

# **EL AL ISRAEL AIRLINES LTD.**

## **FINANCIAL STATEMENTS**

**AS OF MARCH 31, 2011**

(unaudited)

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SECTION A - UPDATE OF CHAPTER A TO 2010 ANNUAL REPORT

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**Update to Chapter A (Description of Corporate Matters of the Business)<sup>1</sup> to the 2010 Periodic Report (the "Periodic Report") of EL AL Israel Airlines Ltd. (the "Company")**

**The following are updates to Chapter A - a Description of the Corporation's Business Matters:**

**General**

The Group's Concise Consolidated Financial Statements (hereinafter: "**the Interim Financial Statements**") have been prepared in accordance with the IAS 34, "Interim Financial Reporting".

In the preparation of these Financial Statements the Group implemented accounting policies, rules of presentation and calculation methods identical to those implemented in the preparation of its Financial Statements for December 31, 2010 and the year ending that date. Regarding the accounting policy implemented in the investment in an affiliate, see Note 2d to the Financial Statements.

**Item 6.1 – Movement in the International Aviation Industry and to Item 7.1.3.(a) – Changes in the Extent of Activity in the Field and its Profitability – International Developments**

According to the data presented by IATA, the first quarter of 2011 saw a 5.9% increase in international passenger traffic and a 4.6% increase in international airborne cargo shipping, compared to the parallel period last year.

The international aviation industry is affected by security and political issues and by special events, such as the outbreaks of epidemics and natural disasters around the world. In this regard, note that in March 2011 international passenger traffic increased by just 3.8%, this after passenger traffic increased by 8.2% and 5.8%, respectively, in January and February 2011. The slowdown in the rate of increase in international passenger traffic in February and March 2011 came in light of the Japanese earthquake and tsunami, as well as the political instability in the Middle East and North Africa (Egypt, Tunisia, Libya and Syria).

Airlines, which increased their capacity by 8.9%, did not adapt on time their capacity to the sudden drop in passenger traffic and as a result, the weight load factor for passenger flights in this quarter decreased to 74.5% from 76.6% in Q1 2010.

IATA predicts that the slowdown in the increase in international passenger will continue in the second quarter of 2011 in light of continuing events and the political instability in the Middle East and North Africa. At the same time, the recovery of the global economy will assist in the recovery of passenger and cargo traffic in the second half of 2011. The greatest threat to the aviation industry lies in jet fuel prices, as the continuing increase in fuel prices may have a material impact on airline profits.

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<sup>1</sup> This update is in accordance with Regulation 39a of the Securities Regulations (Periodic and immediate reports), 1970 and includes material changes or additions that have occurred in corporate business on any matter which is to be described in the Periodic Report. The update refers to item numbers in Chapter A (Description of Corporate Business) in the Group's 2010 Periodic Report published March 23 2011 (ref: 2011-01-089280).

**By Regional Cross-Section: Q1 2011 Vs. Q1 2010:**

Area	Passengers			Cargo	
	RPK	ASK	PLF	FTK	AFTK
	Annual change	Annual change		Annual change	Annual change
Africa	-1.7%	4.0%	63.7%	2.6%	3.0%
Asia	3.2%	6.9%	75.9%	-0.1%	6.0%
Europe	6.8%	9.3%	74.0%	7.1%	9.2%
South America	14.8%	13.8%	77.6%	11.7%	4.3%
Middle East	8.4%	10.4%	73.9%	9.4%	14.4%
North America	6.4%	10.6%	75.4%	9.4%	13.8%
<b>Total</b>	<b>5.9%</b>	<b>8.9%</b>	<b>74.5%</b>	<b>4.6%</b>	<b>9.2%</b>

**To Item 6.2 – Movement in the Israeli Aviation Industry and to Item 7.1.3.(b) – Changes in the Extent of Activity in the Field and its Profitability –Developments in the Israeli Market.**

According to data provided by the Central Bureau of Statistics, the first quarter of 2011 saw 637,000 exits of Israelis via air, a 4% decrease compared to the same quarter last year. Moreover, during this quarter 553,000 tourist entered via air (BGN Airport and Ovda Airport in Eilat), which is a 10% increase over the same period last year.

In this regard, note that the number of Israeli departures and tourist arrivals was influenced by the fact that the Passover fell in April this year (Q2), while last year it fell in March (Q1) According to IAA data, total international passenger traffic through BGN increased by 4% in Q1 2011vs. Q1 2011; the average load factor in passenger flights was 73.9% compared to 77.7% in Q1 2010.

Following the Company's May 8, 2011 immediate report (ref: 2011-01-142386), on May 5, 2011 the Airports Authority informed the airlines operating out of BGN including the Company, that jet fuel refueling at BGN would be halted, after an unidentified contaminant was found in the BGN refueling tanks. As a result, international and domestic flights that were supposed to have departed from BGN were cancelled and disrupted. The Company acted to find alternate solutions for its flights and besides the cancellation of 20 flights by the Company, the Company's flights departed as planned, as alternate refueling solutions were found, including refueling at stopovers. Starting May 10, 21011, airplanes at BGN began returning to the regular refueling procedure, after the Ministry of Transportation announced that regular activity could be restored.

Beyond the cancellation of flights, as noted above, additional expenses were caused to the Company as a result of the change in activity and the need to refuel at stopovers as well as passenger expenses (such as hotel expenses and reimbursements for cancelled flights), an assessment of the damage and additional costs caused the Company as a result of the change in activity due to the event has yet to be concluded.

**To Item 6.3 – Fluctuations in Jet Fuel Prices, and to Item 9.5.1 – Raw Materials and Suppliers – Fuel**

The quarter ending March 31, 2011 saw a 39% increase in the average jet fuel market prices compared to the same quarter last year. The effective average jet fuel price paid by the Company rose, after hedging activity, by 7.1% compared to the same quarter last year. In the reported period, fuel costs constituted 34.7% of the Company's turnover (in the first quarter of 2010 fuel costs constituted 30.5% of its turnover). The following data refers to

jet fuel prices in the Mediterranean Basin region as quoted by Platts<sup>[1]</sup>. For further details, see Section b.1.(3) of the Board of Directors Report.

As of March 31, 2011 the Company held an inventory of jet fuel purchased from suppliers in Israel and abroad to the amount of \$24.1 million.

#### **To 6.4 – Fluctuations in Foreign Currency Rates**

As of March 31, 2011, the exchange rate of the U.S. Dollar vs. the NIS was revaluated by 6.2% compared to March 31, 2010, and by 1.9% compared to December 31, 2010. As of March 31, 2011, the exchange rate of the U.S. dollar vs. the euro was devalued by 5.5.0% relative to March 31, 2010, and by 6.1% relative to December 31, 2010. For further details, see Section b.1.(5) of the Board of Directors Report.

#### **To item 6.5 – Interest Rate Fluctuations**

The average 3-month Libor rate rose by 19.8% in the quarter ending March 31, 2011 compared to the same quarter last year.

For further details, see Section b.1.(4) of the Board of Directors Report.

## **1. Passenger Aircraft Activity**

### **To Item 7.1.4 - Developments in Markets in the Field of Activity, or Changes in the Characteristics of its Customers, Item 7.1.10, Structure of Competition in the Field of Activity and Changes Occurring Thereof, the Open Sky Policy (the "Open Sky Policy") – Implementation of the Open Sky Policy, Item 7.2 – Services in the Field of Activity.**

The following is a description of the main changes deriving from the Ministry of Transportation's Open Skies Policy:

**Colombia** – a new aviation agreement was signed between Israel and Colombia in April 2011. According to the agreement, each party can operate direct flights between the two countries, with no restriction as to the number of carriers, frequencies and types of aircraft. The new aviation agreement includes the operation of passenger and cargo flights and allows passengers and cargo to board and alight at stopovers (“Fifth Freedom”) between the two countries. The agreement also allows Israeli and Colombian airlines to sign code sharing agreements, including code sharing agreements with carriers from a third country.

**Jordan** – in March 2011 Israil received the approval of the Minister of Transportation to act as designated carrier, in addition to Arkia, on the Tel Aviv-Amman route. The date on which flights will begin has not yet been published.

Scheduled foreign airlines increased their capacity by 14% in the first quarter of 2011 and the number of passengers increased by 9% compared to the first quarter of 2010.

The Group increased its seat capacity by 5% in the first quarter of 2011 and but noted a 2% decrease in its passenger traffic by 14%. In all, passenger traffic in BGN in the first quarter of 2011 increased by 4% and seat capacity for all airlines together increased by 9%.

Over the course of the summer season that started on March 27, 2011 and which will continue to the end of October 2011, competition is expected to grow fiercer as a result of the entry of new airlines as well as as a result of increased capacity/frequencies by existing airlines.

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<sup>[1]</sup> To the best of the Company's knowledge, Platts is a member of the McGraw-Hill Group which has provided information on the energy industry for over 75 years. Platts provides information and up-to-date analyses, among other things, on international prices and events pertaining to the petroleum, petrochemical, natural gas and electric and nuclear power markets.

French airline Air Mediterranean began operating flights on the Paris-Tel Aviv route in May 2011 and Norwegian Airlines is expected to begin operating weekly flights on the Stockholm-Tel Aviv route starting late June 2011.

### **Domestic Activity**

In its first quarter of 2011, the Company flew 59,000 passenger legs to Eilat and its share of domestic traffic to Eilat was 19%.

### **To Item 7.1.5 – Technological Changes that May have a Material Impact on the Field of Activities**

The homepage of the new frequent flyer website was launched in March 2011. The new homepage's main characteristics are: use of the graphic language used by the Company's homepage, a personal members area for presenting important information regarding the state of their account, news, updates and offerings costumed to each member. The improvements were designed to create a familiar site, to improve the user experience and provide members with easy, simple and friendly navigation.

A computer for printing out boarding passes for passengers performing express check-ins was recently placed in the terminal. This service was designed to save time and allow passengers traveling without baggage and business passengers to go directly to the gate.

In April 2011 the global Apple Store began offering a new application for frequent flyer club members, allowing them to check their points and membership status and to view their latest actions in their account and details on any actions, as well as a point conversion calculator for all credit card companies.

The Company is currently studying the possible and applicable alternatives for accessorizing the Company aircraft, in whole or in part, with communications systems (internet and/or cellular). As part of the process, cellular and internet trends in the world in general and the aviation industry in particular are being studied, with the aim of putting together a business and operative plan for the project, taking into account the variety of considerations and possibilities in the field of aviation communications.

Following that stated in the December 31, 2010 Periodic Report regarding the process of receiving new proposals from various bodies (RFP) for the implementation of a staged ERP project for select Company organizational units in Israel and around the world, NEE A.T. Ltd. was selected as implementer. An implementation contract has yet to be signed.

**Pursuant to Section 7.2 of the Periodic Report - Services in the Area of Activity**, the following is data regarding developments in passenger traffic by central destination groups: In total, passenger traffic through BGN increased 4% compared to the first quarter of 2010. Passenger traffic in the first quarter of 2011 was divided between the airlines as follows: El Al and Sun D'Or – 48.2%; other scheduled airlines – 56.7%; charter airlines – 5.1%.

As noted in 6.1 and 6.2 above, passenger traffic on routes to and from Israel was influenced both by the fact that the Passover holiday fell in Q2 2011 and as a result of the political instability in the region, which led to a drop in tourist entries to the Company and a drop in the number of Israeli departures abroad.

### **Western European Routes**

Western European routes saw a 6% increase in total passenger traffic in the first quarter of 2011, in total passenger traffic, compared to the same period last year; foreign scheduled airlines listed an 11% increase in passenger traffic and a 19% increase in seat capacity.

As a result, their load factor dropped to 72.1% compared to 77.3% in the first quarter of 2010.

The most prominent companies to increase their activity in Q1 2011 were: Lufthansa operated 19 weekly flights in Q1 2011 on the Tel Aviv-Frankfurt and Tel Aviv-Munich routes, compared to 17 weekly flights in Q1 2010. Furthermore, Lufthansa increased its capacity on the Munich route by using a larger airplane. In total, Lufthansa increased its capacity on routes to Tel Aviv by 22% and listed a mere 7% increase in passenger traffic.

Air Berlin increased its activity and operated 9 weekly frequencies in Q1 2011 on the Berlin/Munich/Dusseldorf/Cologne–Tel Aviv routes compared to just 2 frequencies on the Berlin-Tel Aviv route in Q1 2010 and listed a significant increase (370%) in passenger traffic.

Iberia Airlines added 3 weekly frequencies to the Madrid-Tel Aviv route and in total operated 17 weekly flights compared to 14 frequencies in the corresponding quarter last year, listing a 27% increase in its seat capacity, but listed a mere 5% increase in passenger traffic.

British low-cost airline Easy Jet operated 7 weekly flights in Q1 2011 on the Luton-Tel Aviv route compared to 6 flights on this route in Q1 2010 and listed a 14.5% increase in passenger traffic on this route in addition to its activity on the Geneva-Tel Aviv and Basel–Tel Aviv routes.

Note that in Western European routes, foreign charter flights reduced their seat capacity by 27% and their passenger numbers dropped by 29%.

The Group increased its seat capacity by 5% in the first quarter of 2011 and listed a slight decrease of 1% in its passenger traffic.

The Group's average load factor in Q1 2011 was 77.8% and its share of total passenger traffic in this route network was 38.7%.

#### **Routes to Central and Eastern Europe**

In total, passenger traffic on routes to Central and Eastern Europe decreased by 9% in the first quarter of 2011 compared to the same quarter last year. The Group's market share in this route network in the first quarter of 2011 reached 43.4%.

Routes to Central and Eastern Europe listed a 15% decrease in the seat capacity of scheduled foreign airlines and a 2% decrease in passenger traffic.

The average load factor of foreign airlines was 66% in the first quarter of 2011 compared to 72.2% in the first quarter of 2010.

At the same time, foreign charter companies significantly increased their activity on these routes (a 33% increase in seat capacity compared to 2010) and listed a significant increase in the extent of passenger traffic on these routes (+57% compared to 2010).

The Group increased its seat capacity on these routes by 7% and listed a similar 6% increase in passenger traffic on these routes. The increase in the Group's activity in this route network derives mainly from the increase in Sun D'Or activity on routes to Poland.

#### **Routes to the CIS**

Routes to Russia and CIS states listed a significant increase in total passenger traffic (+33%) and in seat capacity (+36%). Most of the increase was listed for routes between Russia and Israel (+21%) and between Ukraine and Israel (+106%). In this regard, note that starting February 2011, visa requirements for travelling between Israel and Ukraine were revoked. Scheduled foreign airlines operating on routes to significantly increased their seat capacity (+49%) compared to the first quarter of 2010 and listed a 53% increase in passenger traffic, and their load factor reached 63.2% compared to 61.3% in the first quarter of 2010.

Most of the increase in passenger traffic in the first quarter of 2011 derived from new airlines that had not operated on these routes in the first quarter of 2010:

Aeroflot, which had not operated in Q1 2010 and began operating 5 weekly flights on the Moscow route starting August 2010, Ukraine Air International, which operates 6 weekly flights on the Tel Aviv-Kiev route and Israeli airlines Israir (to Moscow) and Arkia (to Kiev and Moscow).

In addition to the above, Ukrainian airline Aerosvit, which operated 16 weekly flights on routes between Ukraine and Israel in this quarter compared to 8 weekly flights it operated

in the first quarter of 2010 along with Donbasaero, controlled by the same owners. During this period, the Group (El Al and Sun D'Or) increased the number of seats offered in this route network by 5% and the Group's passenger numbers decreased by 4% compared to the same period last year. The Group's share of passenger traffic on these routes in Q1 2010 was 24.2%

### **Transatlantic Routes**

A 5% increase in passenger traffic on transatlantic routes was listed in this quarter, with foreign airlines operating on these routes listing a 16% increase in seat capacity and a 14% increase in passenger traffic.

Most of the growth was listed in the activity of Delta Airlines, which increased its seat capacity on the New York route by 83% and passenger traffic on this route increased by 72%, this through the use of a large-body plane starting June 2010. In addition, Air Canada, which operates flights on the Tel Aviv-Toronto route, operated 4 weekly flights in Q1 2011 compared to 3 weekly flights in the corresponding quarter last year, in total increasing its seat capacity by 25% and listing a 19% increase in passenger traffic.

In the first quarter of 2011 the Company reduced its seat capacity in this route network by 4% and listed a 7% decrease in passenger traffic.

### **East Asian Routes**

An increase of 21% occurred in passenger traffic on routes to East Asia in January-March 2011 and seat capacity in this route network increased by 18%, due to the increase in Company activity, with added frequencies on routes to Hong Kong (5 frequencies instead of 4), Mumbai and Beijing (4 frequencies instead of 3). Likewise, the Company increased its seat capacity on the route to Bangkok through the use of a larger airplane (a Boeing 747-400).

Korean Air, which operates flights on the Tel Aviv-Seoul route, reduced its seat capacity by 7% and listed a 17% decrease in passenger traffic.

### **Regional Network**

The regional route network saw a 12% decrease in passenger traffic and a 117 decrease in seat capacity compared to Q1 2010.

This came as a result of the deterioration of relations between Israel and Turkey in the first quarter of 2011 and the 28% decrease in passenger traffic to Turkey.

Note also that a sharp decrease was also listed in traffic to Egypt (-47%), in light of the riots breaking out in Egypt in January 2011 and the continuing political instability in Egypt. At this stage the Company is continuing with its activity on the Cairo-Tel Aviv route, adjusting its activity on the route to developments in the area.

In this period the Group (El Al and Sun D'Or) operated routes to Cairo and Greece only. The Group's seat capacity on this route network decreased by 19% compared to the first quarter of 2010 and the number of Group passengers on this route decreased by 36%.

The Group's share of these routes reached a mere 6.1% in the first quarter of 2011.

### **To Item 7.4 – New Services**

- ✓ The Company and Knafaim Holdings Ltd., the Company's controlling shareholder (“**Knafaim**”), are studying the establishment of a joint international venture in China for the provision of maintenance services for commercial aircraft operating in the Chinese and international market, in conjunction with a Chinese company (the “**Venture**”). Pursuant to the study of the Venture's feasibility, the Company, Knafaim and the Chinese company (the “**Parties**”) signed a non-binding memorandum of understandings according to which the Parties shall study the various options for establishing the venture for a period of six months. The Memorandum of Understanding also stated that launching the Venture shall be subject, among other things, to a feasibility test by each of the parties regarding the second party, outlining a full business plan and signing binding agreements subject to the approval of the proper

- organs of each of the parties. At this stage there is no certainty as to any of the parties entering any binding agreement and the terms of such an agreement.
- ✓ The Company recently signed an agreement with the Flix company (the "**Israeli YouTube**") to provide entertaining content on flights to Eilat.
  - ✓ In order to improve the entertainment experience for passengers of luxury classes on Boeing 767 aircraft to long distance destinations, the Company began distributing iPad/PMP devices to business class passengers for their personal use during the flight. At the same time, Company flights have begun selling iPads duty-free (with advance orders and on select flights) at an attractive price with the option to purchase with a combination of money and points.
  - ✓ The Company began distributing destination booklets, in conjunction with tourist guide publishers "Shichur", for passengers on Company flights; the destination booklets are divided by flight destination with their content being updated on a quarterly basis. The booklet includes a map of the city and additional maps as well as recommendations by subject. In addition, a destination guide in English is distributed to tourists arriving to Israel featuring maps and recommendations for Jerusalem and Tel Aviv.
  - ✓ In March 2011 a joint project was launched between the Company and Steimatzky's Books – "Our Story", in which Company customers are invited, during their flights, to take part in an award-bearing short story competition on the subject of "home". Some 1,400 stories have been written to date, of which the 30 best will reach the finals, with the best story awarding its writer with two flight tickets to Europe and a publishing contract for their first work. In addition, the 20 best stories will be selected and collected in a book sold at Steimatzky shops. All revenues pursuant to this collaboration constitute charitable donations.
  - ✓ The Company launched a joint deal with Leumi Card designed to encourage the conversion of points from Leumi Card cards to the El Al frequent flyer club. As part of the special offering, Leumi Card customers will enjoy reduced prices at a variety of Company destinations by payments using the Leumi Card credit cards plus El Al points.
  - ✓ The Company launched a joint deal with Yediot Acharonot, in which yearly Yediot Acharonot benefit card-holding subscribers will be entitled to reduced-price packages to various destinations in Europe and the U.S., which include flight tickets and hotel rooms.

Following the Company's reports in the 2010 Periodic Report regarding a code sharing agreement signed in November 2010 with Siberia Airlines, regarding the Tel Aviv–Novosibirsk route, it is hereby made clear that the agreement does not required the approval of the Restraint of Trade Commissioner due to its compliance with the conditions of the type exemption for agreements between air carriers (regarding the type exemption, see Section 9.11.2.(i) of the 2010 Periodic Report). Note also that in May 2011, the agreement was expanded to nine additional destinations throughout Russia (besides Novosibirsk): Omsk, Rostov, Chelyabinsk, Nizhny Novgorod, Perm, Kazan, Samara, Sochi, Krasnoyarsk. The expanded agreement is expected to come into effect in May 2011.

A code sharing agreement signed with the Armenian airline Armavia in December 2010 came into effect late March 2011.

#### **To Item 7.6.1 Marketing and Distribution – Travel Agents and Marketers of Tourist Packages**

Following the Company's reports in the 2010 Periodic Report, the Company decide to close its Haifa branch on August 31, 2011 for economic reasons. Sales promotion activity in Northern Israel shall be managed from the Company's central branch in Tel Aviv, and therefore the Company shall operate, starting from September 2011, from four sales offices throughout the country (Tel Aviv, Jerusalem, Beersheba and Eilat).

**To Item 7.10 – Manufacturing Ability**

The Company increased its ASK by 5% in the first quarter of 2011 and the Company's RPK dropped by 0.7% compared to the same quarter last year. As a result, a 5.4% decrease was listed in its weighted load factor, reaching 76.7% compared to 81.2% in the same quarter last year.

