.6% for the same period last year. The decrease in the general and administrative expenses as a percentage of rental income is attributable to economies of scale resulting from the continued growth in the operational activities of EQY and FCR, as well as to salary adjustments, which are connected to the Company's net income.

**Financing expenses, net**

The change in financing expenses stems from the following factors:

1. The financial statements are no longer adjusted for changes in purchasing power ("inflation") in countries in which the Company operates, in accordance with Israel Accounting Standards No. 12 and No. 13, while in the same period last year the financial statements were adjusted for the effects of inflation (approximately 0.8% in the USA and approximately 0.5% in Canada). The adjustment for the effects of inflation in the same period last year resulted in the financing expenses being approximately NIS 45 million lower than they would have been, had no such adjustment been made.
2. An increase in the Group's loans from an average balance of NIS 8.2 billion in the third quarter of 2003 to an average balance of NIS 9.8 billion in the reporting period. Interest expenses for the quarter reflect an average nominal interest rate of approximately 6% on the Group's indebtedness.

3. The weakening of the U.S. dollar against the shekel by 0.3% generated NIS 0.8 million in financing income from the erosion of the security deposits of Mishkenot Clal's tenants; this compares to the strengthening of the U.S. dollar against the shekel in the same period last year by 4%, which created a financing expense of approximately NIS 3.9 million due to the erosion of tenants' securities deposits.
4. Transactions in securities generated a gain of NIS 4.3 million, compared to a gain of NIS 7.7 million in the same period last year.
5. The following table presents the percentage changes in the CPI and exchange rates of the U.S. and Canadian dollars and the euro, versus the shekel:

	Consumer Price Index			Exchange Rates		
	Israel	USA	Canada	U.S. dollar	Canadian dollar	Euro
<b>7-9/2004</b>	(0.2%)	0.1%	(0.2%)	(0.3%)	5.4%	1.1%
<b>7-9/2003</b>	(1.0%)	0.8%	0.5%	3.0%	3.8%	5.2%

### **Other income, net**

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

The Group recorded a net gain of NIS 9 million (the Company's share being NIS 8.2 million) as a result of the dilution of its holdings in consolidated subsidiaries, compared to a gain of NIS 24.7 million (the Company's share being NIS 21 million) in the same period last year.

In addition, the sale of properties by EQY and FCR produced a net gain for the Group of NIS 45.7 million (the Company's share being NIS 10.6 million), compared to a net gain from the sale of properties of NIS 4.7 million (the Company's share being NIS 1.7 million) in the same period last year.

### **The Company's Share in the Profits of Associated Companies**

The Company's share in the profits of Citycon for the third quarter of the year amounted to NIS 12.4 million.

### **C. F.F.O.<sup>(\*)</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 one-time income and expenditure and with the addition of the Company's share of depreciation 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 U.S.-based National Association of Real Estate Investment Trusts (NAREIT).

In view of Israel Accounting Standards No. 12 and No. 13 that came into effect on January 1, 2004, the Company's financial statements are no longer adjusted for changes in purchasing power in Israel; the new treatment is the accepted practice in the U.S. and Canada. The Company is of the opinion that F.F.O. and F.F.O. per share are more accurate reflections 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 a previous period, and for comparing the Company's operating results to those of other property companies.

<sup>(\*)</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 a company's accountants.

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

	<u>1-9/2004</u>	<u>1-9/2003</u>	<u>7-9/2004</u>	<u>7-9/2003</u>	<u>1-12/2003</u>
	<u>NIS in thousands (except per share amounts)</u>				
<b>Reported net income</b>	<u>66,969</u>	<u>125,070</u>	<u>31,241</u>	<u>49,325</u>	<u>136,576</u>
<b>Adjustments:</b>					
Loss (gain) from dilution in holdings of subsidiaries	<u>(23,184)</u>	<u>(32,447)</u>	<u>(8,160)</u>	<u>(20,995)</u>	<u>(37,450)</u>
Gains from the sale of properties	<u>(12,642)</u>	<u>(4,455)</u>	<u>(10,629)</u>	<u>(1,721)</u>	<u>(4,205)</u>
<b>Total adjustments</b>	<u>(35,826)</u>	<u>(36,902)</u>	<u>(18,789)</u>	<u>(22,716)</u>	<u>(41,655)</u>
<b>Company's share in depreciation and amortization</b>	<u>87,483</u>	<u>69,022</u>	<u>32,209</u>	<u>25,622</u>	<u>97,095</u>
<b>Reported F.F.O.</b>	<u>118,626</u>	<u>157,190</u>	<u>44,661</u>	<u>52,231</u>	<u>192,016</u>
<b>F.F.O. (pro forma) (*)</b>	<u>118,626</u>	<u>(*)89,728</u>	<u>44,661</u>	<u>(*)32,504</u>	<u>(*)125,751</u>
<b>Reported F.F.O. per share</b>	<u>1.42</u>	<u>1.98</u>	<u>0.53</u>	<u>0.73</u>	<u>2.39</u>
<b>F.F.O. per share (pro forma) (*)</b>	<u>1.42</u>	<u>(*)1.10</u>	<u>0.53</u>	<u>(*)0.47</u>	<u>(*)1.55</u>
<b>F.F.O. per share (pro forma) (*) (without the effect of convertible securities, which are included in the basic EPS computation)</b>	<u>1.44</u>	<u>(*)1.20</u>	<u>0.53</u>	<u>(*)0.43</u>	<u>(*)1.65</u>