**To Item 7.11 – Aircraft Fleet in the Passenger Aircraft Field**

Following the Company's reports in the December 31 2010 Periodic Report regarding its passenger aircraft fleet, the following are key changes:"

- ✓ Following the agreement signed with R.B. **Leasing Company Limited** for the purchase of a 747-400 aircraft, the airplane was received at the Company in early March 2011. The plane is currently undergoing renovation and adaptation works expected to be completed by the end of June 2011. Upon the completion of works, the plane is expected to be configured for 455 seats.
- ✓ In April 2011 the Company signed letter of intentions with International Lease Finance Corporation to lease a 767-300ER aircraft, manufactured in 1998, starting September-November 2011, for a lease period of 6 years.
- ✓ In Late May 2011, the leasing period of the 757-200 airplane (4X-EBS) is expected to end and the aircraft is expected to return to its owners (M.K. **AVIATION S.A.**).
- ✓ Following the agreement with AWMS to lease a 767-300ER airplane, in April 2011 the aircraft was accepted and joined the Company's aircraft fleet.

Following the agreement signed with airplane manufacturer Boeing for the purchase of 737-900ER aircraft, in May 2011 an agreement was signed with engine manufacturer CFM International S.A. for the purchase of a thrust upgrade for engines provided along with the airplanes and for the purchase of a CFM5-7B-24/3 spare engine for the 737 fleet. According to the agreement, the Company retains the option to purchase an additional spare engine by December 2018. The Company is studying methods of financing the agreements.

Following the Company's report in the December 31, 2010 Periodic Report regarding the agreement with the Histadrut and workers' representatives to expand the responsibilities of technicians ("signing technician"), in May 2011 the agreement was extended to December 31, 2012.

## **2. Cargo Aircraft Activity**

**To Item 8.1.1 – Structure of the Field of Activity and Changes Occurring Therein**

Pursuant to Item 8.1.1 of the Periodic Report, according to the Company's estimates, the Group's share of cargo transport in January-March 2011 of all cargo shipped to and from Israel by air (including cargo carried in the holds of passenger aircraft, including mail activity but not including Sixth Freedom) amounted to 35.7%, this in comparison with 31.6% in the same quarter last year.

**To Item 8.1.3 (a) – Extent of Global Cargo Transport**

According to IATA reports, in January-March 2011, the global scope of cargo transportation (including in passenger aircraft holds) increased by 4.6% compared to the same period last year; the increase in activity is at a lower rate than the projected yearly rate according to IATA estimates (5.6%).

**To Item 8.1.3.(b) – Extent of Cargo Transport on Aircraft to and from Israel.**

Airport Authority data indicates that in January-March 2011, cargo traffic through BGN decreased by 4.3% relative to the corresponding period last year.

**To Item 8.2 – Services in the Field of Activity.**

The Company has decided to discontinue its weekly flight to Hong Kong on a Boeing 747-200F cargo airplane in its summer schedule, starting April 2011.

**To Item 8.10 – Aircraft Fleet**

Following the Company's reports in its December 31, 2010 Periodic Report, the Company is expected to discontinue operation of its 747-200 cargo airplane (AXL) starting June 2011 due to the need for heavy maintenance works required for its continued activity. The Company approached the State for its consent to remove the plane from service.

**3. Details on the Two Areas of Operation**

**9.1 – Fixed Assets and Installations – Terminal 3**

In March 2011 the Airports Authority informed the Company that it had decided not to exercise its option in the agreement between it and the Company allowing an additional extension of 24 months for the provision of services for managing and operating the Company passenger lounge. The agreement ends on November 1 2011. The Airports Authority informed the Company that it was preparing for the issue of a tender for a commercial license to operate the lounge. The Company objects to the refusal to extend the agreement and asked to continue negotiations to extend the agreement.

**To Item 9.4.2 – Employees**

Pursuant to Item 9.4.2 of the Periodic Report, the following is an updated table on the Company's employees as of March 31, 2011:

	<b>March 31, 2011</b>	<b>December 31, 2010</b>
Regular employees	3,870	3,814
Temporary employees	2,205	2,150
<b>Total employees</b>	<b>6,075</b>	<b>5,964</b>

In April 2011 the Company granted bonuses for 2010 totaling \$6.9 million (including the payment of a bonus agreed upon in the collective work agreement for 2008-2012) for senior employees and executives (not including the Company CEO).

**To Item 9.4.16 – Executives and Senior Management**

Following the Company's report regarding the submittal of a court motion to approve a claim as a Derivative Claim (hereinafter –the "**Derivative Claim**"), on April 10, 2011, the Company submitted a motion to grant the power of a verdict to a proposed settlement in the Derivative Claim, according to which the Company would be compensated to the amount of 4,750,000 NIS (the "**Compensation Sum**").

According to the agreement, this sum shall constitute full, final and absolute compensation for all matters pertaining to the Derivative Claim.

Pursuant to the above motion, the court was asked to: (a) revise the Derivative Claim in such a manner that the Company's outgoing CEO and other Company directors, past and present, not appearing originally as respondents in the claim motion, be added to the defendants; and (b) revise the grounds of the claim so that it also includes other issues pertaining to the approval of the terms of service and employment of the outgoing CEO and resulting reports, including those noted in the Securities Authority audit review dated March 10, 2011 (published by the Company on the same date).

Out of the sum of the compensation, a total of 1,000,000 NIS was paid the Company by the outgoing CEO in April 2011, as a retroactive reduction of the sums of the bonuses he

received during his tenure. In addition, the Company signed a waiver for the Outgoing CEO according to which, upon the repayment of the sum in question, the Company shall have no complaints against him for any matter pertaining to the terms of his employment at the Company.

In accordance with the court ruling dated April 27, 2011, notice of the request for the settlement in question and additional details was published in two economic daily newspapers and a copy of the motion was provided to the Securities Authority.

On May 22, 2011 the court approved the agreement motion (including requested changes, as detailed in the Company's May 22, 2011 immediate report, ref: 2011-01-157107). The Court reduced the Plaintiff's legal fees to a total of 150,000 NIS and the Plaintiff's compensation to 75,000 NIS.

**To Item 9.7.1. – Sun D'Or International Airlines Ltd. ("Sun D'Or")**

Sun D'Or's operational license was cancelled on April 1, 2011.

In April and May 2011, Sun D'Or continued to market the flights operated by it in the past which were carried out by the Company (weekdays) and by other airlines (weekends and holidays). Starting June, Sun D'Or acts as a tourism organizer, while preserving the Sun D'Or brand for charter flights marketed by it and carried out by the Company on weekdays only. An examination is currently being conducted regarding the nature of Sun D'Or's future activities and as of the publication of the Financial Statements this has no material impact on Sun D'Or's operating results. Following Sun D'Or's appointment as designated carrier to various destinations by the Ministry of Transportation and following the cancellation of its operational license, these appointments were transferred to the Company, except for the Eilat-Moscow route.

On April 1, 2011 the Company ceased leasing to Sun D'Or, via dry lease, three aircraft from its Boeing 757-200 fleet and the aircraft returned to the Company's service.

**To Item 9.8.3 – Credit Frameworks**

The Company's credit frameworks amounted to \$35 million as of March 31, 2011, \$24 million of which were guaranteed frameworks.

**To Item 9.8.4 Guarantees Against Collateral**

With the drop in jet fuel prices below price levels defined by hedging agreements with international institutions, the Company was required to provide collateral to guarantee its compliance with hedging refunds to which it was obligated in accordance with its agreements with hedging institutions. As of March 31, 2011 there was no request for such deposits. The hedging institutions provided the Company with unguaranteed frameworks to the amount of \$29 million.

**To Item 9.8.5 – Loans for Unique Use**

As of March 31, 2011, the balance of loans from banking corporations and other institutions, including short term borrowings, amounted to \$705.9 million.

- a. The repayment date of a loan from a banking organization to the amount of \$76 million will fall in January 2012. On March 30, 2011 the Company entered into an agreement with the banking institution to revise the existing agreement, according to which the balance of the loan, including principal payments remaining until the original repayment date, shall be spread out across a period of 6 years from the signing date. At the end of this period a \$32 million balloon balance shall remain. The loan is in USD and bears variable Libor interest plus a margin. Principal and interest payments are quarterly payments. This sum is presented in the March 31, 2011 Financial Statements pursuant to Non-Current Liabilities under Loans from Banking Corporations.
- b. The repayment date of a loan from a banking organization to the amount of \$14,000,000 will fall in April 2011. This sum is presented in the March 31, 2011 Financial Statements under Current Liabilities charged to Short-Term Borrowing and Current Maturities. The credit was extended for an additional year under the same

- terms, with the parties determining the terms of the redeployment of the uncleared balance over the course of this period.
- c. The repayment date of a loan from a banking institution to the amount of \$60,000,000 will fall in August 2011. This sum is presented in the March 31, 2011 Financial Statements under Current Liabilities charged to Short-Term Borrowing and Current Maturities. The Company is holding advanced talks with the banking institution according to which repayment of this sum will be spread out across an extended period.
  - d. Following the agreement signed with R.B. Leasing Company Limited. To purchase a Boeing 747-400 airplane, received in the Company in early March 2011 (the airplane being purchased from the Company's own resources), in May 2011 the Company signed a loan agreement with a local bank to finance the purchase of the aircraft to the amount of \$14.5 million. The Company has the option of increasing the sum of the financing after improving the aircraft. The financing is for a period of 4 years with quarterly repayments of principal plus interest.
  - e. In May 2011 the Company signed agreements to place specific liens in favor of a banking institution on the Company's right to receive money from the sale of flight tickets from specific companies. In addition, the Company placed a lien on its property on 32 Ben Yehuda St. in favor of this banking institution.

**To Item 9.10.2 – Restrictions on Nighttime Takeoffs from BGN**

Following the company's reports regarding High Court of Justice proceedings filed by the City of Holon against the permit received by the Company to conduct takeoffs during certain hours of the night between Thursday and Friday and on the nights before holiday eves (in spite of the existence of a general restriction on takeoffs during nighttime hours), on March 29 2011 a ruling was issued in which the Supreme Court rejected the petition against the Company and the other respondents (the Minister of Transportation and Road Safety, the Minister of the Environment, the Airports Authority and the Civil Aviation Authority).

**To Item 9.10.7 – Restrictions on Engine Emission Levels**

Following the Company's reports regarding EU regulations that set conditions for the supervision, reporting and confirmation of gas emissions during flights, the Company hereby updates that in January 2011 an information system was implemented for the management and tracking of air pollution (CO2 emissions) from Company aircraft. The system, employing advanced technology, collects data from various sources (messages and files both from the ground and from Company aircraft) and concentrates it into a single database, and features control and analyzing tools. The purpose of the system is to create a database for processing the data and producing statistical reports. These reports serve as a decision support system for the fuel control system and allow the location of potential fuel savings.

In early 2011 the EU approved the reports issued by the Company on the subject of tracking air pollution from Company aircraft as a result of the EU's new emission regulations. The EU inspector commended the Company for the level of precision and quality of data collected using the system described above.

The system is an intra-organizational system and is not exposed. Statistical data is encoded to prevent linkage. System authorizations are granted at the level of organizational user groups, with the Company being responsible.

**To Item 9.11.2 (a) - Restrictions on and Supervision of the Corporation's Business - the Aviation Law**

The Aviation Law, 2010 passed its first, second and third vote by the Knesset. This law is expected to replace the old 1927 law and constitutes a key element of the State of Israel's return to FAA Safety Category 1.

**To Item 9.11.2.(i) – Limitations and Supervision of the Corporation's Business – Regulatory Arrangements – the Restriction of Business Law, 1988.**

On April 7, 2011 the Company received a notice from the Restraint of Trade Authority, according to which the Restraint of Trade Commissioner was considering using his authority to declare the Company a monopoly in the supply of aviation security services abroad, according to professional guidelines provided airlines by a certified officer in accordance with the Arrangement of Security in Public Bodies Law, 1998 regarding passengers and cargo on passenger flights.

The Company approached the Authority with a request to receive the examination material, is studying the subject and shall examine its open course of action, among other things in light of the Company's position that aviation security is the State's responsibility as sovereign and therefore it is not a commercial service the Company must supply.

**To Item 9.11.2 (j) - Limitations and Supervision of the Corporation's Business - the Aviation Law, 1981**

Following the Company's reports in the December 31, 2010 Periodic Report, on March 31, 2011 the incidence of the exception of tourism and flight services outside of Israel from the Consumer Protection Regulations (Cancelling Transactions), 2010 was extended by an additional 4 months, to July 14, 2011.

**To Item 9.11.11 – Standards**

The Company is preparing for the implementation of the SMS – Safety Management System plan. The plan's implementation constitutes an advanced perception of the Company's safety management, in a manner compatible with ICAO guidelines. The essence of the plan is the integration of safety issues as an inseparable part of management as a whole. The existence of the SMS plan and its implementation shall be inspected in the IOSA inspection planned for 2012.

**To Item 9.12 – Essential Agreements**

In March 2011 an extension and correction agreement was signed with SR Technics Switzerland Ltd. for the maintenance of CFM56-7B engines to the total amount of \$24 million for the extended period, to February 5, 2019. The agreement includes maintenance of eighteen engines owned by the Company as well as additional engines as determined by the Company.

**To Item 9.14 – Legal Proceedings**

Following Item 9.14.4 of the Company's December 2010 Periodic Report the sum of the provision for the suit was increased, this among other reasons due to talks with the plaintiffs and in light of an update the Company received from its legal counsel regarding the sizes of the settlements between the plaintiffs and other airlines.

Following the Company's immediate report, on May 15, 2011 Company's main office received a motion to approve a claim as a class action (hereinafter: the "**Motion**"), which was filed against the Company in the Tel Aviv District Court on May 9, 2011. The motion was filed by a Company passenger, whose flight had been cancelled on May 5, 2011 following the contamination found in the jet fuel.

In the motion, the sum of the Plaintiff's personal claim was set at a total of 5,000 NIS and the general damage estimated by the Plaintiff for the entire Group, including all of the purchasers of flight tickets from the Company whose flights had been cancelled under the circumstances in question (estimated by the Plaintiff at 2,500 passengers), amounts to 12,500,000 NIS for the Group as a whole. The Company is studying the motion.

**El Al Israel Airlines Ltd.**  
**Report of the Board of Directors on the State of the Corporation's Affairs**  
**for the Period Ending March 31, 2011**

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*Overview*

*1.1 Points of emphasis for the Reported Period*

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We hereby present the Report of the Board of Directors on the State of the Corporation's Affairs for the period ending March 31 2011.

Total passenger traffic through Ben Gurion Airport in the first quarter of 2011 amounted to 2.3million passengers compared to 2.2 million passengers in the first quarter of 2010, a 3.7% increase, while airborne cargo decreased by 4.3% to 77.9 thousand tons compared to 81.4 thousand tons in the same quarter last year.

The Group flew some 889 thousand passenger legs and 29.1 thousand tons of cargo on international and domestic flights this quarter, a 5.2% and 15.3% increase, respectively, compared to the same quarter last year.

The Company's market share in international scheduled and charter flights amounted to 38.2% compared to 40.2% in the same quarter last year and the average load factor for the quarter was 76.7% compared to 81.2% in the same quarter last year.

Key exogenous factors impacting the Company's operating results in the reported quarter compared to the same quarter last year were: a 39% increase in the average price of jet fuel, a 19.8% average increase in Libor interest rates and a 3.6% revaluation of the average rate of the NIS vs. the USD.

In the first quarter of 2011 the Company purchased a 747-400 passenger plane that is expected to enter service after renovation and adaptation works are completed in June 2011, and in addition, a leased 737-800 joined the Company's fleet in January 2011. A new leased 767-300ER was received in April.

In January 2011 an information system was implemented for managing and tracking air pollution from Company aircraft, this in accordance with EU regulations that set conditions for the supervision, reporting and confirmation of gas emissions during flights. The homepage of the frequent flyer website was launched in March 2011. The Company's online sales increased 14% in the reported quarter compared to the corresponding quarter last year and call center sales increased 9%.

The code sharing agreement signed by the Company in 2010 with Siberia Airlines was expanded to nine additional destinations throughout Russia. The expanded agreement is expected to come into effect over the course of May 2011. A code sharing agreement signed with the Armenian airline Armavia came into effect late March 2011.

In the first quarter of 2011 the Company saw an operational loss of \$53.5 million compared to an operational loss of \$14.7 million in the corresponding quarter last year. The loss for the reported period amounted to a total of \$42.9 million compared to a loss of \$16.5 million in the first quarter of 2010.

In the first quarter of 2011 the Company saw cash flow from current activities to the amount of \$56.7 million (cash flow of \$53.9 million in the first quarter of 2010).

The Group's cash balances, cash equivalents and short term deposits as of March 31 2011 amounted to a total of \$182.3 million, while equity as of March 31 2011 amounted to a total of \$231.1 million.

### *1.2 Changes in International Standards (IFRS)*

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Starting from the first quarter of 2009, the Company has applied changes in accounting policy in its Financial Statements deriving from the application of new standards and interpretations of International Financial Reporting Standards (IFRS), which came into effect in 2009, including IFRS 8 "Operating Segments", IAS 1 (Revised) – "Presentation of Financial Statements", IFRIC 13 – "Customer Loyalty Plans" and the revision to IAS 19 – "Employee Benefits", in the framework of the IFRS improvements in 2008. For further details regarding the standards and the impact of their application to the Group's Financial Statements, see Note 3 to the December 31 2010 Financial Statements. Regarding the implementation of IAS 28 due to the first-time achievement of material influence over Maman, see Note 2d to the Financial Statements.

### *1.3 The Company and its Business Environment*

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The Company serves as the designated air carrier of the State of Israel on most of the international routes operating to and from Israel.

The key activities of the Company and its subsidiaries are the transport of passengers and freight on scheduled flights, and on the matter of the transport of passengers, also on charter flights, between Israel and foreign countries and starting August 2010, on domestic flights as well. The Company is also engaged in providing security services and maintenance services, including for other airlines at Ben Gurion Airport, in the sale of duty-free products, in the leasing of aircraft, and through investees – in ancillary activities, mainly the manufacture and supply of airline food and the management of several overseas travel agencies.

The business environment in which the Company operates is the international and domestic civil aviation industry, and inbound and outbound tourism, which is characterized by a seasonal nature and strong competition, which grows stronger in periods of excess capacity, as well as high levels of sensitivity to the economic, political and security situation in Israel and around the world.

The Group has two operating sectors reported as operating segments in the Company's consolidated Financial Statements:

a) Passenger aircraft activity – In this segment, the Group transports passengers, as well as freight in the belly of passenger aircraft, and provides ancillary services, such as the sale of duty-free products and the leasing of planes. In the field of passenger transport, the Company competes in its flights to and from Israel with 2 Israeli airlines (Arkia and Israir), 60 foreign airlines operating scheduled flights and over 60 foreign charter airlines. Revenues of this segment constituted 86.1% of the Group's total revenues in Q1 2011.

b) Cargo aircraft activity – In this segment, the Group transports cargo in cargo aircraft. In the field of cargo transport, the Company competes with one Israeli airline (CAL) and with 6 foreign airlines operating cargo aircraft on a continuous basis, and with most of the scheduled airlines that operate passenger planes that carry cargo in their belly. Revenues from this area of activity constituted 7.2% of all of the Group's revenues in the reported period.

The Group has additional revenues that are not allocated to its major areas of activity, accounting for 6.7% of total revenues.

For further details regarding the Company's areas of activity, see Item as of the Board of Directors Report.

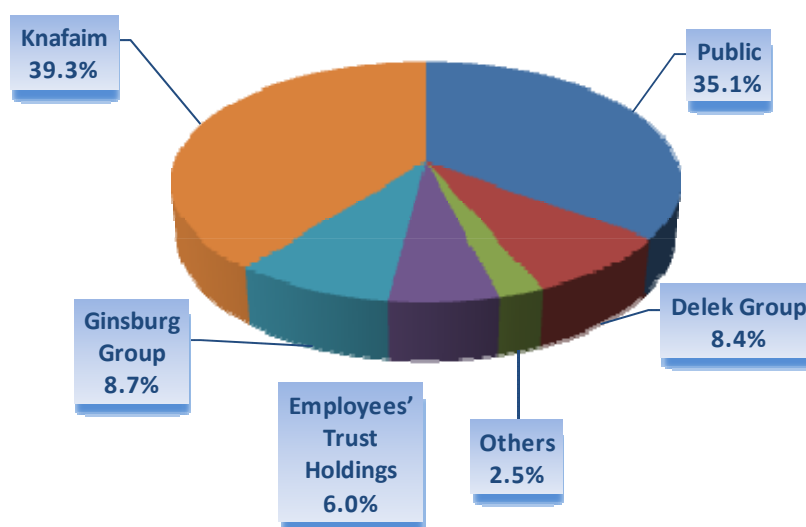
#### *1.4 Holdings of Company Shareholders*

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As of March 31, 2011, the holdings in the Company were:

Knafaim Holdings Ltd. ("Knafaim") – 39.3%, the Ginsburg Group – 8.7%, a Company employee corporation called "Holdings in Trust of El Al Employees Ltd." ("Employees Corporation") – 6.0%, the Delek Group - 8.4%, others – 2.5%, the public – 35.1%.

#### **Ratio of Holdings in Company Shares on March 31, 2011 (undiluted):**



*a. Explanations of the Board of Directors for the State of the Corporation's Affairs*

*a.1 Financial Position (Consolidated Statements)*

	31.03.2011 in thousands US dollars	31.12.2010 in thousands US dollars	change in thousands US dollars	
				%
<b>Current assets</b>				
Cash and cash equivalents	173,507	111,002	62,505	56%
Short-term deposits	8,780	63,565	(54,785)	(86%)
Trade receivables	167,780	132,960	34,820	26%
Other accounts receivables	26,338	20,880	5,458	26%
Derivative financial instruments	61,431	42,190	19,241	46%
Prepaid expenses	30,202	26,995	3,207	12%
Inventories	33,523	18,756	14,767	79%
<b>Total current assets</b>	<b>501,561</b>	<b>416,348</b>	<b>85,213</b>	<b>20%</b>
<b>Non-current assets</b>				
Long-term bank deposits	1,881	1,869	12	1%
Investment in affiliated companies	14,841	693	14,148	2042%
Investments in other companies	1,235	11,552	(10,317)	(89%)
Derivative financial instruments	-	4,291	(4,291)	(100%)
Fixed assets, net	1,236,433	1,231,687	4,746	0%
Intangible assets, net	7,832	7,844	(12)	(0%)
Prepaid expenses	8,244	8,121	123	2%
Assets due to employee benefits	39,546	38,799	747	2%
<b>Total non-current assets</b>	<b>1,310,012</b>	<b>1,304,856</b>	<b>5,156</b>	<b>0%</b>
<b>Total Assets</b>	<b>1,811,573</b>	<b>1,721,204</b>	<b>90,369</b>	<b>5%</b>
<b>Current liabilities</b>				
Borrowings and current maturities	153,075	147,587	5,488	4%
Trade payables	169,251	157,912	11,339	7%
Other payables	61,260	49,625	11,635	23%
Provisions	30,813	44,939	(14,126)	(31%)
Derivative financial instruments	5,401	2,329	3,072	132%
Employee benefit obligations	117,683	98,712	18,971	19%
Unearned revenues	330,097	231,204	98,893	43%
<b>Total current liabilities</b>	<b>867,580</b>	<b>732,308</b>	<b>135,272</b>	<b>18%</b>
<b>Non-current liabilities</b>				
Loans from financial institutions	544,511	561,084	(16,573)	(3%)
Employee benefit obligations	66,234	65,590	644	1%
Derivative financial instruments	13,029	19,739	(6,710)	(34%)
Other payables	7,586	10,700	(3,114)	(29%)
Deferred taxes	32,225	32,792	(567)	(2%)
Unearned revenues	49,273	51,467	(2,194)	(4%)
<b>Total non-current liabilities</b>	<b>712,858</b>	<b>741,372</b>	<b>(28,514)</b>	<b>(4%)</b>
<b>Shareholders' equity</b>	<b>231,135</b>	<b>247,524</b>	<b>(16,389)</b>	<b>(7%)</b>
<b>Total liabilities and equity</b>	<b>1,811,573</b>	<b>1,721,204</b>	<b>90,369</b>	<b>5%</b>

*Principal changes in asset, liability and shareholders' equity items as of March 2011:*

**Current assets:**

The Company's current assets increased by \$85.2 million as of March 31, 2011 relative to December 31 2010.

Most of the increase derived from the customers item – as a result of seasonal increase (sales for Passover, which fell in April this year), from an increase in the inventory of jet fuel held by the Company, an increase in the balance of cash and deposits, as a result of a positive cash flow from current activity and from an increase in the fair value of derivative financial instruments.

The following changes occurred to the Company's derivative financial instruments (presented in the Financial Statements under current and non-current assets and current and non-current liabilities):

The total net change of the fair value of jet fuel, interest and foreign currency hedging was expressed in a \$18.6 million increase compared to the fair value at the end of 2010, as a result of transactions reaching redemption, from additional transactions occurring in the reported period and from changes in the fair value of transactions still open as of the balance sheet date. The increase in fair value of derivative financial instruments was expressed in a \$26.4 million increase (net after tax) in the capital reserve in respect of cash flow hedges recognized directly in equity, in the \$8.2 million increase in the deferred tax liability, in the \$1.7 million net decrease in fuel and financing expenses in the Statement of Operations and in the \$17.7 million net increase in cash balances as a result of the sale of jet fuel hedging transactions recognized for accounting purposes and from the purchase of jet fuel hedging options. For further details see b.1.(3), b.1.(4) and b.1.(5) below and Note 8 to the Financial Statements

**Non-Current Assets:**

The Company's non-current assets increased as of March 31, 2011 by \$5.2 million relative to December 31 2010.

Most of the increase derived from investment in fixed assets, including the purchase of a 747-400 aircraft using the Company's resources and the payment of advance payments on account of the 737-900 aircraft, less depreciation created in the period. Investment in affiliates increased as a result of a receipt of an additional portion of 3.75% from Maman's stock capital. Due to the first-time achievement of material influence over Maman, the investment listed in the December 31 Financial Statements under "investment in another company" was classified in this report under "investments in affiliates". For further details see Note 6a to the Financial Statements.

**Current liabilities:**

The Company's current liabilities increased by \$135.3 million as of March 31, 2011 relative to December 31,2010. Most of the increase derived from an increase in unearned revenues from the sale of flight tickets deriving mainly from advance sales for the Passover holiday that fell in April this year. An increase occurred in the employee benefit obligations item mainly as the payment of the December 2010 salary was pushed forward to December 31 while the salary for March 2011 was paid in April 1 2011. Likewise, a provision was listed for the implementation of the work agreement. Trade and other payable items increased both as a result of seasonality and as a result of rising prices, mainly in the field of jet fuel. A decrease was listed in the provisions item as a result of the payment of the agreed-upon debt to Income Tax deductions (see Note 6f to the Financial Statements), offset by the listing of an additional provision for a civil cargo claim in the U.S. (see Note 27.c.(3) to the December 31 2010 Financial Statements).

**Non-Current Liabilities:**

The Company's non-current liabilities decreased by \$28.5 million as of March 31 2011 relative to December 31 2010. Most of the decrease derived in the loans from banking corporations' item as a result of current repayment of loans and from the resorting of loans to the current maturities item (regarding the spreading of balloon loans from banking institutions see Note 9 to the Financial Statements).

**Shareholders' Equity**

The decrease in shareholders' equity is primarily due to a loss in the period offset by an increase in capital reserves due to cash flow hedging as a result of the increase in fair value of hedging agreements recognized as hedging in the Company's possession.

As of March 31 2011, the Company has a working capital deficit of \$366.0 million, compared with a deficit of \$316.0 million on December 31 2010. The Company's current ratio as of March 31 2011 amounted to 57.8% compared to 56.9% as of December 31 2010. The main factor behind the increase in working capital deficit derived from an increase in unearned revenues from the sale of flight tickets deriving from sales for the Passover holiday that fell in April this year. The working capital deficit consists of three material elements included under the Company's current liabilities items and characterized by current business cycles: unearned revenues from the sale of flight tickets, including airport taxes, unearned revenues from frequent flyer clubs, and employee vacation obligations. Therefore, a material part of the capital deficit is not cash-flow based and allows the Company to repay its short-term liabilities.

**a.2 Analysis of Operating Business Results of El Al**

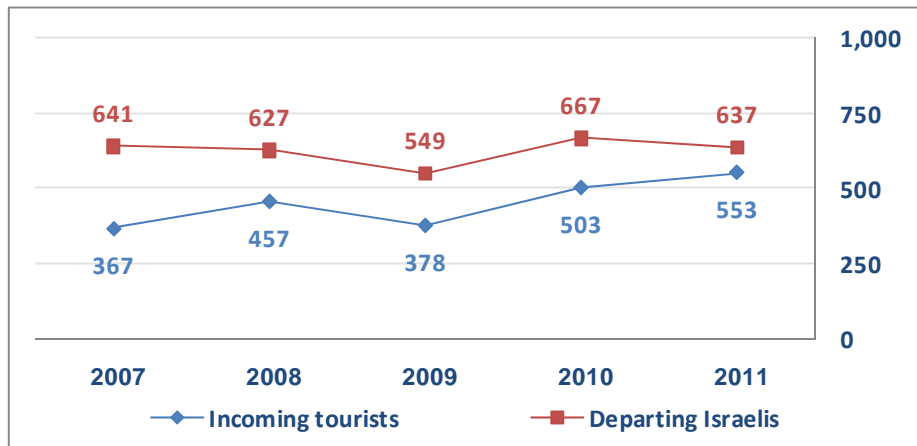
**a.2.1 Market Data**

Passenger and cargo traffic at BGA	Jan - Mar 2011	Jan - Mar 2010	change	
	in thousands	in thousands	in thousands	%
Incoming tourists *	553	503	50	10%
Departing Israelis *	637	667	(30)	(4%)
Cargo import - tons **	36	34	2	7%
Cargo export - tons **	42	48	(6)	(12%)

\* Source: Central Bureau of Statistics.

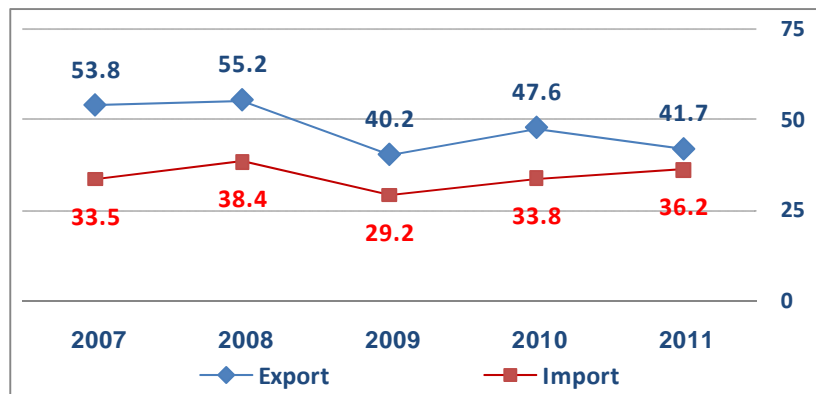
\*\* Does not include cargo in transit.

**Incoming Tourist & Departing Israeli Traffic, in the First Quarters of (In Thousands):**



\* Source: Central Bureau of Statistics.

**Imports & Exports of Cargo by Air to and from Israel, in the First Quarters of (In Thousands of Tons):**



\* Source: The Civil Aviation Authority.

a.2.2 *Company Operating Data\**

	Jan - Mar 2011	Jan - Mar 2010	change
Passenger leg (scheduled and chartered) - in thousands	889	845	5%
RPK (scheduled) - in millions	3,730	3,755	(1%)
ASK (scheduled) - in millions	4,861	4,627	5%
Load factor (scheduled)	76.7%	81.2%	(5%)
The Company's market share (scheduled and chartered)	38.2%	40.2%	(5%)
Flown cargo, in thousand tons	29.1	25.3	15%
RTK - in millions	152.6	130.1	17%
Weighted flying hours (including leased equipment) - in thousands (*)	39.0	36.2	8%
<u>Average man-years (El AL only):</u>			
Permanent	3,872	3,810	2%
Temporary	2,074	1,877	10%
Total	5,946	5,687	5%
Aircraft in operation - end of period - number of units	40	37	3
Average age of owned fleet at the end of the period - in years	13.8	12.7	1.1

\* Operating data refers both to international and domestic activity.

Glossary:

*Passenger leg* - Flight coupon in one direction.

**RPK** - Revenue Passenger Kilometer – number of paying passengers multiplied by distance flown.

**ASK** - Available Seat Kilometer – number of seats offered for sale multiplied by distance flown.

**RTK** - Revenue Ton Kilometer – weight of paid flown cargo in tons multiplied by distance flown.

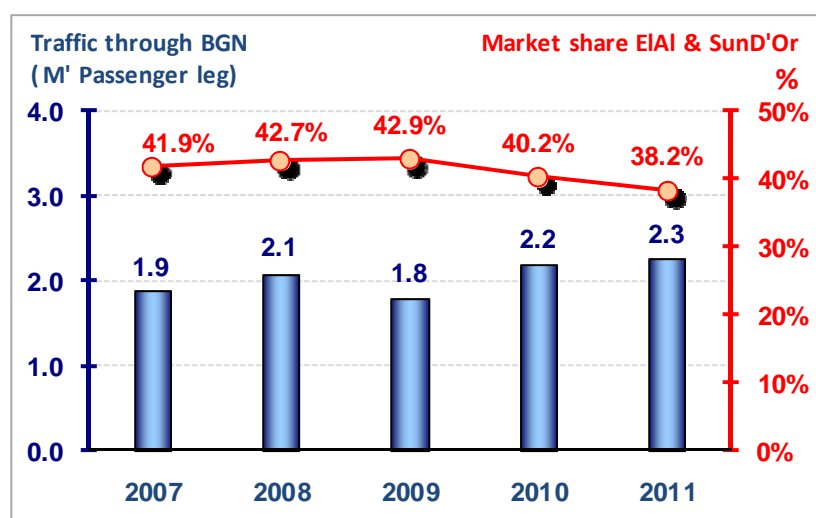
**Passenger Load Factor (occupancy)** – flown passenger-km is expressed as a percentage of available seat-km.

\* Weighted flight hours in terms of Boeing 767/757.

Weighted value of the planes: Boeing 767/757 = 1.0; Boeing 747 = 2.0; Boeing 777 = 1.6; Boeing 737 = 0.6.

These weighted values were determined based on an estimate of the total expenses of each type of aircraft, and are used consistently to calculate weighted flight hours as an indicator of the volume of aviation activity.

**Total Traffic through BGN (in Million of Passenger Legs) and the Market Share of El Al and Sun D'Or (in %) in the First Quarters of:**



**a.3 Statement of Operations Data for the Quarter Ending March 31, 2011 (Consolidated Financial Statements):**

The key factors that influenced the business results in the year ending March 31, 2011 compared to the same period last year are:

	Jan - Mar 2011		Jan - Mar 2010		change	
	in thousands US dollars	% of operating revenues	in thousands US dollars	% of operating revenues	in thousands US dollars	%
Operating revenues	425,174	100%	423,190	100%	1,984	0%
Operating expenses	(403,400)	(94.9%)	(363,582)	(85.9%)	(39,818)	11%
<b>Gross profit</b>	21,774	5.1%	59,608	14.1%	(37,834)	(63%)
Selling expenses	(44,943)	(10.6%)	(48,577)	(11.5%)	3,634	(7%)
General and administrative expenses	(24,324)	(5.7%)	(23,861)	(5.6%)	(463)	2%
Other operating expenses, net	(6,012)	(1.4%)	(1,885)	(0.4%)	(4,127)	219%
<b>Operating loss before financing</b>	(53,505)	(12.6%)	(14,715)	(3.5%)	(38,790)	264%
Financing expenses	(4,270)	(1.0%)	(9,130)	(2.2%)	4,860	(53%)
Financing income	5,493	1.3%	2,009	0.5%	3,484	173%
The Company's share of the profits of subsidiaries, net of tax	735	0.2%	-	0.0%	735	
<b>Loss before income taxes</b>	(51,547)	(12.1%)	(21,836)	(5.2%)	(29,711)	136%
Tax benefit	8,611	2.0%	5,304	1.3%	3,307	62%
<b>Loss for the period</b>	<b>(42,936)</b>	<b>(10.1%)</b>	<b>(16,532)</b>	<b>(3.9%)</b>	<b>(26,404)</b>	<b>160%</b>

The seat offerings of all scheduled airlines at BGN increased by 10.9% in the reported period while the number of passengers increased by just 4.8%. The surplus capacity increase led to a drop in yield per seat-kilometer and a decrease in load factor. Furthermore, the sharp increase in jet fuel prices in the reported period compared to the corresponding period last year also contributed to the profitability of airlines.

**Operating revenues** – operating revenues remained unchanged compared to the same quarter last year. Passenger revenues decreased both from a decrease in the amount of passenger-kilometers flown by the Company and from the decrease in the yield per passenger kilometer. Cargo shipping revenues increased, mainly as a result of the increase in cargo traffic and the increase in yield per ton kilometer.

**Operating expenses** – the first quarter of 2011 saw an 11.0% increase in the Company's operating expenses compared to the corresponding period last year, mainly as a result of the increase in jet fuel expenses and the increase in salary expenses as detailed below as well as the increase in activity in the reported period. The operating expenses rate deriving from the sales turnover increased from 85.9% in the first quarter of 2010 to 94.9% in the reported quarter as a result of a lack of change in sales turnover.

- Salary expenses in the first quarter of 2011 increased relative to the same period last year. Most of the increase derived from the revaluation in the rate of the NIS relative to the USD, from the application of the salary agreement and from the increase in activity. Regarding the impact of the changes in the NIS/USD rate of exchange on the Company's employee benefit obligations, see a.4 below.

- The Company's jet fuel expenses increased mainly as a result of the increase in jet fuel prices in the reported quarter relative to the corresponding quarter last year. The market prices for jet fuel increased by an average of 39% compared to the same quarter last year, while the Company's effective price after hedging activity increased by 7.1%. In the reported quarter the Company received jet fuel refunds payments to the amount of \$15.5 million, which were charged to gain/loss (relative to \$18.7 million in hedging payments in the corresponding period last year). The change in the fair value of transactions, not recognized for accounting purposes, charged to gain/loss reduced jet fuel expenses by \$1.9 million.

For further information on jet fuel price hedging see b.1.(3) below.

The **gross profit** rate dropped from 14.1% of turnover in the first quarter of 2010 to 5.1% in the reported period.

**Selling expenses** – selling expenses decreased compared to the same quarter last year, mainly as a result of the decrease in distribution expenses and as a result of the decrease in advertising expenses. The rate of sales expenses from turnover amounted to 10.6% compared to 11.5% of turnover in the same quarter last year.

**General and administrative expenses** – general and administrative expenses remained unchanged relative to the same quarter last year, with their share of turnover reaching 5.7% compared to 5.6% in the first quarter of 2010.

**Other expenses, net** – in the reported quarter the Company listed other net expenses to the amount of \$6.0 million, mainly as a result of an additional provision for a civil cargo suit in the U.S. (see Note 28.c.b.3 to the December 31 2010 Financial Statements) as well as from an update to liabilities due to early retirement plans based on CPI increase rates. In Q1 2010 the Company listed other expenses to the amount of \$1.9 million, mainly as a result of the write-off of an investment in a software module that failed to reach fruition.

**Operational loss** in the reported quarter amounted to \$53.5 million, 12.6% of turnover, compared to an operational loss in the comparable period last year of \$14.7 million, 3.5% of turnover.

**Financing expenses** – the decrease in financing expenses in the first quarter of 2011 relative to the same quarter last year derives mainly from a decrease in interest hedging agreement expenses.

**Financing income** – an increase occurred in the Company's financing income deriving mainly from an increase in receipts due to NIS/USD hedging agreements.

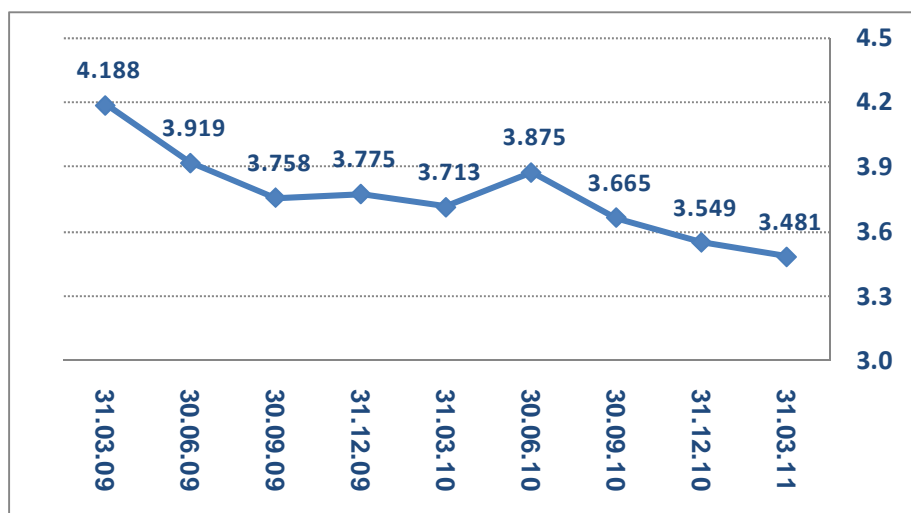
**Pre-tax loss** for the reported quarter amounted to \$51.5 million compared to a pre-tax loss of \$21.8 million last year.

**Loss for the period** amounted to \$42.9 million, 10.1% of turnover, compared to a loss of \$16.5 million, 3.9% of turnover last year.

**a.4 Effect of Changes in the Exchange Rate on the Company's Severance Pay Liabilities**

In the three month period ending March 31, 2011 the exchange rate of the shekel increased against the dollar by 1.9%, compared with a 1.6% revaluation in the exchange rate of the shekel against the dollar in the same quarter last year.

**US Dollar - NIS Exchange Rate:**



The Company has a net obligation to its employees mainly for severance pay, retirement plans, sick pay redemption and vacation pay as of March 31, 2011 to the amount of \$83 million. Since most of these obligations are denominated in shekels, whereas the functional currency of the Company is the dollar, these obligations must be translated into dollars, which causes differences deriving from changes in the exchange rate of the shekel vs. the dollar. Exchange rate changes are not one-way, and cause revenues or expenses to be listed in the Company's Financial Statements. These revenues or expenses do not impact cash flow or operating costs of the Company in the short run. In order to enable a comparison of the Company's business results for the long run, these revenues or expenses should be neutralized.

The quarter ending March 31 2011 saw expenses for this element to the amount of \$1.2 million, compared with the same period last year, in which the expenses for this element amounted to \$1.0 million.

Presented below are details of the business results, after neutralizing the effect of the exchange rate on the accrued severance pay element, as described above:

Three-month period ended March 31,	<u>Before</u>		<u>After</u>	
	<u>neutralizing the exchange-rate effect</u>			
	<u>on the accrued severance pay</u>			
	2011	2010	2011	2010
	<u>(in thousands US dollars)</u>			
Operating expenses	403,400	363,582	402,486	362,860
Gross profit	21,774	59,608	22,688	60,330
Gross profit rate	5.1%	14.1%	5.3%	14.3%
Selling, general and administrative expenses	69,267	72,438	69,148	72,343
Other operating expenses ,net	(6,012)	(1,885)	(5,846)	(1,662)
Operating loss before financing expenses	(53,505)	(14,715)	(52,306)	(13,675)
Operating loss rate before financing	(12.6%)	(3.5%)	(12.3%)	(3.2%)
Loss for the period	(42,936)	(16,532)	(41,737)	(15,492)
Loss rate for the period	(10.1%)	(3.9%)	(9.8%)	(3.7%)

## **a.5 Segment Reporting**

Presented below is operational segment data on a consolidated basis:

### **a. General:**

The Group has applied IFRS 8, "Operating Segments" (hereinafter "IFRS 8") starting January 1, 2009.

According to IFRS 8, operational segments are identified based on internal reports on the Group's components, which are reviewed on a regular basis by the Group's chief operating decision maker for the purpose of allocating resources and assessing the performance of the operational segments.

The report array conveyed to the Group's chief operating decision maker, for the purpose of allocating resources and assessing the performance of the operational segments based on the difference between revenues from passenger aircraft, cargo aircraft, charter flights (mainly to subsidiary Sun D'Or) and other revenues. In light of the above, the following are the Company's reported operating segments in accordance with IFRS 8:

Segment A - passenger aircraft activity.

Segment B - cargo aircraft activity.