(\*) Pro forma (assuming implementation of Israel Accounting Standards No. 12 and No. 13, as of January 1, 2003).

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

##### **Liquidity**

The Group has a policy of maintaining a high level of liquidity so as to be able to pursue business opportunities in its areas of operations.

As of September 30, 2004, the liquid assets available to the Group, including short-term investments, totaled NIS 175 million, compared to NIS 121 million as of December 31, 2003. In addition, as of September 30, 2004, the Group had unutilized credit facilities available for immediate drawdown of NIS 1,626 million, compared to NIS 1,196 million as of December 31, 2003.

The increase in cash and unutilized credit facilities derives from the capital raised by the Group during the reporting period, after deducting funds used for the acquisition of properties.

**In aggregate, the Group has cash reserves and unutilized credit facilities available for immediate drawdown amounting to NIS 1.8 billion.**

##### **Investments in Associated Companies**

Investments in associated companies, as of September 30, 2004, totaled NIS 453 million, compared to NIS 16 million as of December 31, 2003. The increase in this item derives from the acquisition of 40 million shares in Citycon, net of the dividend received from that company, as described in section 2.B, and with the addition of the Company's share in Citycon's profits for the second and third quarters, for a total net consideration of NIS 439 million.

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

Long-term investments, as of September 30, 2004, totaled NIS 175 million, compared to NIS 40 million as of December 31, 2003.

The increase in this item derives primarily from EQY's acquisition of shares and preferred shares in CDR.

##### **Fixed Assets, Net**

Net fixed assets as of September 30, 2004, totaled NIS 14.1 billion, compared to NIS 12.1 billion at the end of 2003.

In the reporting period, the Group acquired properties, developed new properties, redeveloped existing properties, and for the first time consolidated (by the proportionate consolidation method) the properties of Hatsrot Hadar Ltd., at a total cost of NIS 2 billion. Depreciation expenses for the reporting period amounted to NIS 202 million.

##### **Long-Term Liabilities**

Long-term liabilities as of September 30, 2004 totaled NIS 9.8 billion, compared to NIS 7.4 billion at the end of 2003.

The increase in this item is derives principally from the receipt of new loans and the issuance of debentures, designated principally for financing investments in fixed assets and the purchase of shares in Citycon.

### **Shareholders' Equity**

As of September 30, 2004, the Company's shareholders' equity, together with minority interests, totaled an aggregate of NIS 4.8 billion, which financed 30.5% of total assets; this compares to NIS 4.1 billion, which financed 32% of total assets, as of December 31, 2003. Taking into consideration the convertible debentures in FCR, which may be converted into shares by FCR (at the sole discretion of FCR), the shareholders' equity and minority interests, together with the convertible debentures, account for 33.5% and 37%, respectively, of the total assets at the above dates).

The increase in shareholders' equity from NIS 1,141 million as of December 31, 2003 to NIS 1,286 million as of September 30, 2004 stems mainly from the net income for the reporting period (NIS 67 million), from the exercise of option warrants into shares (NIS 78 million) and from the increase due to "translation adjustments deriving from translation of the financial statements of FCR and EQY" and other capital surpluses (NIS 46 million). These were partly offset by the dividend of NIS 46 million paid by the Company.

### **Current Ratio**

The current ratio (current assets to current liabilities) was 0.52 as of September 30, 2004, compared to 0.57 as of December 31, 2003 and 0.83 as of September 30, 2003. The decline in the above ratio stems from the utilization of short-term financing to acquire properties and long-term investments and to repay long-term financing. A parallel consequence of the above actions has been to significantly increase the Company's unutilized credit facilities available for immediate drawdown (NIS 1.6 billion).