In determining the results of the reported operating segments, a number of components not part of the direct costs involved in operating the flights, such as depreciation as a result of aviation equipment, fixed maintenance costs and fixed costs at overseas offices are also included.

b. Analysis of income and results by operating segments:

For Three-month period ended :					
31.03.2011	<u>passenger aircraft</u>	<u>cargo aircraft</u>	<u>others</u>	<u>Adjustment</u>	<u>Total consolidated</u>
in thousands US dollars					
<b>operating revenues</b>					
revenue from external customers	366,006	30,765	11,906	16,497	425,174
inter-segment revenues	-	-	15,463	(15,463)	-
<b>Total segment revenues</b>	<b>366,006</b>	<b>30,765</b>	<b>27,369</b>	<b>1,034</b>	<b>425,174</b>
<b>segment results</b>	<u>(2,237)</u>	<u>899</u>	<u>8,339</u>		7,001
Unassigned expenses					(60,506)
<b>Operating loss before financing</b>					<b>(53,505)</b>
Financing expenses					(4,270)
Financing income					5,493
The Company's share of the profits of subsidiaries, net of tax					735
<b>Loss before income taxes</b>					<b>(51,547)</b>
Tax benefit					8,611
<b>Loss for the period</b>					<b>(42,936)</b>

For Three-month period ended :					
31.03.2010	<u>passenger aircraft</u>	<u>cargo aircraft</u>	<u>others</u>	<u>Adjustment</u>	<u>Total consolidated</u>
in thousands US dollars					
<b>operating revenues</b>					
revenue from external customers	377,696	18,044	11,440	16,010	423,190
inter-segment revenues	-	-	16,567	(16,567)	-
<b>Total segment revenues</b>	<b>377,696</b>	<b>18,044</b>	<b>28,007</b>	<b>(557)</b>	<b>423,190</b>
<b>segment results</b>	<u>32,011</u>	<u>(946)</u>	<u>8,127</u>		39,192
Unassigned expenses					(53,907)
<b>Operating loss before financing</b>					<b>(14,715)</b>
Financing expenses					(9,130)
Financing income					2,009
The Company's share of the profits of subsidiaries, net of tax					-
<b>Loss before income taxes</b>					<b>(21,836)</b>
Tax benefit					5,304
<b>Loss for the period</b>					<b>(16,532)</b>

For year ended:					
31.12.2010	<u>passenger</u> <u>aircraft</u>	<u>cargo</u> <u>aircraft</u>	<u>others</u>	<u>Adjustment</u>	<u>Total</u> <u>consolidated</u>
in thousands US dollars					
<b>operating revenues</b>					
revenue from external customers	1,765,282	87,508	38,790	80,659	1,972,239
inter-segment revenues	-	-	78,573	(78,573)	-
<b>Total segment revenues</b>	<b>1,765,282</b>	<b>87,508</b>	<b>117,363</b>	<b>2,086</b>	<b>1,972,239</b>
<b>segment results</b>	<u>251,825</u>	<u>(264)</u>	<u>28,573</u>		280,134
Unassigned expenses					(192,091)
<b>Operating profit before financing</b>					<b>88,043</b>
Financing expenses					(35,911)
Financing income					10,849
The Company's share of the profits of subsidiaries, net of tax					45
<b>Profit before income taxes</b>					<b>63,026</b>
Income taxes					(5,971)
<b>Profit for the year</b>					<b>57,055</b>

Income in the three-month period ending March 31, 2011 decreased in the passenger airplane segment, mainly as a result of the decrease in income per passenger kilometer and in the amount of passenger kilometers flown by the Company, while revenues in the cargo airplane segment increased mainly as a result of the increase in the amount of cargo flown and the increase in revenue per ton kilometer. Other revenues saw a slight drop.

The passenger airplane segment listed a loss in the reported quarter as a result of a decrease in revenues as explained above, while the segment's expenses increase mainly as a result of the increase in jet fuel prices, the increase in payroll and the increase in activity. The cargo aircraft segment results improved mainly as a result of a significant increase in revenues, as explained above. No material changes were listed in other segment results.

#### **a.6 Seasonal Factors**

The Group's activity is seasonal and focuses on peak periods. High traffic of Israeli residents abroad occurs principally in the summer seasons and during holidays, and the highest level of tourist traffic to Israel is principally in the summer season or approaching the Jewish or Christian holidays or vacation time in their countries of origin. In this regard, note that the number of Israeli departures and tourist arrivals in the reported quarter was influenced by the fact that the Passover holidays fell in April this year (Q2), while last year it fell in March (Q1).

**a.7 Liquidity and Financing Sources**

Movement in cash flows for the three month period ending March 31, 2011 compared to the same period last year is:

	<b>Jan - Mar 2011 in thousands US dollars</b>	<b>Jan - Mar 2010 in thousands US dollars</b>	<b>change in thousands US dollars</b>
Cash flows from operating activities	56,666	53,875	2,791
Cash flows (used for) from investing activities	17,442	(5,624)	23,066
Cash flows used for financing activities	(11,603)	(11,173)	(430)
Net increase in cash and cash equivalents	62,505	37,078	25,427

**Operating Activities**

The Group received cash flow from current activity to the amount of \$56.7 million in the quarter ending March 31 2011 compared to a cash flow from current activity to the amount of \$53.9 million in the same quarter last year. The improvement in cash flow relative to the corresponding quarter last year, despite in the increase in pre-tax loss, derives mainly from an increase in unearned revenues from passenger flights as well as from receipts from the sale of jet fuel hedging transactions not yet recognized to gain/loss.

**Investment Activities**

In the first quarter of 2011 the Company saw \$17.4 million from investment activity. The Company realized \$54.8 million in short-term deposits; investment in fixed and intangible assets amounted to \$37.5 million.

In the first quarter of 2010, the Company invested a net sum of \$5.6 million. Investment in fixed and intangible assets amounted to a total of \$8.6 million. On the other hand the Company received \$1.9 million from the realization of restricted deposits and \$1.2 million from the realization of fixed assets.

**Financing Activities**

In the first quarter of 2011 the Company used \$11.6 million for financing activity, mainly for the redemption of long-term loans from banking institutions.

In the first quarter of 2010 the Company used \$11.2 million for financing activity, mainly for the redemption of long-term loans.

In total, the balance of cash and cash equivalents as of March 31 2011 amounted to \$182.3 million.

*b. Market risk exposure and ways of managing them:*

**b.1 Qualitative Reporting on Market risk exposure and ways of managing them**

*b.1. (1) General – Description of Market risks to which the Company is Exposed*

Presented below is a summary of the market risks to which the Company is exposed:

Changes in prices of jet fuel, which constitutes a significant element of the Company's operating expenses, have a material effect on the Company's profitability. In the Company's estimation, at its current level of activity, every change of \$0.01 US in the price of a gallon of jet fuel during an entire year affects the Company's fuel expenses by \$2.5 million. The Company has taken hedging measures to reduce the exposure, as detailed in b.1.(3) below.

Changes in jet fuel may influence the scope of securities the Company may be required to deposit with jet fuel hedgers. The Company is taking steps to hedge this exposure.

Exposure to changes in interest rates – most of the Company's long-term loans are at variable interest. Therefore, an increase in the Libor rate could impact the Company's profitability. At the present level of activity, every 1% increase in the Libor rate for a full year increases the Company's financing expenses by \$6.1 million. The Company has adopted hedging measures to reduce the exposure, as provided in Section b.1.(4) below.

Currency exposure – Most of the Company's revenues and expenses are in foreign currency (mainly the U.S. dollar), except for several shekel expenses, mainly salary expenses and payments to local suppliers in Israel. Accordingly, a change in the shekel/dollar exchange rate influences the Company's shekel expenses in dollar terms. In the Company's estimation, at the present level of activity, appreciation of the exchange rate of the shekel relative to the dollar of each 1% for an entire year increases the Company's annual expenses by \$4.0 million. Likewise, a surplus of payments over receipts exists in euros, but at insignificant rates.

The Company has adopted hedging measures to reduce the exposure, as provided in Section b.1.(5) below.

Exposure in long-term loan frameworks – according to the provisions of the loan agreements, the Company must maintain a minimal collateral ratio between the market value of the aircrafts and the balance of the loans that financed their purchase. Likewise, the Company is required to comply with certain covenants, which, if not complied with, can be used to compel the Company to immediately repay the loans. The Company's exposure to market risks in this area derives from the changes that occur in the market value of aircrafts around the world, due to exceptional security events, and to the excess supply of seats on airlines around the world. For further details, see Note 16.g. and note 22.g.1 to the Financial Statements as of December 31, 2010.

*b.1.(2) El Al Market Risk Management Policies, Officials Responsible for their Management and Means of Controlling and Executing Policy*

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The Company has a Market Risk Management Committee headed by Mr. Nadav Palti, which is responsible for determining the coverage policies for existing exposures. The CFO is responsible for executing the policy and reporting to the Market Risks Management Committee.

From time to time, the Market Risk Management Committee evaluates the Company's status as regards jet fuel, interest and exchange rate exposure, the need to invest in derivatives, to reduce the exposure in accordance with policy, as well as the financial instruments used to perform the required hedging.

The Company's policy as regards jet fuel hedging in 2010 was: hedging jet fuel quantities for up to 24 months forward, so that for every period, a minimum and maximum rate was set for hedging out of total expected consumption, in a gradual and decreasing manner. Therefore, the maximum hedging rate at the beginning of the period was 80% and the minimum hedging rate at the end of the period was 20%.

Starting 2011, the jet fuel hedging policy was altered as follows: hedging jet fuel quantities for up to 24 months forward, so that for every period, a minimum and maximum hedging rate would be set out of total expected consumption, in a gradual and decreasing manner. Hedging agreements shall be carried out on a monthly basis. The maximum hedging rate at the beginning of the period is 75% and the minimum hedging rate for the 12th month is 5%. Instruments and hedging levels shall be selected so that the Company limits its maximum exposure to cash securities. As of this report, the Company is hedged according to its policy.

The Company's policy with respect to interest hedging is to hedge half of the credit portfolio for a period of up to 5 years. As of this report, the Company is hedged according to its policy.

The Company's policy with respect to NIS/USD exchange rates in 2010 was to hedge up to half of its shekel exposure for one year forward. Starting 2011, the NIS/USD exchange rate hedging policy was changed to hedge up to 75% of its cash flow exposure for a 1-year outlook as decided by the management. As of this report, the Company is hedged according to its policy.

From time to time the Market Risk Management Committee instructs Company Management to exceed these rates set for jet fuel, interest and exchange rates for limited periods of time in accordance with market developments.

For details on the policy adopted, see Sections b.1.(3), b.1.(4) and b.1.(5) below. For implications of the crisis in capital markets and market risks after the balance sheet date, see Section e below.

### *b.1.(3) Hedging Jet Fuel Prices*

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The Company executes financial transactions to hedge against changes in jet fuel prices, in accordance with its policy as described in Section b.1.(2) above.

As of March 31, 2011, the Company entered into several agreements in order to hedge jet fuel prices, at a scope estimated at 63% of expected consumption for April-December 2011 and 4% of expected consumption in 2012. Some of these transactions are recognized as hedging agreements for accounting purposes and some are not. The fair value of all jet fuel hedging instruments as of March 31, 2011 is \$45.8 million, presented in the Financial Statements as part of current assets under "Derivative Financial Instruments". In the reported quarter the Company received refunds for these hedging agreements to the amount of \$15.5 million. For details regarding the jet fuel instrument swap carried out by the Company in March 2011, see Note 8.b to the Financial Statements. For details regarding changes in jet fuel prices subsequent to the balance sheet date, see Section e(b) of the Board of Directors Report below.

### *b.1.(4) Hedging Interest on Loans*

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The Company executes hedges of the exposure in its long-term credit portfolio, due to changes in interest rates, in accordance with its policy as laid out in Section b.1.(2) above.

Some of these financial instruments are recognized for accounting purposes as hedging transactions and some are not. The fair value of all interest hedging instruments as of March 31, 2011 is a negative sum of \$18.4 million, which is presented in the Financial Statements in the framework of current liabilities and non-current liabilities under "Derivative Financial Instruments".

After executing these hedges, as of March 31, 2011, 38.6% of the balance of the Company's loans is at fixed interest for a period of up to eighteen months. In addition, the Company has as of March 31, 2011 a balance of loans to the amount of \$96.7 million at fixed interest for a period of 10 years constituting 13.7% of all of the Company's loans.

The Company paid a total of \$4 million for these hedging agreements in the reported quarter.

For information on changes in interest rates occurring subsequent to the balance sheet date, see Section e.(c) of the Board of Directors Report below.

### *b.1.(5) Exchange Rate Hedges*

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The Company executes hedges to protect its currency exposure due to changes in the exchange rate of the NIS versus the USD, in accordance with its policy as laid out in Section b.1.(2) above.

In August 2010 the Company entered into a number of financial transactions intended to protect the Company from drops in the exchange rate of the USD vs. the NIS for a 13 month period starting December 2010 and ending December 2011. These transactions are recognized as hedging agreements. In February 2011, the Company entered into additional financial transactions for a period of 13 months ending February 2012. These transactions are recognized as hedging agreements.

The fair value of these instruments as of March 31, 2011 is \$15.6 million, presented in the Financial Statements as part of current and non-current assets under "Derivative Financial Instruments".

The Company received refunds in the reported period for exchange rate hedging agreements to the amount of \$3.4 million.

For details on changes in the NIS/USD exchange rate occurring subsequent to the balance sheet date, see e.(d) below.

### *b.1.(6) Sensitivity Analysis Reporting*

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The following is an analysis of the sensitivity of the fair value of the financial instruments sensitive to changes possible in the risk factors to which they are exposed. The analyses are relative to the fair value of the financial instruments as of March 31, 2011.

Presented below are sensitivity analysis tables for instruments sensitive to changes in market factors:

a) Sensitivity to changes in NIS/USD exchange rate – thousands of dollars:

	Gain (loss) from changes		Fair value	Gain (loss) from changes	
	Increase 10%	Increase 5%		Decrease 5%	Decrease 10%
	3.829 NIS/\$	3.655 NIS/\$		3.481 NIS/\$	3.307 NIS/\$
Cash and cash equivalents	(260)	(136)	2,861	151	318
Short-term deposits	(798)	(418)	8,780	462	976
Trade receivables	(454)	(238)	4,994	263	555
Other accounts receivables	(654)	(343)	7,194	379	799
Derivative financial instruments	(1,423)	(745)	15,649	824	1,739
Long-term bank deposits	(171)	(90)	1,881	99	209
<b>Total financial Assets</b>	<b>(3,760)</b>	<b>(1,970)</b>	<b>41,359</b>	<b>2,177</b>	<b>4,594</b>
Borrowings and current maturities	18	9	(194)	(10)	(22)
Trade payables	2,905	1,522	(31,954)	(1,682)	(3,550)
Other payables - Current	326	171	(3,585)	(189)	(398)
Other payables - Non-current	403	211	(4,437)	(234)	(493)
<b>Total financial liabilities</b>	<b>3,652</b>	<b>1,913</b>	<b>(40,170)</b>	<b>(2,114)</b>	<b>(4,463)</b>
Exposure in linkage balance sheet due to surplus of financial liabilities over financial assets	(109)	(58)	1,189	63	131

b) Sensitivity to changes in Euro/USD exchange rate - thousands of dollars:

	Gain (loss) from changes		Fair value	Gain (loss) from changes	
	Increase 10%	Increase 5%		Decrease 5%	Decrease 10%
	0.773 Euro/\$	0.738 Euro/\$		0.703 Euro/\$	0.668 Euro/\$
Cash and cash equivalents	(789)	(413)	8,674	457	964
Trade receivables	(1,998)	(1,047)	21,979	1,157	2,442
<b>Total financial Assets</b>	<b>(2,787)</b>	<b>(1,460)</b>	<b>30,653</b>	<b>1,614</b>	<b>3,406</b>
Trade payables	1,596	836	(17,560)	(924)	(1,951)
Other payables	427	223	(4,693)	(247)	(521)
<b>Total financial liabilities</b>	<b>2,023</b>	<b>1,060</b>	<b>(22,253)</b>	<b>(1,170)</b>	<b>(2,473)</b>
sheet due to surplus of financial liabilities over financial assets	(764)	(400)	8,400	444	933

c) Sensitivity to changes in jet fuel prices on inventory (USD/gallon) – in thousands of dollars:

Type of instrument	Gain from changes		Fair value	Loss from changes	
	Increase 10%	Increase 5%		Decrease 5%	Decrease 10%
	2.541 \$/gallon	2.426 \$/gallon		2.310 *	2.195 \$/gallon
Jet fuel Inventorie	2414	1,207	24,143	(1,207)	(2,414)

\* The price of jet fuel according to a moving weighted average for the period ended March 31, 2011.

**d) Sensitivity of jet fuel hedge to changes in jet fuel prices - in thousands of dollars:**

According to the model's principles, jet fuel hedges that react to market factors in a similar manner were grouped together, since there was no loss of material information required to understand the Company's exposure to market risks as a result of the grouping. On January 5, 2009 jet fuel prices changed by 14%, and therefore the following sensitivity analysis includes a 15% change in jet fuel prices.

Type of instrument	Gain from changes			Fair value*	Loss from changes		
	Increase 15% 3.657, 3.741 \$/gallon	Increase 10% 3.498, 3.578 \$/gallon	Increase 5% 3.339, 3.416 \$/gallon		Decrease 5% 3.021, 3.090 \$/gallon	Decrease 10% 2.862, 2.928 \$/gallon	Decrease 15% 2.703, 2.765 \$/gallon
SWAP transactions - designed for hedging	17,132	11,421	5,711	34,323	(5,711)	(11,421)	(17,132)
Options - not designed for hedging	16,212	9,523	4,090	11,460	(2,744)	(4,269)	(4,662)
<b>Total transactions - jet fuel hedge</b>	<b>33,344</b>	<b>20,944</b>	<b>9,801</b>	<b>45,783</b>	<b>(8,455)</b>	<b>(15,690)</b>	<b>(21,794)</b>

\* The price of jet fuel in the Mediterranean Basin (\$3.180/gallon) and Northwest Europe (\$3.253/gallon) as of March 31, 2011, according to which the fair value of the Company's hedge transactions is calculated.

**e) Sensitivity of an interest hedge to changes in market interest rates – in thousands of dollars:**

According to the principles of the model, the Group executed interest hedges that respond in a similar manner to market factors (IRS agreements intended for hedging, IRS agreements not intended for hedging), since no loss of significant information is sustained that is required to understand the Company's exposure to the market risk, as a result of the grouping. On December 16, 2008 a 75% change occurred to the dollar monetary interest rate, and therefore the following sensitivity analysis led to a 75% change in interest rates.

Type of instrument	Gain from changes			Fair value **	Loss from changes		
	Increase 75% in interest rate	Increase 10% in interest rate	Increase 5% in interest rate		Decrease 5% in interest rate	Decrease 10% in interest rate	Decrease 75% in interest rate
IRS transactions - designed for hedging	0*	0*	0*	(300)	0*	0*	0*
IRS transactions - not designed for hedging	1,667	229	117	(18,130)	(108)	(233)	(1,688)
<b>Total</b>	<b>1,667</b>	<b>229</b>	<b>117</b>	<b>(18,430)</b>	<b>(108)</b>	<b>(233)</b>	<b>(1,688)</b>

\* A sum lower than \$1,000.

\*\* Fair value was calculated according to the market Libor rate as of the report date, at the following rates: 3-month Libor: 0.30%, 6-month Libor: 0.46%, and 12-month Libor: 0.78%, all as applicable and according to the relevant transaction.

**f) Sensitivity of NIS/USD exchange rate hedge to changes in market interest rates – in thousands of dollars:**

Type of instrument	Loss from changes		Fair value NIS/\$ *	Gain from changes	
	Increase 10% in exchange rate 3.829	Increase 5% in exchange rate 3.655		Decrease 5% in exchange rate 3.307	Decrease 10% in exchange rate 3.133
<b>FORWARD transactions - designed for hedging</b>	<b>(22,289)</b>	<b>(11,148)</b>	<b>15,649</b>	<b>11,141</b>	<b>22,289</b>

\* The sensitivity analysis was conducted in shekel terms, and the profit or loss in the event of a 5% or 10% decrease or increase was translated according to an exchange rate of 3.481 NIS per USD as of March 31, 2011.

**b2. Linkage Basis Report**

The following is the consolidated linkage basis report for March 31, 2011:

	In, or linked to the US dollar	In Israeli currency	In, or linked to the euro	In, or linked to the other currencies	Non-monetary items	Total
(in thousands US dollars)						
<b>Current assets</b>						
Cash and cash equivalents	148,427	2,861	8,674	13,545	-	173,507
Short-term deposits	-	8,780	-	-	-	8,780
Trade receivables	125,125	4,994	21,979	15,682	-	167,780
Other accounts receivables	16,913	7,194	-	2,231	-	26,338
Derivative financial instruments	45,782	15,649	-	-	-	61,431
Prepaid expenses	-	-	-	-	30,202	30,202
Inventories	-	-	-	-	33,523	33,523
<b>Non-current assets</b>						
Long-term bank deposits	-	1,881	-	-	-	1,881
Investment in affiliated companies	-	-	-	-	14,841	14,841
Investment in other companies	1,235	-	-	-	-	1,235
Fixed assets, net	-	-	-	-	1,236,433	1,236,433
Intangible assets, net	-	-	-	-	7,832	7,832
Prepaid expenses	-	-	-	-	8,244	8,244
Assets due to employee benefits	143	39,403	-	-	-	39,546
	<b>337,625</b>	<b>80,762</b>	<b>30,653</b>	<b>31,458</b>	<b>1,331,075</b>	<b>1,811,573</b>
<b>Current liabilities</b>						
Borrowings and current maturities	(152,881)	(194)	-	-	-	(153,075)
Trade payables	(108,619)	(31,954)	(17,560)	(11,118)	-	(169,251)
Other payables	(46,754)	(3,585)	(4,693)	(6,228)	-	(61,260)
Provisions	(12,917)	(17,896)	-	-	-	(30,813)
Derivative financial instruments	(5,401)	-	-	-	-	(5,401)
Employee benefit obligations	(14,389)	(101,713)	(721)	(860)	-	(117,683)
Unearned revenues	-	-	-	-	(330,097)	(330,097)
<b>Non-current liabilities</b>						
Loans from financial institutions	(544,511)	-	-	-	-	(544,511)
Employee benefit obligations	(7,457)	(53,235)	(618)	(4,924)	-	(66,234)
Derivative financial instruments	(13,029)	-	-	-	-	(13,029)
Other payables	(3,149)	(4,437)	-	-	-	(7,586)
Deferred taxes	-	-	-	-	(32,225)	(32,225)
Unearned revenues	-	-	-	-	(49,273)	(49,273)
<b>Shareholders' equity</b>						
	<b>(909,107)</b>	<b>(213,014)</b>	<b>(23,592)</b>	<b>(23,130)</b>	<b>(642,730)</b>	<b>(1,811,573)</b>
<b>Monetary assets, net of monetary liabilities (monetary liabilities, net of monetary assets)</b>						
	<b>(571,482)</b>	<b>(132,252)</b>	<b>7,061</b>	<b>8,328</b>	<b>688,345</b>	<b>-</b>

Free Translation of the Hebrew Language Financial Report - Hebrew Wording Binding

The following is the consolidated linkage basis report for March 31, 2010 :

	In, or linked to the US dollar	In Israeli currency	In, or linked to the euro	In, or linked to the other currencies	Non-monetary items	Total
(in thousands US dollars)						
<b>Current assets</b>						
Cash and cash equivalents	119,539	2,554	10,978	10,694	-	143,765
Short-term deposits	-	8,086	-	-	-	8,086
Restricted deposits	5,130	-	-	-	-	5,130
Trade receivables	125,687	634	16,543	14,049	-	156,913
Other accounts receivables	6,558	9,733	683	1,169	-	18,143
Derivative financial instruments	8,458	5,345	-	-	-	13,803
Prepaid expenses	-	-	-	-	27,302	27,302
Inventories	-	-	-	-	17,648	17,648
<b>Non-current assets</b>						
Long-term bank deposits	-	1,892	-	-	-	1,892
Investment in affiliated companies	-	-	-	-	648	648
Investment in other companies	1,350	-	-	-	-	1,350
Derivative financial instruments	1,386	-	-	-	-	1,386
Fixed assets, net	-	-	-	-	1,288,120	1,288,120
Intangible assets, net	-	-	-	-	6,200	6,200
Prepaid expenses	-	-	-	-	5,908	5,908
Assets due to employee benefits	118	34,465	-	-	-	34,583
	<b>268,226</b>	<b>62,709</b>	<b>28,204</b>	<b>25,912</b>	<b>1,345,826</b>	<b>1,730,877</b>
<b>Current liabilities</b>						
Borrowings and current maturities	(103,696)	(2,226)	(414)	(150)	-	(106,486)
Trade payables	(88,972)	(19,294)	(15,561)	(11,680)	-	(135,507)
Other payables	(52,364)	(3,690)	(3,780)	(3,968)	-	(63,802)
Provisions	(6,343)	(52,603)	-	-	-	(58,946)
Derivative financial instruments	(43,498)	-	-	-	-	(43,498)
Employee benefit obligations	(4,743)	(90,609)	(662)	(507)	-	(96,521)
Unearned revenues	-	-	-	-	(261,946)	(261,946)
<b>Non-current liabilities</b>						
Loans from financial institutions	(692,903)	-	-	-	-	(692,903)
Employee benefit obligations	(7,980)	(52,508)	(735)	(4,981)	-	(66,204)
Loans from others	(220)	-	-	-	-	(220)
Derivative financial instruments	(16,807)	-	-	-	-	(16,807)
Other payables	(6,095)	(4,437)	-	-	-	(10,532)
Deferred taxes	-	-	-	-	(4,620)	(4,620)
Unearned revenues	-	-	-	-	(51,313)	(51,313)
<b>Shareholders' equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(121,572)</b>	<b>(121,572)</b>
	<b>(1,023,621)</b>	<b>(225,367)</b>	<b>(21,152)</b>	<b>(21,286)</b>	<b>(439,451)</b>	<b>(1,730,877)</b>
<b>Monetary assets, net of monetary liabilities (monetary liabilities, net of monetary assets)</b>	<b>(755,395)</b>	<b>(162,658)</b>	<b>7,052</b>	<b>4,626</b>	<b>906,375</b>	<b>-</b>

Free Translation of the Hebrew Language Financial Report - **Hebrew Wording Binding**

The following is the consolidated linkage basis report for December 31, 2010:

	In, or linked to the US dollar	In Israeli currency	In, or linked to the euro	In, or linked to the other currencies	Non-monetary items	Total
(in thousands US dollars)						
<b>Current assets</b>						
Cash and cash equivalents	81,807	13,260	4,667	11,268	-	111,002
Short-term deposits	55,000	8,565	-	-	-	63,565
Trade receivables	104,504	1,114	14,879	12,463	-	132,960
Other receivables	10,551	8,717	514	1,098	-	20,880
Derivative financial instruments	30,020	12,170	-	-	-	42,190
Prepaid expenses	-	-	-	-	26,995	26,995
Inventory	-	-	-	-	18,756	18,756
<b>Non-current assets</b>						
Long-term bank deposits	-	1,869	-	-	-	1,869
Investment in affiliated companies	-	-	-	-	693	693
Investments in other companies	1,228	10,324	-	-	-	11,552
Derivative financial instruments	4,291	-	-	-	-	4,291
Fixed assets, net	-	-	-	-	1,231,687	1,231,687
Intangible assets, net	-	-	-	-	7,844	7,844
Prepaid expenses	-	-	-	-	8,121	8,121
Assets due to employee benefits	143	38,656	-	-	-	38,799
	<b>287,544</b>	<b>94,675</b>	<b>20,060</b>	<b>24,829</b>	<b>1,294,096</b>	<b>1,721,204</b>
<b>Current liabilities</b>						
Borrowings and current maturities	(146,826)	(761)	-	-	-	(147,587)
Trade payables	(88,098)	(32,680)	(25,194)	(11,940)	-	(157,912)
Other payables	(40,717)	(1,814)	(3,555)	(3,539)	-	(49,625)
Provisions	(9,192)	(35,747)	-	-	-	(44,939)
Derivative financial instruments	(2,329)	-	-	-	-	(2,329)
Employee benefit obligations	(3,690)	(93,536)	(767)	(719)	-	(98,712)
Unearned revenues	-	-	-	-	(231,204)	(231,204)
<b>Non-current liabilities</b>						
Loans from financial institutions	(561,084)	-	-	-	-	(561,084)
Employee benefit obligations	(7,813)	(52,092)	(675)	(5,010)	-	(65,590)
Derivative financial instruments	(19,739)	-	-	-	-	(19,739)
Other payables	(6,263)	(4,437)	-	-	-	(10,700)
Deferred tax	-	-	-	-	(32,792)	(32,792)
Unearned revenues	-	-	-	-	(51,467)	(51,467)
<b>Shareholders' equity</b>	-	-	-	-	(247,524)	(247,524)
	<b>(885,751)</b>	<b>(221,067)</b>	<b>(30,191)</b>	<b>(21,208)</b>	<b>(562,987)</b>	<b>(1,721,204)</b>
<b>Monetary assets, net of monetary liabilities (monetary liabilities, net of monetary assets)</b>	<b>(598,207)</b>	<b>(126,392)</b>	<b>(10,131)</b>	<b>3,621</b>	<b>731,109</b>	<b>-</b>

### *c. Aspects of Corporate Governance:*

#### *Disclosure in the Report of the Board of Directors regarding the Financial Statements approval process*

The body charged with ultimate control in the Company regarding the approval of the Financial Statements is its Board of Directors. Starting from the approval of the 2010 yearly Financial Statements, the financial statement approval process is covered by directives set in the Companies Regulations (Directives and Conditions for the Financial Statement Approval Process), 2010 (“the Regulations”).

Within the framework of the Board of Directors, the Company operates several committees, including the Audit Committee, the Market Risks Management Committee, the Human Resources and Appointments Committee and the Government Affairs and Regulations Committee. In addition, the Company also has a Finance, Budget and Balance Sheet Committee (which serves as the Financial Statements examination committee), which according to the Regulations, discusses the yearly Financial Statements prior to bringing them before the Board of Directors for approval and recommends to the Board of Directors whether to approve the Company’s Financial Statements.

The following three members serve on the Financial Statements Examination Committee:

- 1) Mr. Yair Rabinowitz, Chair of the Committee, outside director. Possessing accounting and financial qualifications, holding an accounting certificate from the Hebrew University in Jerusalem. Owns a tax consulting firm and is fluent in accounting issues and financial statement preparation. Mr. Rabinowitz provided a statement (as defined in the regulations) prior to his appointment.
- 2) Professor Yehoshua Shemer, outside director. Possessing accounting and financial qualifications, with a degree in internal medicine and an expert in medical administration on behalf of the Ministry of Health. Professor Shemer serves as the Chairman of the Board of Directors of Assuta Medical Centers and formerly served as General Manager of Maccabi Health Services. Professor Shemer has extensive business experience, including in managing major corporations and is capable of and experienced in reading financial statements. Professor Shemer provided a statement (as defined in the regulations) prior to his appointment.
- 3) Mr. Nadav Palti, director. Possessing accounting and financial qualifications, economics and accounting graduate from Tel Aviv University and CPA. Serves as President and CEO of Dory Media Group and serves on the boards of many additional corporations. Mr. Palti has extensive experience in understanding financial statements and provided a statement (as this term is defined in the Regulations) prior to his appointment.

The Finance, Budget and Financial Statements Committee meets for extensive and thorough discussion of the draft Financial Statements, in the presence of the auditing accountant. The Chief Executive Officer and the Chief Financial Officer present the members of the committee with extensive details on the Financial Statements, including detailed financial analyses about the Company's performance during the reporting period.

The Financial Statement Examination Committee studies the material issues in financial reporting and formulates a recommendation for the Company’s Board of Directors pertaining to, among other things, the following issues: (a) estimates and evaluations made pursuant to the Financial Statements; (b) internal controls pertaining to financial reporting; (c) the wholeness and propriety of disclosure in the Financial Statements; (d) the accounting policy adopted and the accounting treatment applied to material Group issues; (e) value estimates, including underlying assumptions and estimates, on which the data in the Financial

Statements was based. The Committee also reviews different aspects of control and risk management, both those reflected in the Financial Statements and those impacting the reliability of the Financial Statements.

When complex or material issues are on the agenda, special discussions are held by the Finance, Budget and Financial Statements Committee about the issue on the agenda with the participation of the independent auditor.

The Company's Board of Directors is the organ that discusses and approves the Financial Statements after the members of the Board receive the draft Financial Statements and the recommendations of the Financial Statements Examination Committee at least two business days prior to the meeting.

Over the course of the Board meeting in which the Financial Statements are discussed and ratified, the Company CFO provides a detailed review of the key points of the Financial Statements and the Company's accounting policy. The CEO also reviews the Company's current activity and the influence of this activity on the Company's Financial Statements and emphasizes material issues. In addition, the Chair of the Financial Statement Examination Committee reviews the key points of the Committee's recommendations.

Invited and present at the Board meeting in which the Financial Statements are discussed and ratified are representatives of the Company's auditing accountant, who provide remarks and clarifications to the Financial Statements and who are at the Board members' disposal to answer questions and provide clarifications regarding the reports prior to their approval.

In order to formulate their recommendations for the Board of Directors, on May 16, 2011 and May 22, 2011 the Financial Statements Examination Committee convened in full. Also taking part in the meetings in question were representatives of the Company's auditing accountant and internal auditor, Mr. Gil Ber, along with the Chairman of the Board of Directors, Mr. Amikam Cohen, Mr. Pinchas Ginsburg (Director), the Company CEO, Mr. Elyezer Shkedi, the CFO, Mr. Nissim Malki, the VP of Human Resources and Administration, Mr. Reuven Virovnik and Legal Counsel and Company Secretary, Mr. Omer Shalev, Esq.

The Financial Statements Examination Committee held a discussion about the Financial Statements presented to it, including directing questions to the members of management present and to the independent auditor. Likewise, the independent auditor is asked to present his comments, if any, to the committee members, including accounting policy applied and special events that arose during the review of the Financial Statements.

The following are details of the processes carried prior to the approval of the March 31, 2011 Financial Statements:

- a. The draft Financial Statements were provided the members of the Board of Directors on May 19, 2011.
- b. Committee members are welcome to contact the Company CFO at any time with any question or clarification they require prior to the meeting.
- c. At its meeting, the Committee reviewed the Company's financial results, viewed a comparison of the reported period to corresponding periods and the work plan and the application of the accounting treatment of the Maman transaction was detailed by the Company CFO and auditing accountant.
- d. Pursuant to its meeting the Committee studied the estimates and assessments carried out in relation to the Financial Statements for the reported quarter, the wholeness and propriety of disclosure in the Financial Statements for the reported quarter, the accounting policy adopted and the accounting treatment implemented regarding the Company's material issues.
- e. The Committee discussed the effectiveness of internal controls over financial reporting and disclosure in the Company and examined, among other things, the treatment of the material weakness reported by the

Company in its 2010 Financial Statements. The Committee received a review from the Company's management according to which as of the date of the report's approval, no event or issue has occurred to change the evaluation of the effectiveness of internal controls, as presented pursuant to the latest yearly report on internal controls. Also reviewed for the Committee were the actions the Company took in order to correct the material weakness and the timetabled and actions the Company intended to take in order to complete the correction in question. In addition, also presented to the Committee were the actions taken by the Company to ensure that despite the material weakness, its reports had been prepared properly.

- f. At the conclusion of the discussion and after it has been clarified that the Financial Statements adequately reflect the state of Company affairs and its operating results, the Committee recommended to the Board of Directors to approve the Financial Statements.
- g. The Committee's recommendations were provided to the members of the Board of Directors in writing on May 22, 2011.
- h. On May 24 a discussion was held by the Company Board of Directors regarding the recommendations of the Financial Statements Examination Committee. At the conclusion of the Board meeting, the March 31 2011 Financial Statements, prepared on the basis of IFRS rules, were approved unanimously. Present at the Board of Directors Meeting in which the Financial Statements were approved, were the following Board members: Amikam Cohen, Tamar Moses-Borowitz, Yehuda Levi, Nadav Palti, Eran Ilan, Yair Rabinowitz, Professor Shuki Shemer, Shlomo Hanael, Pinchas Ginsburg and Sofia Kimmerling. The recommendations of the Financial Statements Examination Committee were provided the Board of Directors 2 business days prior to the discussion on the Financial Statements by the Company's Board of Directors. In the Board meeting held May 24 2011 the members of the Board of Directors stated that in light of the scope and complexity of the recommendations, this constituted a reasonable amount of time for receiving the material.

#### *d. Disclosure Provisions with Regard to Financial Reporting by the Corporation:*

##### *d.1 Events Subsequent to the Balance Sheet Date*

Regarding events subsequent to the balance sheet date, see Note 13 to the March 31, 2011 Interim Financial Statements.

##### *d.2 Critical Accounting Estimates*

The implementation of accounting standards by the Company's management upon preparing financial statements occasionally involves various assumptions, assessments and estimates influencing levels of the assets and liabilities and the business results reported in the Financial Statements. Some of the assumptions, assessments and estimates are critical to the financial position or operating results reflected in the Group's Financial Statements, due to their materiality, complexity of the calculations or the likelihood of realization of uncertain issues.

For details on the material estimates included in the Financial Statements see Note 4 to the December 31, 2010 Financial Statements.

*e. Additional information:*

***Disclosure regarding Changes in the Economic Environment, the Implications of the Capital Market Crisis, Market Risks and special events***

a) The international aviation industry is affected by the global security situation and by political and unusual events, such as the outbreak of epidemics and natural disasters around in the world, in general, and in specific regions in particular, as well as by the economic situation in Israel and around the world. Note also in this light regarding the Japanese earthquake and tsunami, as well as the political instability in the Middle East and North Africa (Egypt, Tunisia, Libya and Syria), as factors in the slowdown in the rate of increase in international passenger traffic, and as a result the drop in load factors in passenger flights, alongside the continuing rise in fuel prices. The combination of these circumstances may have a material impact on the profitability of the airlines.

The following are changes occurring to jet fuel prices, interest rates and NIS exchange rates from the end of the first quarter until immediately prior to the publication of the March 31, 2011 Financial Statements:

b) Over the course of the reported period, jet fuel prices increased significantly mainly due to the instability in the Middle East and concerns regarding its impact on the world's fuel supply. Fluctuations continued in jet fuel prices subsequent to the balance sheet date. As of the Balance Sheet date (March 31, 2011) the price of jet fuel in the Med region was 318.0 cents per gallon, while as of immediately prior to the approval of the report this price was 297.1 cents per gallon, a 6.6% decrease. Note that jet fuel expenses constitute nearly 35% of the Company's turnover, and therefore the price changes may have a material impact on its financial results. The average effective price the Company is expected to pay for jet fuel consumption (after hedging) in April and May 2011 is 8% higher than the average effective price paid in the first quarter. At the same time, the fair value of jet hedging instruments shall be set in accordance with price changes which occurred since the end of the year and the completion of accounting for some of the transactions. Following the increase in jet fuel prices the Company decided to update its fuel surcharge starting April 2011.

c) Subsequent to the balance sheet date and until a date immediately prior to the approval of the report for the first quarter of 2011, a 14% decrease occurred in three-month Libor interest rates.

The impact of the change in Libor rates in the payment of interest on loans shall be evident in the next repayment date for each loan. The interest payments on Company loans for the second quarter of 2011 shall be made according to interest rates in previous quarters. The Company possesses hedging agreements for Libor rates (see Section b.1.(4) above), the fair value of which is expected to drop as a result of the decrease in Libor interest rates.

d) Subsequent to the balance sheet date, fluctuations continued in the exchange rate of the NIS vs. the USD. On a date near the approval of the report, the exchange rate of the NIS rose 1.0% relative to the rate on the report date. The Company has hedging agreements on the NIS/USD exchange rate (see b.1.(5) above), the fair value of which may change according to changes in exchange rates. Note that the impact of exchange rates on next quarter's operating results shall be determined based on exchange rates in effect throughout the quarter and at its conclusion (June 30, 2011).

e) On April 1, Sun D'Or's operating license with revoked by the Civil Aviation Administration. For further details see Notes 13.(a) to the Financial Statements.

On May 5 2011 jet fuel refueling at BGN was halted after an unidentified contaminant was found in the BGN refueling tanks. For further details see Note 13.(g) to the Financial Statements.

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**Amikam Cohen**  
**Chairman of the Board**

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**Elyezer Shkedi**  
**CEO**

**May 24, 2011**

**Appendix to the Report of the Board of Directors on the State of the Corporation's Affairs for the Period Ending**

**On March 31 2011**

**Minimal Disclosure Required for Value Estimates and in their Regard, and Rules Pertaining to their Addition to Reports as per Securities Authority Guidelines in Accordance with Section 8b of the Securities Regulations (Periodic and Immediate Reports), 1970.**

**Assessment of the Total Value of the 777-200 and 747-400 Fleets**

**a. Introduction**

International Accounting Standard 36 establishes rules regarding the accounting treatment, presentation and disclosure required in the event of the impairment of assets.

The purpose of the standard is to establish procedures the corporation must implement in order to ensure that these assets are not presented in sums higher than their recoverable amount. An asset is presented in the Financial Statements at higher than its recoverable amount when its book value is higher than the sum received from the use or sale of the asset. In this case the asset has undergone impairment and IAS 36 demands that the corporation recognize the loss from impairment.

*The following document presents the key points of the value estimate performed by El Al Israel Airlines Ltd. (hereinafter "El Al" or "The Company") in order to determine whether the depreciation of its 777-200 and 747-400 fleets (hereinafter "the Fleets") was to be recognized according to IAS 36, in accordance with Securities Authority directives.*

*This document was prepared in accordance with Securities Authority guidelines as per Section 8b of the Securities Regulations (Periodic and Immediate Reports), 1970, regarding minimal required disclosure for value assessments and in their regard and rules on the matter of their addition to reports.*

**b. Specification and Identification of Asset Group**

The asset group for which the test was conducted includes the 777-400 fleet, which consists of 6 aircraft owned by the Company (of which 5 were operational as of the report) and the 747-200 fleet, which consists of 6 aircraft owned by the Company.

**c. Opinion Validity Date**

March 2011. The value estimate was based on financial projections for 2011 and coming years.

**d. Value Assessor**

The value assessment was performed by El Al management.

**e. Circumstances under which the IAS 36 Value Assessment was Conducted**

The book value of the aircraft fleet is higher than its market value as appearing in price lists published by AVAC – the Aircraft Value Analysis Company and Airclaims - ASCEND World Wide.

Note that use of the market value of the aircraft on the basis of AVAC and Airclaims price lists is common practice among airlines around the world as well as among financing banks and has been used by El Al in its various commitments with banks.

IAS 36 states that a provision for impairment must be made when the book value of an asset exceeds its recoverable amount. A recoverable amount is calculated as the asset's net selling price or value in use, whichever is higher.

The net selling price is the sum that may be received from the sale of the asset in a good faith agreement between a willing buyer and a willing seller. The value in use of an asset is the current value of estimated future cash flow expected to derive from continuous use of the asset and its sale at the end of the period of use. The Company considers the market value of the assets as published by AVAC and Airclaims as representing the net sales price of its assets. As of this value assessment, the Company has examined the value in use of the aircraft in its possession and in its service, the depreciated value of which in the Company's March 31 2011 Financial Statements is greater than their selling price.

As of this value assessment, the selling price of the 777-200 fleet amounts to a total of \$449 million, compared to the depreciated retained cost in the books of those aircraft as of March 31 2011, which amounts to a total of \$513 million.

The selling price of the 747-400 fleet amounts to a total of \$176 million, compared to the depreciated retained cost in the books of those aircraft as of March 31 2011, which amounts to a total of \$248 million.

**f. Assessment Method**

The value assessment was conducted according to the discounted cash flow method. According to this approach, assessed cash flows expected for the Company from the use of the aircraft fleet were discounted. The following are the key assumptions used in calculating value:

- Useful life: for the 777-200 fleet - 12 years of activity on average (and sale of the aircraft at net selling price at the end of the 12 year period), for the 747-400 fleet - 8 years of activity on average (and sale of the aircraft at net selling price at the end of the 8 year period).
- Cash flow expected from activity: management calculated that the projected cash flow from the operation of the 777-200 aircraft fleet will amount to \$90 million in 2011, and the cash flow from the operation of the 747-400 aircraft fleet will amount to \$116 million. This cash flow was calculated based on revenues from the aircraft fleet less commissions and variable expenses that may be assigned to the fleet in question and less fixed cash flow expenses such as security and maintenance expenses that may be allocated relative to the cost of these aircrafts' operation.
- Scrap value at the end of useful life (meaning after 12 years for the 777-200 fleet and 8 years for the 747-400 fleet): calculated based on AVAC and Airclaims projections and totaling \$180 million for the 777-200 fleet and \$72 million for the 747-400 fleet (non-discounted values).
- Growth rate: no real future growth in the Company's activities from the aircraft fleet in question was taken into account, and it is based on the projection for 2011.
- Discount rate: an 8% discount rate was assumed. According to Company Management's estimates, this discount rate adequately reflects the capital price component for the Company.
- The load factor for coming years was assumed to equal the same fixed rate as in the 2011 projection.