### **Cash Flows**

Cash inflows from operating activities for the third quarter of the year totaled NIS 129 million, compared to NIS 103 million for the same period last year. The growth in cash inflows from operating activities for the reporting period was due to the continuing improvement in operating profit, which was partly offset by interest expenses on the Company's loans.

In addition, in order to complete the funding of the Group's activities in the third quarter of the year, the Company and its subsidiaries raised capital totaling NIS 123 million and took long-term loans and issued debentures in a net amount of NIS 135 million. The proceeds from the above sources were used primarily to finance investing activities for the purchase of fixed assets, which totaled NIS 302 million in the third quarter of the year and to finance long-term investments and the investments in associated companies, which totaled NIS 37 million.

## **5. Donations**

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

The Company donates to the charity "Larger than Life" – a voluntary, humanitarian organization that assists children and youngsters afflicted with cancer and other chronic diseases.

Chaim Katzman, the chairman of the Company's Board of Directors, serves as the Honorary President of "Larger than Life". The Company acts as the official sponsor of this organization.

The Company also makes donations to Tel-Aviv University, where an institute focusing on research and studies of real estate and real estate related topics has recently commenced its activities (The Chaim Katzman – Gazit Globe Real Estate Institute).

During the reporting period, the Company's donations amounted to NIS 1.9 million.

Of the above sum, the Company donated approximately NIS 200,000 to the 'Larger than Life' charity, approximately NIS 700,000 to the Tel-Aviv University and approximately NIS 800,000 to various bodies in the United States and Canada (through the Company's subsidiaries, such sums being designated for the regions in which they operate).

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

- A.** In August 2004, EQY announced that it had signed a binding agreement to acquire six shopping centers in the greater Boston region for a consideration of US\$ 120 million. The transaction was completed at the beginning of October 2004.

The centers have a total G.L.A. of 36 thousand square meters and are anchored by the region's leading supermarket chains, including: Shaw's and Whole Foods. EQY believes that the centers have some development and expansion potential.

The greater Boston region is one of the most densely populated areas on the East Coast and is characterized by higher than average per capita income and population growth rates.

- B.** From the beginning of October 2004 through the date of the financial statements, Group companies sold 3 shopping centers with a total G.L.A of 28 thousand square meters for a consideration of NIS 77 million. The Company expects to record a capital gain of NIS 6 million in respect of the sale of these properties in the fourth quarter of the year.

- C.** In November 2004, RSC completed the acquisition of two senior living facilities in the state of South Carolina for a total consideration of US\$ 13.8 million.

The senior living facilities, which are located in the suburbs of Columbia (the state capital of South Carolina) and in Greenville, were built in 1999 and 2001 (at a very high standard of finishing), and extend over plots of land of 2 hectares and 4.4 hectares, respectively; each of these facilities has a built-on rental area of 6,000 square meters and contains some 90 residential units.

- D.** In October 2004, the Israeli credit rating company, Midrug Ltd., announced that all the Company's debenture series had been given an Aa3 rating (a rating equivalent to –AA on S&P's rating scale). The Company's debentures have also been given a –AA rating by Maalot – The Israel Securities Rating Co. Ltd.

- E.** In November 2004, a consortium of European banks granted Citycon an unsecured credit facility of € 450 million. The credit facility is for 4.5 years and replaces loans of € 435 million that were secured by properties. The cost of the credit facility is less than the cost of the secured loans that it replaces.

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

- A.** 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 2003 on March 22, 2004, there have been no significant changes in the market risks or the way in which they are managed.

**B. Primary Linkage Report**

The significant change to the primary linkage report is an investment of NIS 411 million that was made to purchase marketable shares in the publicly traded Finnish property company, Citycon. The investment was made in euros, which is Citycon's functional currency and the currency in which its shares are traded. To finance part of this investment, the Company took euro loans and/ or euro-linked loans and issued euro-linked debentures, so that – as of the date of this report - the Company has only a small currency exposure in respect of this investment.

The Company operates in a number of economic regions and in various currencies. The Company has a policy objective of maintaining the various currency exposures, to which its shareholders' equity is subject, at ratios that are similar to the ratio of assets held in those currencies.

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**Chaim Katzman**

Chairman of the Board of Directors

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**Dori Segal**

President and Director