- The current tax rate expected for the Company for the coming 8-12 year period is zero.
- The Company assumes that the aircraft in question will be used as passenger aircraft for the next 8-12 years.
- The Company did not assume the need to make any unexpected investments in these aircraft in order to permit their continued use.

g. Value set using the Discounted Cash Flow Method for the 777-200 fleet (in millions of dollars):

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>Total</u>
Total discounted cash flow	86	80	74	68	63	59	54	50	47	43	40	37	701
Total discounted scrap value (after 12 years)												72	72

**Total value of the above assets based on the discounted cash flow method: \$773 million.**

The following is a sensitivity analysis of the value of these aircraft for changes in discount price, changes in jet fuel prices and for changes in the contribution of cash which according to the Company constitute key elements that may alter value in use projections:

<b>Discount Rate</b>	<b>6.0%</b>	<b>6.5%</b>	<b>7.0%</b>	<b>7.5%</b>	<b>8.0%</b>	<b>8.5%</b>	<b>9.0%</b>	<b>9.5%</b>
<b>Yearly Contribution</b>								
<b>In Millions of Dollars</b>								
<b>75</b>	737	716	696	677	659	641	625	609
<b>80</b>	780	758	737	717	698	680	662	645
<b>85</b>	823	800	778	757	737	718	699	682
<b>90</b>	863	839	816	794	<b>773</b>	753	734	715
<b>95</b>	909	884	860	838	816	794	774	755
<b>100</b>	953	927	902	878	855	833	812	791

**Fuel price sensitivity analysis, use of the asset across 12 years:**

<b>Difference of NPV Vs. Reduced Value</b>	<b>Reduced Value</b>	<b>NPV</b>	<b>Yearly Contribution</b>	<b>Fuel Price (Cent per Gallon)</b>
<b>In Millions of Dollars</b>				
323	513	837	94	<b>238</b>
306	513	819	92	<b>251</b>
260	513	<b>773</b>	90	<b>265</b>
271	513	785	87	<b>278</b>
254	513	767	85	<b>291</b>

**h. Value set using the Discounted Cash Flow Method for the 747-400 fleet (in millions of dollars):**

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<b>Total</b>
<b>Total discounted cash flow</b>	<b>112</b>	<b>104</b>	<b>96</b>	<b>89</b>	<b>82</b>	<b>76</b>	<b>71</b>	<b>65</b>	<b>695</b>
<b>Total discounted scrap value (after 8 years)</b>								<b>39</b>	<b>39</b>

**Total value of the above assets based on the discounted cash flow method: \$734 million.**

The following is a sensitivity analysis of the value of these aircraft for changes in discount price, changes in jet fuel prices and for changes in the contribution of cash which according to the Company constitute key elements that may alter projections of value in use:

<b>Discount Rate Yearly Contribution</b>	<b>6.0%</b>	<b>6.5%</b>	<b>7.0%</b>	<b>7.5%</b>	<b>8.0%</b>	<b>8.5%</b>	<b>9.0%</b>	<b>9.5%</b>
<b>In Millions of Dollars</b>								
<b>90</b>	621	609	598	587	576	566	556	547
<b>95</b>	653	640	629	617	606	595	585	575
<b>110</b>	748	735	721	708	696	684	672	660
<b>116</b>	790	775	761	747	<b>734</b>	721	709	697
<b>120</b>	812	797	783	769	756	742	730	717
<b>125</b>	844	829	814	799	785	772	758	746

Fuel price sensitivity analysis, use of the asset across 8 years:

<b>Difference of NPV Vs. Reduced Value</b>	<b>Reduced Value</b>	<b>NPV</b>	<b>Yearly Contribution</b>	<b>Fuel Price (Cent per Gallon)</b>
<b>In Millions of Dollars</b>				
512	248	760	121	<b>237</b>
499	248	747	119	<b>250</b>
486	248	<b>734</b>	116	<b>263</b>
473	248	722	114	<b>276</b>
461	248	709	112	<b>289</b>

**i. Summary**

The following table presents the summarized value assessment as of March 31 2011 for the 777-200 fleet:

**Recoverable sum calculation**

<b>Net Selling Price</b>	<b>Value in Use For El Al</b>	<b>Recoverable Amount - Whichever is Higher for El Al</b>
<b>In Millions of Dollars</b>		
<b>449</b>	<b>773</b>	<b>773</b>

**Should impairment be listed in the books?**

<b>The Aircrafts' Depreciated Retained Cost as of March 31 2011</b>	<b>The Recoverable Amount of the Same Aircraft to El Al, as of March 31 2011</b>	<b>Should Impairment be Listed in the Books?</b>
<b>In Millions of Dollars</b>		
<b>513</b>	<b>773</b>	<b>No</b>

The following table presents the summarized value assessment as of March 31 2011 for the 747-400 fleet:

**Recoverable sum calculation**

<b>Net Selling Price</b>	<b>Value in Use for El Al</b>	<b>Recoverable Amount - Whichever is Higher for El Al</b>
<b>In Millions of Dollars</b>		
<b>176</b>	<b>734</b>	<b>734</b>

**Should impairment be listed in the books?**

<b>The Aircrafts' Depreciated Retained Cost As of March 31, 2011</b>	<b>The Recoverable Amount of the Same Aircraft to El Al, As of March 31, 2011</b>	<b>Should Impairment be Listed in the Books?</b>
<b>In Millions of Dollars</b>		
<b>248</b>	<b>734</b>	<b>No</b>

**This value assessment is accurate on the date of its preparation and is based upon monetary details for 2011 and on projected income and expenses for the next 8-12 years. Changes in the projected assessments detailed above may alter the value assessment and the Company may subsequently be required to perform impairment.**

**EL AL Israel Airlines Ltd.**

**Interim Consolidated Financial Statements  
As of March 31, 2011**

**(Unaudited)**

**EL AL Israel Airlines Ltd.**

**Concise Consolidated Interim Financial Statements (Unaudited)**  
**As of March 31, 2011**

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## INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF EL AL Israel Airlines Ltd.

### Introduction

We have reviewed the attached financial information on **El Al Israel Airlines Ltd.** and its subsidiaries ("the Group"), which includes the concise consolidated report on its financial status as of March 31 2011 and its consolidated concise Statement of Operations and reports on Comprehensive Income, Changes in Equity and Cash Flows for the three month period ending that date. The Board of Directors and Management are responsible for preparing and presenting financial information for this interim period in accordance with IAS 34, Interim Financial Reporting, and are responsible for preparing financial information for this interim period in accordance with Section D of the Securities Regulations (Periodic and Immediate Reports), 1970. Our responsibility is to express our opinion on this interim financial information based on our review.

We have not reviewed the concise financial information for the interim period of subsidiaries the assets of which included in consolidation account for 1.1% of total consolidated assets as of March 31, 2011, and whose revenues included in consolidation constitute 1.1% of total consolidated revenues for the three month period ending that date. Furthermore, we were presented with reports from other accountants of an affiliated company the investment in which amounted to \$10,322 thousands as of March 31 2011, with the Group's share of their results amounting to \$735 thousands for the three-month period ending that date. The concise interim financial statements of said companies have been audited by other accountants, the reports of whom have been provided us and our conclusion, inasmuch as it refers to amounts consolidated for the aforementioned companies, is based on the reviews conducted by these other accountants.

### Scope of the Review

We conducted our reviews in accordance with Review Standard 1 of the Israeli Institute of Certified Public Accountants, "Reviews of Financial Information for Interim Periods Prepared by the Entity's Auditor." A review of financial information for interim periods consists of inquiries, mainly from people responsible for finances and accounting, and from the application of analytical and other reviewing procedures. A review is significantly limited in scope relative to an audit conducted according to generally accepted Israeli auditing standards, and therefore does not allow us to achieve assurance that we have been made aware of all material issues that might have been identified in an audit. Accordingly, we cannot provide an audit-level opinion.

### Conclusion

Based on our reviews and the reports of other CPAs, nothing has come to our attention that would lead us to believe that the financial information in question has not been prepared, in all material aspects, in accordance with IAS 34.

In addition to the above, based upon our review and that of other CPAs, nothing has come to our attention causing us to believe that the financial information in question does not fulfill, in all material aspects, the disclosure directives laid out in Chapter D of the Securities Regulations (Periodic and Immediate Reports), 1970.

**Brightman Almagor Zohar & Co**  
Certified Public Accountants

Tel Aviv, May 24, 2011.

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**EL AL Israel Airlines Ltd.**  
**Concise Consolidated Balance Sheets**

	As of March 31		As of December 31
	2011	2010	2010
	Thousands of Dollars	Thousands of Dollars	Thousands of Dollars
	(Unaudited)		
<b><u>Assets</u></b>			
<b><u>Current Assets</u></b>			
Cash and cash equivalents	173,507	143,765	111,002
Short-term deposits	8,780	8,086	63,565
Restricted deposits	-	5,130	-
Trade receivables	167,780	156,913	132,960
Other accounts receivable	26,338	18,143	20,880
Derivative financial instruments	61,431	13,803	42,190
Prepaid expenses	30,202	* 27,302	26,995
Inventories	33,523	17,648	18,756
<b>Total current assets</b>	<u>501,561</u>	<u>390,790</u>	<u>416,348</u>
<b><u>Non-Current Assets</u></b>			
Long-term bank deposits	1,881	1,892	1,869
Investment in affiliated companies	14,841	648	693
Investment in other companies	1,235	1,350	11,552
Derivative financial instruments	-	1,386	4,291
Fixed assets, net	1,236,433	1,288,120	1,231,687
Intangible assets, net	7,832	6,200	7,844
Prepaid expenses	8,244	* 5,908	8,121
Assets due to employee benefits	39,546	34,583	38,799
<b>Total non-current assets</b>	<u>1,310,012</u>	<u>1,340,087</u>	<u>1,304,856</u>
<b>Total assets</b>	<u>1,811,573</u>	<u>1,730,877</u>	<u>1,721,204</u>

\*Restated - see Note 5.

The accompanying Notes are an integral part of the Concise Consolidated Financial Statements.

**EL AL Israel Airlines Ltd.**  
**Concise Consolidated Balance Sheets**

	<u>As of March 31</u>		<u>As of December</u>
	<u>2011</u>	<u>2010</u>	<u>31</u>
	<u>Thousands of</u>	<u>Thousands of</u>	<u>2010</u>
	<u>Dollars</u>	<u>Dollars</u>	<u>Thousands of</u>
	<u>(Unaudited)</u>		
			<u>Dollars</u>
<b><u>Liabilities and Shareholders' Equity</u></b>			
<b><u>Current Liabilities</u></b>			
Borrowings and current maturities	153,075	106,486	147,587
Trade payables	169,251	135,507	157,912
Other payables	61,260	63,802	49,625
Provisions	30,813	58,946	44,939
Derivative financial instruments	5,401	43,498	2,329
Employee benefit obligations	117,683	96,521	98,712
Unearned revenues	330,097	261,946	231,204
<b>Total current liabilities</b>	<u>867,580</u>	<u>766,706</u>	<u>732,308</u>
<b><u>Non-Current Liabilities</u></b>			
Loans from financial institutions	544,511	692,903	561,084
Employee benefit obligations	66,234	66,204	65,590
Loans from others	-	220	-
Derivative financial instruments	13,029	16,807	19,739
Other payables	7,586	10,532	10,700
Deferred taxes	32,225	4,620	32,792
Unearned revenues	49,273	51,313	51,467
<b>Total non-current liabilities</b>	<u>712,858</u>	<u>842,599</u>	<u>741,372</u>
<b>Total liabilities</b>	1,580,438	1,609,305	1,473,680
<b><u>Shareholders' equity</u></b>			
Share capital	155,012	155,012	155,012
Share premium	28,007	28,007	28,007
Capital reserve from transactions with a former controlling shareholder	237,122	237,122	237,122
Capital reserve in respect of share-based payment	7,299	6,644	7,198
Capital reserve in respect of cash flow hedging	61,441	(16,729)	35,082
Capital reserve from translation differences of foreign activity	87	-	-
Accumulated loss	(257,833)	(288,484)	(214,897)
<b>Total shareholders' equity</b>	<u>231,135</u>	<u>121,572</u>	<u>247,524</u>
<b>Total liabilities and equity</b>	<u>1,811,573</u>	<u>1,730,877</u>	<u>1,721,204</u>

\_\_\_\_\_  
**Amikam Cohen**  
Chairman of the Board

\_\_\_\_\_  
**Elyezer Shkedi**  
CEO

\_\_\_\_\_  
**Nissim Malki**  
CFO

**Approval date of Financial Statements:** Ben Gurion Airport, May 24 2011.

**The accompanying Notes are an integral part of the Concise Consolidated Financial Statements.**

**EL AL Israel Airlines Ltd.**  
**Concise Consolidated Statement of Operations**

	For the Three Month		For the Year
	Period Ending		Ending
	2011	2010	December 31
	Thousands of	Thousands of	Thousands of
	Dollars	Dollars	Dollars
	(Unaudited)		
Operating revenues	425,174	*423,190	1,972,239
Operating expenses	(403,400)	(363,582)	(1,584,557)
<b>Gross profit</b>	21,774	59,608	387,682
Selling expenses	(44,943)	*(48,577)	(214,755)
General and administrative expenses	(24,324)	(23,861)	(96,153)
Other operating revenues (expenses), net	(6,012)	(1,885)	11,269
	(75,279)	(74,323)	(299,639)
<b>Operating Profit (loss) before financing</b>	(53,505)	(14,715)	88,043
Financing expenses	(4,270)	(9,130)	(35,911)
Financing revenues	5,493	2,009	10,849
<b>Financing revenues (expenses), net</b>	1,223	(7,121)	(25,062)
The Company's share of the profits of subsidiaries, net of tax	735	-	45
<b>Profit (loss) before income taxes</b>	(51,547)	(21,836)	63,026
Tax benefit (income taxes)	8,611	5,304	(5,971)
<b>Profit (loss) for the period</b>	(42,936)	(16,532)	57,055
<b>Profit (loss) per 1 NIS NV ordinary share (in USD):</b>			
Basic profit (loss) per share	(0.09)	(0.03)	0.12
Diluted profit (loss) per share	(0.09)	(0.03)	0.11
<b>Weighted average of number of shares (in thousands) used in the calculation of profit (loss) per share :</b>			
Basic	495,719	495,719	495,719
Diluted	495,719	495,719	496,793

\*Restated - see Note 5.

The accompanying Notes are an integral part of the Concise Consolidated Financial Statements.

**EL AL Israel Airlines Ltd.**  
**Concise Consolidated Statement of Comprehensive Income**

	<b>For the Three Month Period Ending March 31</b>		<b>For the year Ending December 31</b>
	<b>2011</b>	<b>2010</b>	<b>2010</b>
	<b>Thousands of Dollars</b>	<b>Thousands of Dollars</b>	<b>Thousands of Dollars</b>
	<b>(Unaudited)</b>		
<b>Profit (loss) for the period</b>	(42,936)	(16,532)	57,055
<b>Other Comprehensive Income</b>			
Exchange rate differences from the translation of foreign activity, net of tax	87	-	-
Earnings in respect of cash flow hedging, net of tax	26,359	14,093	65,904
<b>Other comprehensive income for the period, net of tax</b>	26,446	14,093	65,904
<b>Total comprehensive income (loss) for the period</b>	(16,490)	(2,439)	122,959

The accompanying Notes are an integral part of the Concise Consolidated Financial Statements.

**EL AL Israel Airlines Ltd.**  
**Concise Consolidated Statement of Changes in Shareholders' Equity**

**For the Three-Month Period Ending March 31 2011**

Share Capital	Share Premium	Capital Reserve from Trans- actions with a Former Controlling Shareholder	Capital Reserve in Respect of Share- Based Payment	Capital Reserve in Respect of Cash Flow Hedging	Capital Reserve from Translation Differences of Foreign Activity	Accum- ulated Loss	Total
Thousands of Dollars							
(Unaudited)							
<b>Balance as of January 1 2011</b>	155,012	28,007	237,122	7,198	35,082	-	247,524
Loss for the period	-	-	-	-	-	(42,936)	(42,936)
Earnings in respect of cash flow hedging, net of tax	-	-	-	26,359	-	-	26,359
Exchange rate differences from the translation of foreign activity, net of tax	-	-	-	-	87	-	87
<b>Total loss for the period</b>	-	-	-	26,359	87	(42,936)	(16,490)
Share-based payment	-	-	101	-	-	-	101
Total transactions with parent company shareholders pursuant to their position as shareholders	-	-	101	-	-	-	101
<b>Total shareholders' equity as of March 31 2011</b>	<b>155,012</b>	<b>28,007</b>	<b>237,122</b>	<b>7,299</b>	<b>61,441</b>	<b>87</b>	<b>231,135</b>

The accompanying Notes are an integral part of the Concise Consolidated Financial Statements.

**EL AL Israel Airlines Ltd.**  
**Concise Consolidated Statement of Changes in Shareholders' Equity**

**For the Three-Month Period Ending March 31 2010**

<u>Share Capital</u>	<u>Share Premium</u>	<u>Capital Reserve from Transactions with a Former Controlling Shareholder</u>	<u>Capital Reserve in Respect of Share- Based Payment</u>	<u>Capital Reserve in Respect of Cash Flow Hedging</u>	<u>Accum- ulated Loss</u>	<u>Total</u>	
Thousands of Dollars							
(Unaudited)							
<b>Balance as of January 1 2010</b>	155,012	28,007	237,122	6,414	(30,822)	(271,952)	123,781
Loss for the period	-	-	-	-	(16,532)	-	(16,532)
Earnings in respect of cash flow hedging, net of tax	-	-	-	14,093	-	-	14,093
<b>Total loss for the period</b>	-	-	-	14,093	(16,532)	-	(2,439)
Share-based payment	-	-	230	-	-	-	230
Total transactions with parent company shareholders pursuant to their position as shareholders	-	-	230	-	-	-	230
<b>Total shareholders' equity as of March 31 2010</b>	<u>155,012</u>	<u>28,007</u>	<u>237,122</u>	<u>6,644</u>	<u>(16,729)</u>	<u>(288,484)</u>	<u>121,572</u>

The accompanying Notes are an integral part of the Concise Consolidated Financial Statements.

**EL AL Israel Airlines Ltd.**  
**Concise Consolidated Statement of Changes in Shareholders' Equity**

**For the Year Ending December 31 2010**

	<u>Share Capital</u>	<u>Share Premium</u>	<u>Capital Reserve from Trans- actions with a Former Controlling Shareholder</u>	<u>Capital Reserve in Respect of Share- Based Payment</u>	<u>Capital Reserve in Respect of Cash Flow Hedging</u>	<u>Accum- ulated Loss</u>	<u>Total</u>
	Thousands of Dollars						
<b>Balance as of January 1 2010</b>	155,012	28,007	237,122	6,414	(30,822)	(271,952)	123,781
Yearly profit	-	-	-	-	-	57,055	57,055
Earnings in respect of cash flow hedging, net of tax	-	-	-	-	65,904	-	65,904
<b>Total comprehensive income for the year</b>	-	-	-	-	65,904	57,055	122,959
Share-based payment	-	-	-	784	-	-	784
Total transactions with parent company shareholders pursuant to their position as shareholders	-	-	-	784	-	-	784
<b>Total shareholders' equity as of December 31 2010</b>	<u>155,012</u>	<u>28,007</u>	<u>237,122</u>	<u>7,198</u>	<u>35,082</u>	<u>(214,897)</u>	<u>247,524</u>

The accompanying Notes are an integral part of the Concise Consolidated Financial Statements.

**EL AL Israel Airlines Ltd.**  
**Concise Consolidated Statement of Cash Flow**

	<b>For the Three Month Period Ending March 31</b>		<b>For the year Ending December 31</b>
	<b>2011</b>	<b>2010</b>	<b>2010</b>
<b>Thousands of Dollars</b>			
<b>(Unaudited)</b>			
<b><u>Cash Flows from Operating Activities</u></b>			
Income (loss) for the period	(42,936)	(16,532)	57,055
Appendix A - Adjustments required for presentation of cash flow from operating activities	99,602	70,407	146,236
<b>Cash deriving from operating activities, net</b>	<u>56,666</u>	<u>53,875</u>	<u>203,291</u>
<b><u>Cash Flows from (for) Investment Activities</u></b>			
Acquisition of fixed assets (including general engine overhauls and payment on account of aircraft)	(37,143)	(8,250)	(46,548)
Proceeds from the realization of fixed assets	155	1,233	2,802
Investment in intangible assets	(372)	(311)	(3,054)
Realization of restricted deposits	-	1,873	7,003
Decrease (increase) in short-term deposits, net	54,785	(153)	(55,632)
Investment in deposits for service providers and long-term	(48)	(57)	(157)
Repayment of deposits for service providers and long-term	65	41	354
<b>Cash from (for) investment activity, net</b>	<u>17,442</u>	<u>(5,624)</u>	<u>(95,232)</u>
<b><u>Cash Flows for Financing Activity</u></b>			
Repayment of long-term loans from financial institutions	(11,871)	(11,711)	(77,804)
Receipt of other long-term loans	-	2,391	2,568
Repayment of other long-term loans	(623)	(27)	(1,596)
Increase (decrease) in short-term credit, net	891	(1,826)	(26,912)
<b>Cash used for financing activity, net</b>	<u>(11,603)</u>	<u>(11,173)</u>	<u>(103,744)</u>
<b>Increase in cash and cash equivalents</b>	<u>62,505</u>	<u>37,078</u>	<u>4,315</u>
<b>Balance of cash and cash equivalents at the beginning of the period</b>	<u>111,002</u>	<u>106,687</u>	<u>106,687</u>
<b>Balance of cash and cash equivalents at the end of the period</b>	<u>173,507</u>	<u>143,765</u>	<u>111,002</u>

The accompanying Notes are an integral part of the Concise Consolidated Financial Statements.

**EL AL Israel Airlines Ltd.**  
**Concise Consolidated Statement of Cash Flow**

	For the Three Month Period Ending March 31		Ending December 31
	2011	2010	2010
	Thousands of Dollars (Unaudited)		
<b><u>Appendix A</u></b>			
<b>Income and expenses not involving cash flows:</b>			
Depreciation and amortization (including disposal of accessories, disused components, consumption of consumable equipment and impairment of fixed and intangible assets)	33,286	34,226	130,580
Adjustment of value of deposits to trade payables and long-term	(36)	(30)	(98)
Share of earnings of affiliated companies	(735)	-	(45)
Deferred taxes, net	(8,730)	(5,370)	6,098
Increase (decrease) in liabilities in respect of employee benefits and in provisions	4,742	19,115	(495)
Net capital gains from realized fixed assets	(142)	(212)	(672)
Benefit value of employee stock option program	101	230	784
Loss (gain) from adjustment of fair value of derivatives via gain/loss	(1,728)	1,569	555
Purchase of options for jet fuel hedging	(13,385)	-	-
Receipts from the sale of hedging transactions for jet fuel hedging	31,047	-	-
Profit from shares and options received for no return	(886)	-	(11,145)
Revaluation of shares and options received for no return	533	-	821
<b>Changes in asset and liability items:</b>			
Increase in trade receivables	(34,820)	(44,827)	(20,874)
Increase in other accounts receivable	(5,451)	(1,988)	(4,725)
Increase in prepaid expenses	(3,330)	(5,759)	(7,665)
Decrease (increase) in inventories	(14,767)	4,299	3,191
Increase in trade payables	11,339	6,537	28,942
Increase (decrease) in other payables	5,865	4,615	(6,430)
Increase in unearned revenues	96,699	58,002	27,414
	99,602	70,407	146,236
<b><u>Appendix B – Payment (Receipt) of Interest, Taxes and Dividends, Classified Under Cash Flow from Operating Activities</u></b>			
Interest payments	5,698	3,503	25,138
Interest receipts	(974)	(146)	(2,817)
Tax payments – advances in respect of extraneous expenses	15	19	334
Dividend receipts	-	-	(20)

The accompanying Notes are an integral part of the Concise Consolidated Financial Statements.

**EL AL Israel Airlines Ltd.**  
**Notes to the Concise Consolidated Financial Statements**

**Note 1 - General**

- a. El Al Israel Airlines Ltd is primarily engaged, through its subsidiaries (hereinafter – "the Group") in the transport of passengers and cargo, including luggage and mail, on scheduled and charter flights between Israel and foreign countries. For information on the Group's operating segments, see note 12.
- b. Passenger traffic through Ben Gurion Airport (BGN) is characterized by a high level of seasonality. Most activity is during summer months, peaking July-September. Winter months (January-March) are characterized by low passenger activity levels. The number of Israeli departures and tourist arrivals in the reported quarter was influenced by the fact that the Passover holidays fell in April this year (Q2), while last year it fell in March (Q1).
- c. These concise statements must be seen in context with the Company's yearly Financial Statements dated December 31, 2010 and the year ending that date, and the attached notes.
- d. **Failure to Include Separate Financial Information:**

In accordance with Regulation 4 of the Periodic and Immediate Reports Regulations, the Company did not attached separate financial information as per Regulation 38.d of the Securities Regulations (Periodic and Immediate Reports), 1970, to the Financial Statements for the period ending on March 31, 2011.

The reason due to which no separate information was included was in light of the negligible impact the financial statements of the affiliated companies have on the Consolidated Financial Statements.

The parameters used by the Company in order to establish the impact in question are: revenues, profits and cash flow from regular operations of up to 5% of all assets, revenues, profits and cash flow from regular operations in the consolidated statements – accordingly, ignoring the impact of uncommon exceptional occurrences.

For information regarding transactions and commitments between the Company and its consolidated companies, see Note 11 below

**Note 2 - Significant Accounting Policies**

- a. **Basis for the preparation of the Financial Statements:**

The Group's concise interim consolidated financial statements (hereinafter: "Interim Statements") have been compiled in accordance with International Accounting Standard 34, "Interim Financial Reporting" (hereinafter: "IAS 34").

In the preparation of these Interim Financial Statements the Group implemented accounting policy, rules of presentation and calculation methods identical to those implemented in the preparation of its Financial Statements for December 31, 2010 and the year ending that date.
- b. The Consolidated Concise Financial Statements have been prepared in accordance with the provisions of Chapter D of the Securities Regulations (Immediate and Periodic Reports), 1970.
- c. **Exchange rates and linkage basis:**
  - (1) Balances in foreign currency, or linked to foreign currency, are included in the Financial Statements according to official exchange rate published by the Bank of Israel and in effect as of the balance sheet date.
  - (2) Balances linked to the Consumer Price Index are presented using the most recent known CPI value upon the balance sheet date (the CPI for the month prior to the month of the balance sheet date).

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(3) Below is data on dollar exchange rates and the CPI in Israel:

	<u>As of March 31</u> <u>2011</u>	<u>As of March 31</u> <u>2010</u>	<u>As of December 31</u> <u>2010</u>
Consumer Price Index – in points	118.4	104.3	117.8
USD/NIS exchange rate	3.481	3.713	3.549
USD/EUR exchange rate	0.703	0.744	0.749
USD/Pound Sterling Exchange Rate	0.622	0.662	0.646

**Change in %:**

	<u>For the Three-Month Period Ended</u> <u>March 31</u>		<u>For the Year</u> <u>Ended December</u> <u>31</u>
	<u>2011</u>	<u>2010</u>	<u>2010</u>
Consumer Price Index	0.5	(0.9)	2.7
USD vs. NIS	(1.9)	(1.6)	(6.0)
USD vs. EUR	(6.1)	7.2	7.9
USD vs. Pound Sterling	(3.7)	7.1	4.5

**d. Investment in Affiliate**

In accordance with international standards, the purchasing company (hereinafter: “the Buyer”) which achieves material influence over another company (hereinafter “the Affiliate” or “the Purchased Company”) must make an allocation of the purchase price (PPA) for the proceeds paid, in accordance with IAS 28. In accordance with the standard, the Buyer must identify the Purchased Company’s identified assets as of the date of the purchase (on the date material influence was achieved).

IAS 28 states that the investment in an affiliate company shall be made using the Equity method, meaning that investment in an affiliate will first be recognized according to the cost and the book value will increase or decrease in order to recognize the investor’s share in the profit or loss of the affiliate subsequent to the purchase date.

**Note 3 - New Financial Reporting Standards and Clarifications Published**

**a. New standards and interpretations impacting the current period and/or previous reported periods:**

▪ **IAS 1 (Revised) "Presentation of Financial Statements" – Clarifications Regarding the Report on Changes in Equity.**

The revision establishes that other comprehensive income items shall be presented in the Report on Changes in Equity or as part of the Notes, according to the company's accounting policy. Accordingly, companies can choose whether to present the details of the other comprehensive income items charged directly to equity over the course of the presented reporting periods in the Report on Changes in Equity or in the Notes.

The Company decided to present other comprehensive income items in the Report on Changes in Equity.

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**b. New standards and clarifications, already in effect, which have no material impact on the current period and/or on previous reporting periods:**

▪ **IAS 34 – “Interim Financial Reporting”**

The revision emphasizes the principles detailed in IAS 34, that the purpose of the information presented regarding events and transactions material to understanding the changes in the entity's financial status and performance since the last yearly report date, is to update the information referring to them in the latest yearly Financial Statement. Furthermore, the manner of the implementation of this principle in the matter of financial instruments was clarified, and certain disclosure requirements were added. The revision is applied retroactively to yearly reporting periods starting January 1, 2011 or subsequently.

▪ **IFRIC 19 "Removal of Financial Liabilities by Capital Instruments"**

The interpretation establishes the accounting treatment regarding the removal of financial liabilities by issuing capital instruments. The interpretation established that in the event of such an occurrence, the liability shall be subtracted when the difference between its book value on the clearance date and the fair value of the yield paid, measured at the height of the fair value of the capital instruments issued, shall be charged to the Statement of Operations.

In the Company's management opinion, implementation of the interpretation has no impact on its financial status and operating results.

▪ **IFRIC 14 (Revision) "Advance Payments on Account of Minimal Deposit Requirements"**

This revision states that when measuring a plan's assets as regards a defined benefit plan, advance payments on account of minimal deposit requirements shall be included as part of the economic benefits available in the form of refunds from the plans or a reduction in future deposits to the plan.

In the opinion of Company management, implementation of the interpretation has no impact on its financial status and operating results.

**c. New standards and clarifications that have been published and are not in effect, and which have not been adopted by the Group by way of early adaptation, which are expected to or may have an impact on future periods.**

▪ **IFRS 7 (Revision) “Financial Instruments: Disclosure”**

The revision includes demands regarding the entity's exposure to risk due to financial asset transfer transactions in which the transferring party retains a certain level of continuing exposure to the asset (“continuous involvement”), and regarding financial asset transfer transactions subtracted in full, carried out near the end of the reported period.

For information regarding the standard's start dates and transition orders, see Note 3.c to the Company's Financial Statements as of December 31, 2010.

**Note 4 - Critical Accounting Considerations and Key Sources for Estimates of Uncertainties**

In applying Group accounting policy, as set forth in Note 2 above, the Company's management is sometimes required to exercise considerable judgment with regard to estimates and assumptions on the carrying amount of assets and liabilities, which may not be available from other sources. These estimates and related assumptions are based on past experience and other factors deemed relevant. Actual results may differ from these estimates.

Estimates and underlying assumptions are regularly reviewed by management. Changes in accounting estimates are only recognized in the period in which a change was made to the estimate, if the change only affects that

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period, or are recognized in said period and in subsequent periods in cases where the change affects both the current period and the subsequent periods.

For further details regarding critical accounting estimates employed by the Company, see Note 4 to the Financial Statements as of December 31, 2010.

**Note 5 - Reclassification of Balance Sheet Balances**

The following are balance sheet items of which their balances as of March 31, 2010 were reclassified:

Prepaid expenses for the lease of aircrafts to the amount of \$3,396 thousand were reclassified from Current Prepaid Expenses to Non-Current Prepaid Expenses.

The following are Statement of Operations items of which their balances were reclassified for the three-month period ended March 31, 2010:

Discounts within operating revenues item to the amount of \$2,696 thousand were classified to distribution expenses within sales expenses.

**Note 6 - Material Transactions and Events over the Course of the Reported Period**

- a. Pursuant to Note 39.a to the Financial Statements of 2010, in January 2011 the Company was allocated an additional 1,598,783 shares, constituting 3.75% of Maman's issued and paid-up share capital, so that the Company's total holdings after this allocation amounted to 11.25% of Maman's issued and paid-up share capital. In addition, in November 2010 the Company was allocated options exercisable to regular shares at a rate close to 10% of Maman's issued and paid-up capital. Therefore, starting January 2011, as a result of first-time achievement of material influence over Maman, the Company included in its Financial Statements for the first quarter of 2011, an allocation of the purchase price (PPA) for the proceeds, this as per IAS 28. Regarding the accounting policy implemented by the Company due to the first-time achievement of material influence over Maman, see Note 2.d.
- b. In January 2011 civil uprisings began in several North African and Middle Eastern countries resulting from the lack of civil rights, the absence of democracy and poor economic conditions with increasing unemployment. As a result of this instability, fuel costs increased by 20% over the course of the reported period, compared to the fourth quarter of 2010. The meaning of a 1 cent increase in jet fuel prices for an entire year means an added yearly expense of \$2.5 million. Following the increase in jet fuel prices the Company decided to update its fuel surcharge starting April 2011.
- c. On January 19, 2011 the Company's General Meeting ratified the continuation of the tenures of the directors serving on the Company's Board of Directors (who are not external directors) as follows: Amikam Cohen, Tamar Mozes Borowich, Yehuda (Yudi) Levi, Professor Israel (Izzy) Borowich, Amnon Lipkin-Shahak, Amiaz Saggis, Nadav Palti, Eran Ilan, Pinchas Ginsburg and Shlomo Hannael as well as the appointment of Ms. Sophia Kimmerling as member of the Company's Board of Directors, until the conclusion of next annual General Meeting.
- d. In February 2011, a special collective agreement pertaining to temporary flight attendants and temporary employees in the administrative sector was signed. According to the agreement, a special reserve shall be established of 150 employees from each sector, who shall remain employed for an additional period of ten years as temporary employees. The working conditions of these employees shall be equivalent to full-time second generation workers, with the exception of the education fund. These employees shall adhere to the second generation employee disciplinary code. Dismissal of such employees due to incompatibility shall be via a consensual on parity committee or following arbitration. The agreement shall remain in effect for three years with the option of extending it by an additional two years.
- e. On February 2, 2011 the Company was provided with a copy of a motion to approve the filing of a claim as a derivative claim ("the Motion") as well as a copy of the derivative claim. The motion was filed to the

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Economic Department of the Tel Aviv District Court by a holder of 5,000 Company shares (constituting 0.001%). Note that the shareholder had submitted two demands to the Company, which had been rejected by the Company's Board of Directors.

According to the motion, the court was asked to approve a derivative claim to the amount of 22,800 thousand NIS against Israel (Izzy) Borowich, Tamar Mozes Borowich, Amiaz Saggis, Nadav Palti, Amnon Lipkin-Shahak, Yigal Arnon, Eyal Rosner, Shimon Katzanelson and Yehoshua Ne'eman, who had served on the Company's Board of Directors in 2005 during the ratification of the employment contract of the former CEO of the Company, Mr. Chaim Romano. The motion claimed, *inter alia*, that the aforementioned board members were negligent in determining and approving the yearly incentive bonus for Mr. Romano, who had served as the Company's CEO between 2005 and 2009, as well as regarding the Company's reports on the formula of the bonus in question. Regarding developments occurring subsequent to the reported period see Note 13 (e).

- f. On February 10, 2011 the Company's Board of Directors ratified the signing of a settlement with the Tax Authorities (Ramla Tax Officer).

This settlement came as a result of a dispute between the Company and Income Tax in which the Company received assessments followed by orders for 1998 through tax year 2005. The sum of the assessments issued was estimated by the Company at a total sum of 186 million NIS (\$53.4 million) including interest and linkage differentials up to December 31, 2010.

The key points of the dispute between the Company and the tax authorities are the value of flight tickets, on the basis of available seats and on the basis of reserved seats, granted to employees in discounts, as follows:

a. For flight tickets granted on an available seat basis, the Company's position was that the value of the ticket shall be calculated at a rate of 22.5% of the flight ticket prices established as a basic price for the issue of employee economy class tickets, according to an arrangement conducted in the past with Income Tax and revoked in 1997. The tax officer determined, in assessments issued for the Company for 1998-2005, the value of the flight tickets at variable rates from the average price of economy class tickets, which are higher than the rate set by the Company above (up to 75% of the price of an average ticket), this based on the average load factor for the month in which the flight took place.

b. For flight tickets on the basis of a reserved seat which the Company allows its employees to purchase in return for a payment of 50% of the cost of a flight ticket set by the Company as an average economy class price, the Company paid fixed tax rates, but in assessments issued for the Company for 2001 to 2005, Income Tax determined that the value of the flight ticket is 214% of the price of an average economy class ticket.

c. In addition, the assessments issued for 1998 through 2002 included tax debits for employees stationed abroad for periods of over 4 years as well as for a tax offset paid by the employees of the Company in the U.S.

The Company has appealed these assessments before the District Court based, among other things, on economic opinions materially different from those of the Income Tax assessments.

The parties held talks to resolve the disputes in question and on February 10 2011 the Company's Board of Directors ratified a settlement between the Company and the Ramla Tax Officer, as follows:

a. The Company shall pay Income Tax up to and including 2010 a final and absolute sum of 65 million NIS including payment for the assessments for which the orders were issued for tax years 1998-2005 and the full deduction debts for employee flight tickets, surplus and other expenses for 2006 through 2010 (including). The agreed-upon sum of 65 million NIS was paid in February 2011.

b. An agreement regarding the value of flight tickets for the employees of the Company in the purchase of flight tickets on an available seat basis and on a reserved seat basis, for 2011 through 2013.

On February 16, 2011 the agreement was approved by the court, thus concluding the legal proceedings between the Company and Income Tax regarding the deduction assessments issued for the Company.

For all of the above Income Tax requests, up to and including 2010, the Company made financial provisions exceeding the sum of the settlement described above and therefore the Company reduced the sum of the provision listed in its books and recognized other revenues to the amount of \$22.25 million in its 2010 Financial Statements under "Other Operating Revenues".

In addition to the above, as of March 31, 2011 an appropriate provision exists in the Company's books for Social Security commitments deriving from the settlement with Income Tax.

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- g. On March 10, 2011, the Securities Authority provided the Company with an audit report regarding the terms of the employment of senior Company executives, including the Company's outgoing CEO, Mr. Haim Romano. On March 14, 2011 the Company announced that pursuant to the talks the Company is conducting to restore and/or receive compensation for an excess of 4 million NIS which paid the outgoing CEO, the Company negotiated with the outgoing CEO that he would refund the Company a total of 1 million NIS and the Company also negotiated with the insurance company, with which the Company entered into an executive insurance policy, that it would pay the Company a total of \$750,000 U.S., on account of the compensation required from directors and executives or either to reduce or clear the derivative claim. Note that Professor Israel Borowitz resigned from the Company's Board of Directors on March 9, 2011. Regarding developments occurring subsequent to the reported period, see Note 13 (e).
- h. On March 22, 2011 the Company CEO informed the Company Board of Directors, at his own initiative, that he had decided to transfer to the Excellence and People fund, to be established in 2011, a sum equal to 50% of the yearly bonus owed him for 2010, in accordance with the term of his employment, meaning a total of 5.7 million NIS (gross). This sum will be added to a sum of 2 million NIS, which will be deposited in the above fund.  
The sums in this fund are intended for the development, encouragement and promotion of excellence in the Company and personal excellence, as pertains to all of the Company's employees in Israel and around the world who are not members of its management.
- i. On March 22 2011 the Company approved an engagement to receive various advertising and purchasing services for 2011 and ratified, for the sake of prudence, an engagement to receive various advertising services granted in the past for 2008, 2009 and 2010.  
The advertising services in question shall be ordered for the Company by the Company's advertising agency from various bodies, including the Yediot Acharonot Group and the C. T. V. Media Enterprise for the sale of billboard advertising ("the Enterprise"). In addition, the Company Board of Directors approved the purchase of newspapers and magazines belonging to the Yediot Acharonot group for distribution to passengers on Company's flights.  
The engagements in question were approved by the Company's Board of Directors as non-exceptional transactions, in which the Company's executives and controlling shareholders may have a personal interest, in light of the fact that Yediot Acharonot is a company owned by the brother of Ms. Tamar Borowitz (Deputy Chairman of the Board of Directors and a controlling shareholder of Knafaim holdings Ltd.), and that the Enterprise is operated by companies, including C.T.V. Media Israel Ltd., in which Ms. Borowitz and Mr. Nadav Palti (a Company director) indirectly hold a portion of its shares and serve on its board of directors, and in which Professor Israel Borowitz (a Knafaim controlling shareholder) indirectly holds a portion of its shares.  
The Board of Directors' state reasons for approving the engagements in question were that the engagements are for the Company's good, taking into account the distribution and rating data of the newspapers, magazines and websites of the Yediot Acharonot Group and of the enterprise, and taking into account the Company's marketing needs.  
The Company's Board of Directors set a yearly framework for 2011 for the engagements detailed above to the amount of 3,450 thousand NIS for engagements with the Yediot Acharonot group and to the amount of 1,480 thousand for engagements with the Enterprise only, so long as all of the engagements are under market conditions.  
In addition, the Company Board of Directors established mechanisms for supervising compliance with the terms of the engagement framework as well as for supervision of their performance under market conditions and prices.
- j. In March 2011 the Airports Authority informed the Company that it had decided not to exercise its option in the agreement between it and the Company allowing an additional extension of 24 months to the provision of managing and operating services for the Company passenger lounge. The agreement ends on November 1, 2011. The Airports Authority informed the Company that it is preparing for the publications of a tender for a commercial license to operate the lounge. The Company objects to the refusal to extend the agreement and asked to continue negotiations to extend the agreement.

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**Note 7 - Fixed Assets**

**a. Impairment of Fixed Assets**

Over the course of the reported period, the Company examined the recoverable sum of aircraft fleets in which signs of impairment were evident. The recoverable sum is calculated as the net sales price or the value in use of the asset that is the current value of the estimated future cash flow expected to derive from continuous use of the asset and its sale at the end of the period of use ("cash flow capitalization").

The key assumptions employed in calculating the capitalization of the cash flow are: useful life – for the 777-200 fleet - 12 years average of activity, for the 747-400 fleet - 8 years average of activity. An 8% discount rate. The load factor for coming years was assumed as a fixed rate according to the projection for 2011. The current tax rate expected for the Company for the coming 8-12 year period is zero. The expected cash flow from activity was calculated according to the 2011 projection.

It was found that the recoverable sum for each aircrafts fleet surpasses its depreciated cost as of that date. Accordingly, no provision for the impairment of aircraft assets was made in these Financial Statements.

**b. Aircraft Fleet Decommission Dates**

In accordance with a renewed evaluation of the Company's flight equipment needs, and looking towards alternate aircrafts entering service, the average life span until decommissioning of the 747-400 fleet was extended by 18 months.

Following the change in estimate in question, the Company listed a decrease in depreciation expenses in Q1 2011, within the framework of operating expenses, to the amount of \$1.2 million. The total decrease in depreciation costs for all of 2011 following the change in estimate is expected to amount to a total of \$4.8 million.

**c. Unrestricted Assets**

The value of the Group's total fixed assets as of March 31, 2011 is \$1,236 million.

The Group's main assets are aircrafts and spare engines, the depreciated cost of which as of March 31, 2011 is \$1,087 million. The depreciated cost of the Group's main assets that are not restricted by a third party amounts to a total of \$22 million.

In addition, as of the balance sheet date, the Group possesses parts and other fixed assets to the amount of \$149 million, free of any encumbrance.

**d.** Following Note 39.d. (5) to the December 31, 2010 Financial Statements regarding the agreement with Wilmington Trust Sp Services (Dublin) Limited for the lease of a Boeing 737-800 aircraft, the airplane was received in January 2011 and joined the Company's aircraft fleet. The lease was classified as an operational lease in the Financial Statements.

**e.** On February 7, 2011 an agreement was signed, and was ratified by the Company's Board of Directors on March 22, 2011, with aircraft manufacturer Boeing ("the Agreement") for the purchase of 4 new Boeing 737-900ER aircrafts and two additional aircraft of the same model convertible to purchase options. In addition, the Company was granted the option to purchase two additional aircraft of this model ("the Option"). In addition, the Company's Board of Directors approved the purchase of an engine to serve as an additional reserve engine for the aircraft fleet from CFM International SA. In this Agreement the Company was granted conversion rights for other models as well as associated rights. The comprehensive value of the agreement is estimated at between \$215 million and \$320 million (respectively for four to six aircrafts, as purchased in practice, without the option), and reflects an average market value of aircraft of this model and similar production year, in accordance with generally accepted industry price lists and subject to adjustments and investments in accordance with the version agreed upon by the parties, including linkage of aircrafts prices, using an agreed-upon linkage formula.

The payments for each plane shall begin two years before each plane will delivered to the Company, or according to other payment options the Company may choose. Furthermore, the parties agreed upon conditions for the use of advance payments made by the Company to Boeing for previous agreements. According to the agreement, the aircrafts are expected to join the Company's aircrafts fleet between

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late 2013 and 2016. The aircrafts are expected to serve the Company in short and medium ranges (Europe and regional destinations) and shall replace narrow-bodied aircrafts as per Company strategy. The aircraft shall be operated in a 160 seats configuration, divided into two service classes. Note that these are aircrafts of a new and advanced model, with modern engines and advanced internal configurations. Regarding the aircrafts purchase agreement, the Company paid advance payments of immaterial sums in the reported quarter.

- f. Following Note 42(5) to the December 31 2010 Financial Statements regarding the agreement signed with R.B. Leasing Company Limited for the purchase of a 747-400 Boeing passenger aircraft, the airplane was received at the Company in March 2011. The plane is currently undergoing renovation and adaptation works expected to be completed by the end of June 2011. Upon the completion of works, the plane is expected to be configured for 455 seats. The aircraft was purchased using the Company's own resources. In May the Company signed a loan agreement with a local bank to finance the purchase of the aircraft to the amount of \$14.5 million. The Company has the option of increasing the sum of the financing after improving the airplane. The financing is for a period of 4 years with quarterly repayments of principal plus interest.
- g. In March 2011 an extension and correction agreement was signed with SR Technics Switzerland Ltd. For the maintenance of CFM56-7B engines to the total amount of \$24 million for the extended period, to February 5, 2019. The agreement includes the maintenance of eighteen engines owned by the Company as well as additional engines as determined by the Company.

**Note 8 - Financial Instruments**

**a. Material changes to the fair value of financial instruments measured at fair value:**

The following are the changes in the fair value of financial instruments measured at fair value, for which material changes have been made to their fair value in the reported period:

	Fair Value as of January 1, 2011	Change in Fair Value in Reported Quarter	Fair Value as of March 31, 2011
<b><u>Financial Instrument</u></b>	<b>Thousands of Dollars</b>		
Jet fuel hedging agreements ( 1)	34,311	11,471	45,782
Interest rate swap agreements (2)	(22,068)	3,638	(18,430)
Forward agreements for the purchase of foreign currency (3)	12,170	3,479	15,649

- (1) The increase in the fair value of jet fuel hedging transactions derives mainly from the increase in jet fuel prices and from the purchase of jet fuel hedging options in the reported period.
- (2) The decrease in the negative fair value of interest rate swap agreements derives mainly from the expiry of transactions during the reported period.
- (3) The increase in the fair value of advance contracts for the purchase of foreign currency derives mainly from the drop in the NIS/USD exchange rate, and from additional hedging transactions conducted in the reported quarter.

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**b. Sale and purchase of jet fuel hedging transactions in the reported quarter:**

In March 2011 the Company conducted sales and purchases of its jet fuel hedging transactions for the period between September 2011 and March 2012, mainly consisting of replacing some of the financial instruments used to hedge jet fuel in the period in question with other financial instruments, while making an early realization of hedging revenues to the amount of \$31 million and purchasing other financial instruments worth \$6 million in such a manner that the total result of the actions in question derived a cash bonus of \$25 million that entered the Company's accounts.

Hedging revenues to the amount of \$31 million shall be recognized in the Company's Statements of Operations based on the original repayment date of the transaction for the period in question of which \$22 million shall be recognized in the second half of 2011 and the balance to the amount of \$9 million shall be recognized in the first quarter of 2012.

In addition, over the course of the reported period the Company purchased additional jet fuel hedging options to the amount of \$7 million.

**Note 9 - Loans from Banking Corporations**

**a. Ratio of Loan Balance to Guarantees**

As of the reported period, the Company meets the ratio of loans to collateral required in accordance with the agreements with the lending banks.

**b.** The repayment date of a loan from a banking organization to the amount of \$76 million will fall in January 2012. On March 30, 2011 the Company entered into an agreement with the banking institution to correct the existing agreement, according to which the balance of the loan, including principal payments remaining until the original repayment date, shall be spread out across a period of 6 years from the signing date. At the end of this period a \$32 million balloon balance shall remain. The loan is in USD and bears variable Libor interest plus a margin. Principal and interest payments are quarterly payments. In light of the above, this sum is presented in the March 31, 2011 Financial Statements as part of Non-Current Liabilities under Loans From Financial Institutions.

**c.** The repayment date of a loan from a banking organization to the amount of \$14 million will fall in April 2011. This sum is presented in the March 31, 2011 Financial Statements as part of Current Liabilities under Short-Term Borrowing and Current Maturities.

The credit was extended for an additional year under the same terms and over the course of this period the terms of the redeployment of the uncleared balance shall be determined.

**d.** The repayment date of a loan from a banking organization to the amount of \$60 million will fall in August 2011. This sum is presented in the March 31 2011 Financial Statements under Current Liabilities under Short-Term Borrowing and Current Maturities. The Company is holding advanced talks with the banking institution according to which repayment of this sum will be spread out across an extended period.

**Note 10 - Legal Proceedings**

**a.** As of March 31, 2011, claims filed against the Company amount to a total of \$154 million, for which the Company listed an \$11.4 million provision in its Financial Statements, this based on the opinions of the Company's legal counsel.

Legal claims not quantified in monetary amounts have also been filed against the Company. The above provision in the Financial Statements also includes provisions for non-quantified claims, as estimated by Company management.

In the assessment of Company management, based upon the opinions of its legal counsel, it is not anticipated that the Company will be exposed to an additional loss with respect to the aforementioned claims in excess of the above provisions recorded in the financial statements.

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- b. Lawsuits were filed against the Company in the first quarter of 2011 to the amount of \$0.4 million, of which \$0.2 million are in the opinion of Company Management, based on the advice of legal counsel, have a risk level of over 50%. The Company has listed provisions in its Financial Statements for these claims based on the advice of its legal counsel.
- c. Following Note 27.c.c.(8) to the December 31, 2010 Financial Statements regarding High Court of Justice proceedings filed by the City of Holon against the permit received by the Company to conduct takeoffs during certain hours of the night between Thursday and Friday and on the nights before holiday eves (in spite of the existence of a general restriction on takeoffs during nighttime hours). On March 29, 2011 a ruling was issued in which the Supreme Court rejected the petition against the Company and the other respondents (the Minister of Transportation and Road Safety, the Minister of the Environment, the Airports Authority and the Civil Aviation Authority).
- d. Regarding other material legal proceedings pending against the Company, see Note 27c to the December 31, 2010 Financial Statements.
- e. Following Note 27.c.b.(3) to the 2010 Financial Statements regarding a civil suit on the subject of air cargo transportation service rates, the sum of the provision for the suit was increased, this amount other reasons due to talks with the plaintiffs and in light of an update the Company received from its legal counsel regarding the sizes of the settlements between the plaintiffs and other airlines.

**Note 11 - Transactions and Commitments with Subsidiaries**

1) As stated in Note 1d the Company did not include separate financial information in its report for the period ending March 31, 2011 due to the negligibility of the added information.

The Company fully owns several companies the activity of which complements the primary activity conducted within the framework of the Company. These companies do not act independently, but are in effect specific components of the Company's array of activities divisions in the form of companies and this from regulation and other administrative reasons (salary agreements etc.). These companies are not material relative to the Company as the extent of assets, liabilities and revenues managed as part of the subsidiaries are negligible relative to the extent of the assets, liabilities and revenues managed within the framework of the Company. Therefore, publication of separate Financial Statements will not provide additional material information to the reasonable investor.

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2) The Company has entered into agreements with its subsidiaries as detailed below:

a. **Activity between the parent company and its subsidiaries:**

<u>Company</u>	<u>Type of Activity</u>	<u>For the Three Month Period Ending March 31</u>		<u>Investment Account as of March 31</u>		<u>Credit/Debit Account as of March 31</u>	
		<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
<b>Thousands of Dollars</b>							
<b>Sun D'Or</b>	Leasing aircraft and associated services	15,465	16,400	3	3	5,927	5,040
	Commissions	290	208				
<b>Tamam</b>	Purchasing food for Company flights at BGN	5,313	4,454	514	1,239	4,221	4,691
<b>Borenstein</b>	Purchasing food for Company flights from New York	1,384	1,426	4,661	4,476	1	131
	Management fees	36	28				
	Loan to parent company (1)					2,600	2,600
	Interest from parent company (1)	15	15				
<b>Superstar</b>	Sale of flight tickets	2,525	2,944	(115)	(53)	136	119
	Loans from parent company (2)			507	310		
<b>Katit</b>	Purchasing food for employees and food services in the King David Lounge in Terminal 3	790	697	-	-	1,198	945

(1) In December 2008 the Company received a \$2,600 thousand loan from Borenstein for a period of three years, at a 2.3% annual interest rate paid on December 15 every year.

(2) In September 2007 the Company provided Superstar with a £205,000 loan. In October 2010 the Company provided an additional with a £110,000 loan. The two loans have no repayment date and bear no interest.

b. **Mutual activity between subsidiaries:**

<u>Companies</u>	<u>Type of Activity</u>	<u>For the Three Month Period Ending March 31</u>		<u>Credit/Debit Account as of March 31</u>	
		<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
<b>Thousands of Dollars</b>					
<b>TAMAM-Katit</b>	Food purchasing	8	14	9	22
<b>Superstar-Sun D'Or</b>	Flight Ticket Purchasing	1,005	912	513	995

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**Note 12 - Segment-Based Reporting****a. General:**

The Group has applied IFRS 8, "Operating Segments" (hereinafter "IFRS 8") starting January 1 2009. According to IFRS 8, operational segments are identified based on internal reports on the Group's components, which are reviewed on a regular basis by the Group's chief operating decision maker for the purpose of allocating resources and assessing the performance of the operational segments.

In light of the above, the following are the Company's reported operating segments in accordance with IFRS 8:

**Segment A** - passenger aircraft activity.

**Segment B** - cargo aircraft activity.

Passenger aircraft activity includes revenues from the transport of passengers including baggage, transporting cargo in the holds of passenger aircraft, mail transport and the contribution from the sale of duty free products.

Cargo aircraft activity includes revenues from airborne cargo shipping fees.

The Company's other activities include revenues from charter flights via subsidiary Sun D'Or (which are written off in the "Adjustments" column), revenues from maintenance service provided to outside elements as well as a broad variety of services and revenues such as equipment leasing, frequent flyer membership fees, loading and unloading services and more.

The Company's chief operational decision maker does not receive reports regarding the measurement of segment assets and therefore, in accordance with the revision to IFRS-8, this information is not included in the segment reporting.

**b. Analysis of revenues and results according to operating segments:**

	<b>For the Three-Month Period Ending March 31 2011</b>				
	<b>Passenger Aircraft</b>	<b>Cargo Aircraft</b>	<b>Others</b>	<b>Adjust- ments</b>	<b>Total</b>
	<b>Thousands of Dollars</b>				
	<b>(Unaudited)</b>				
<b>Revenues</b>					
Revenues from outside customers	366,006	30,765	11,906	16,497	425,174
Inter-segment revenues	-	-	15,463	(15,463)	-
Total segment revenues	<u>366,006</u>	<u>30,765</u>	<u>27,369</u>	<u>1,034</u>	<u>425,174</u>
<b>Segment results</b>	<u>(2,237)</u>	<u>899</u>	<u>8,339</u>	<u>-</u>	<u>7,001</u>
Unassigned expenses					(60,506)
<b>Operational loss</b>					<u>(53,505)</u>
Financing expenses					(4,270)
Financing income					5,493
The Company's share of the profits of subsidiaries, net					735
<b>Loss before taxes on income</b>					<u>(51,547)</u>
Tax benefit					8,611
<b>Loss for the period</b>					<u>(42,936)</u>

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<b>For the Three-Month Period Ending March 31 2010</b>					
	<b>Passenger Aircraft</b>	<b>Cargo Aircraft</b>	<b>Others</b>	<b>Adjust- ments</b>	<b>Total</b>
Thousands of Dollars					
(Unaudited)					
<b>Revenues</b>					
Revenues from outside customers	* 377,696	18,044	11,440	16,010	423,190
Inter-segment revenues	-	-	16,567	(16,567)	-
Total segment revenues	<u>377,696</u>	<u>18,044</u>	<u>28,007</u>	<u>(557)</u>	<u>423,190</u>
<b>Segment results</b>	<u>32,011</u>	<u>(946)</u>	<u>8,127</u>	<u>-</u>	<u>39,192</u>
Unassigned expenses					(53,907)
<b>Operational loss</b>					<u>(14,715)</u>
Financing expenses					(9,130)
Financing income					2,009
The Company's share of the profits of subsidiaries, net					-
<b>Loss before taxes on income</b>					<u>(21,836)</u>
Tax benefit					5,304
<b>Loss for the period</b>					<u>(16,532)</u>

\*Restated - see Note 5.

<b>For the Year Ending December 31 2010</b>					
	<b>Passenger Aircraft</b>	<b>Cargo Aircraft</b>	<b>Others</b>	<b>Adjust- ments</b>	<b>Total</b>
Thousands of Dollars					
(Audited)					
<b>Revenues</b>					
Revenues from outside customers	1,765,282	87,508	38,790	80,659	1,972,239
Inter-segment revenues	-	-	78,573	(78,573)	-
Total segment revenues	<u>1,765,282</u>	<u>87,508</u>	<u>117,363</u>	<u>2,086</u>	<u>1,972,239</u>
<b>Segment results</b>	<u>251,825</u>	<u>(264)</u>	<u>28,573</u>	<u>-</u>	<u>280,134</u>
Unassigned expenses					(192,091)
<b>Operating profit</b>					<u>88,043</u>
Financing expenses					(35,911)
Financing income					10,849
The Company's share of the profits of subsidiaries, net					45
<b>Profit before income tax</b>					<u>63,026</u>
Income Tax					(5,971)
<b>Yearly profit</b>					<u>57,055</u>

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**Note 13** - **Events Subsequent to the Balance Sheet Date**

- a. Sun D'Or's operational license was cancelled on April 1 2011.  
In April and May 2011, Sun D'Or continued to market the flights operated by it in the past which were carried out by the Company (weekdays) and by other airlines (weekends and holidays). Starting June, Sun D'Or will act as a tourism organizer while preserving the Sun D'Or brand for charter flights marketed by it and carried out by the Company on weekdays only. A test is currently being conducted regarding the nature of Sun D'Or's future activities and as of the publication of the Financial Statements this has no material impact on Sun D'Or's operating results. Following Sun D'Or's appointment as designated carrier to various destinations by the Ministry of Transportation and following the cancellation of its operational license, these appointments were transferred to the Company, except for the Eilat-Moscow route.  
On April 1 2011 the Company ceased leasing to Sun D'Or, via dry lease, three aircraft from its Boeing 757-200 fleet and the aircraft returned to the Company's service.
- b. On April 7 2011 the Company received a notice from the Restraint of Trade Authority, according to which the Restraint of Trade Commissioner was considering using his authority to declare the Company a monopoly in the supply of aviation security services abroad, according to professional guidelines provided airlines by a certified officer in accordance with the Arrangement of Security in Public Bodies Law, 1998 regarding passengers and cargo on passenger flights.  
The Company approached the Authority with a request to receive the examination material, is studying the subject and shall examine its open course of action, among other things in light of the Company's position that aviation security is the State's responsibility as sovereign and therefore it is not a commercial service the Company must supply.
- c. Following Note 39.d.(9) to the December 31 2010 Financial Statements regarding the agreement with AWMS for the lease of a 767-300ER airplane; in April 2011 the aircraft was accepted and joined the Company's aircraft fleet.
- d. In April 2011 the Company signed letter of intentions with International Lease Finance Corporation to lease a 767-300ER aircraft, manufactured in 1998, starting September-November 2011 for a lease period of 6 years with an option to end the lease agreement early after 4 years in accordance with the conditions agreed upon by the parties..
- e. Pursuant to Note 6e regarding the submittal of a motion to the court to approve a claim as a derivative, and to Note 6g regarding a Securities Authority audit report, on April 10 2011, the Company submitted a motion to grant the power of a verdict to a proposed settlement in the derivative claim, according to which the Company would be compensated to the amount of 4,750,000 NIS ("the Compensation Sum").  
According to the proposed agreement, this sum shall constitute full, final and absolute compensation for all matters pertaining to the derivative claim.  
Pursuant to the above motion, the court was asked to: (a) revise the derivative claim in such a manner that Mr. Chaim Romano (hereinafter – "the Outgoing CEO") and other Company directors, past and present, not appearing originally as respondents in the claim motion, be added to the defendants; and (b) revise the grounds of the claim so that it also includes other issues pertaining to the approval of the terms of service and employment of the outgoing CEO and resulting reports, including those noted in the Securities Authority audit review dated March 10 2011 (published by the Company on the same date).  
Out of the sum of the compensation, a total of 1,000,000 NIS was paid the Company by the outgoing CEO in April 2011, as a retroactive reduction of the sums of the bonuses he received during his tenure. This sum will be charged to gain/loss during Q2 2011. In addition, the Company signed a waiver for the Outgoing CEO according to which, upon the repayment of the sum in question, the Company shall have no complaints against him for any matter pertaining to the terms of his employment at the Company.  
In accordance with the court ruling dated April 27 2011, notice of the request for the settlement in question was published in two economic daily newspapers and additional information and a copy of the motion were delivered to the Securities Authority.  
On May 22 2011, the court approved the motion to settle according to which the Company would be refunded a total sum of 4,750,000 NIS, constituting full, final and absolute compensation for all matters pertaining to the derivative claim.

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For all matters pertaining to the approval of bonuses to Company executives for 2005 as noted in the authority's report, the Company's Audit Committee and Board of Directors discussed and ratified these bonuses on May 22 2011 and on May 24 2011, respectively.

- f. On May 1 2011, the Company's Board of Directors approved an engagement with "Yediot Subscribers" of the Yediot Acharonot group for a joint deal, restricted in time, in which Yediot Acharonot subscribers (as defined by the newspaper) would be offered tourism packages, including Company flights to selected destinations at special prices in return for the allocation of advertising space for the Company in the newspaper. The deal and the package destinations will be published over the course of the deal period. This agreement was approved by the Company's Board of Directors as an exceptional transaction, in which a Company executive and Company controlling shareholders may have a personal interest, as Yediot Acharonot is controlled by the brother of Mrs. Tamar Moses-Borowitz (Deputy Chairman of the Company's Board of Directors and a controlling shareholder in the Company and in Knafaim holdings Ltd.). The essence of the Board of Directors stated grounds for approving the transaction is that the engagement will provide the Company with broad advertising exposure, taking into account the newspaper's distribution data and will allow the Company to advertise destinations it is interested in promoting.
- g. On May 5 2011 the Airports Authority informed the airlines operating out of BGN, including the Company, that jet fuel refueling at BGN would be halted, after an unidentified contaminant was found in the BGN refueling tanks. As a result, international and domestic flights that were supposed to have departed from BGN were cancelled and disrupted. The Company acted to find alternate solutions for its flights, and with the exception of the cancellation of 20 flights by the Company, the Company's flights departed as planned, as alternate refueling salutations were found, including refueling at stopovers. Starting May 10 2011, airplanes at BGN gradually returned to normal refueling procedures, after the Ministry of Transportation announced that regular activity can continue. Beyond the cancellation of flights, as noted above, additional expenses were caused the Company as a result of the change in activity and the need to refuel at stopovers as well as passenger expenses (such as hotel expenses and reimbursements for cancelled flights), however, the assessment of the damage and additional costs caused the Company as a result of the change in activity due to the event has yet to be completed.
- h. On May 15 2011 Company HQ received a motion to approve a claim as a class action (hereinafter: "the Motion"), filed against the Company at the Tel Aviv District Court on May 9 2011. The motion was filed by a Company passenger, whose flight had been cancelled on May 5 2011 following the jet fuel contamination. In the motion, the sum of the claimant's personal claim was set at a total of 5,000 NIS and the general damage estimated by the claimant for the entire Group including all purchasers of flight tickets from the Company whose flights had been cancelled under the circumstances in question (estimated by the claimant at some 2,500 passengers) amounts to 12.5 million NIS for the entire Group. The Company is studying the motion.
- i. Following the agreement signed with airplane manufacturer Boeing for the purchase of 737-900ER aircraft, in May 2011 an agreement was signed with engine manufacturer CFM Aircraft, S.A. for the purchase of a thrust upgrade for engines provided with the airplanes and for the purchase of a CFM56-7B24/3 spare engine for the 737 fleet. According to the agreement, the Company retains the option to purchase an additional spare engine by December 2018. The Company is studying methods of financing the agreements.\
- j. In Late May 2011, the leasing period of a 757-200 airplane (EBS) is expected to end and the aircraft is expected to return to its owners (MK Aviation). Likewise, the Company is expected to discontinue operation of its 747-200F airplane (AXL) starting June 2011 due to the need for heavy maintenance works required for its continued activity. The Company approached the State for its consent for removing the plane form service.
- k. In May 2011 the Company signed agreements to place specific liens in favor of a banking institution on the Company's right to receive money from the sale of flight tickets from a limited number of agents. In addition, the Company placed a lien on its property on 32 Ben Yehuda St. in favor of this banking institution.