

# **EL AL ISRAEL AIRLINES LTD.**

## **FINANCIAL STATEMENTS**

**AS OF JUNE 30, 2008**

(unaudited)

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SECTION A - UPDATE OF CHAPTER A TO 2007 ANNUAL REPORT

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**Update to Chapter 1 (Description of Corporate Business)<sup>1</sup>**  
**to the 2007 annual report ("periodic report")**  
**of EL AL Israel Airlines Ltd. ("the Company")**

**1. Description of general development of Group business**

Starting in the first quarter of 2008, the Company has begun preparing its Financial Statements in accordance with International Financial Reporting Standards (IFRS).

As a result of the shift to IFRS reporting, the Company has presented its Financial Statements for the reported period as well as comparison numbers for the same period last year and for the year ending 2007 in accordance with international standards .

As for the accounting implications and adjustments required as a result of the shift to IFRS reporting, see Note 9 of the Company's Financial Statements dated June 30 2008.

The following is data prepared in accordance with the IFRS, which appeared in Chapter A - Description of the Corporation's Business for the 2007 Periodic Report, as required by the Securities Authority (FAQ 1).

Note that according to the transfer guidelines to IFRS reporting, 2005 and 2006 data need not be presented anew.

**To item 5 - Financial Data Regarding the Corporation's Areas of Activity 2007:**

	<b>Passenger aircraft</b> <b>(Thousands of Dollars)</b>	<b>Cargo aircraft</b> <b>(Thousands of Dollars)</b>	<b>Others and adjustment to consolidated</b> <b>(Thousands of Dollars)</b>	<b>Total</b> <b>(Thousands of Dollars)</b>
<b>Passenger revenues</b>	1,547,505	-	-	1,547,505
<b>Cargo and mail revenues</b>	106,217	216,338	-	322,555
<b>Other revenues</b>	38,692	994	22,704	62,390
<b>Total revenues</b>	1,692,414	217,332	22,704	1,932,450
<b>Costs</b>	(1,567,319)	(255,344)	(15,114)	(1,837,777)
<b>Operating income (loss)</b>	125,095	(38,012)	7,590	94,673
<b>Fixed assets at year end</b>	1,196,726	42,467	46,559	1,285,752

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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 which 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 1 (Description of Corporate Business) in the Group's 2007 annual report.

**To item 7.3 – Income Segmentation and Service Profitability in the Area of Passenger Aircraft**

	<b>2007</b>	<b>*2006</b>	<b>* 2005</b>
Gross income (in thousands of dollars)	416,626	240,063	354,211
Gross margin (%)	25%	17%	25%

\* Data for 2005 and 2006 was re-stated due to change in Company revenue distribution between passenger operations and cargo operations.

**To item 8.3(b) – Income Segmentation and Services Profitability in the Area of Cargo Aircraft**

	<b>2007</b>	<b>*2006</b>	<b>*2005</b>
Gross income (in thousands of dollars)	(13,346)	17,821	10,622
Gross margin (%)	(6%)	8%	5%

\* Data for 2005 and 2006 was re-stated due to change in Company revenue distribution between passenger operations and cargo operations.

**To item 9.4.8 – Pension agreements**

Below are details of Group long-term liabilities in respect of employee benefits (consolidated data, in thousands of dollars):

	<b>December 31, 2007 (Thousands of Dollars)</b>
<b>Employee severance pay liabilities and pension funds</b>	179,725
<b>Less - compensation and pension funds</b>	(200,518)
<b>Liabilities resulting from unutilized sick days, retirement bonuses, jubilee bonuses and retirement adjustment payments</b>	37,336
<b>Liabilities resulting from early retirement plans, net</b>	40,029
<b>Less – current maturities</b>	(1,821)
<b>Total</b>	54,751

**To item 9.6.5 – Working capital Deficit**

As of December 31, 2007, the Group had a working capital deficit amounting to \$150 million compared to \$204 million at the end of the previous year. The Company's current ratio at the end of 2007 is 77%, compared to 65% at the end of the previous year. For details of the causes for decrease in working capital deficit, see item 2.1 of the Board of Directors' report for 2007.

**The following are additional updates to Chapter A – Description of corporate business:**

**To item 3.1 – Investments in corporate capital - General**

On May 30, 2008, the Company issued a shelf prospectus based on its financial statements as of December 31, 2007.

On May 30, 2008, the Company re-stated its financial statements as of December 31, 2007 and as of March 31, 2008.

**To item 3.4 – Changes in holdings of interested parties**

In the period from June 30, 2008 to August 06, 2008, Mr. Pinchas Ginsburg, an interested party in the Company, conducted multiple transactions to buy and sell shares (as reported by the Company).

Following the aforementioned transactions, Mr. Ginsburg owns, in his name and on behalf of other individuals in the Ginsburg Group, 38,226,813 shares or 7.71% of the Company's issued and paid-up capital.

2. **General environment and impact of external factors on the corporation**

**To item 6.1 – Traffic in the international airline industry**

The IATA forecast issued in March 2008 expected income of the global airline industry in 2008 to reach \$4.5 billion (this forecast was based on an average price of \$86 per oil barrel); however, in view of the deteriorating US economy and higher oil prices, IATA has updated its forecast, and now estimates that total loss for airlines in 2008 would amount to \$2.3 billion, based on a price of \$106.5 per oil barrel. IATA also estimated that should the price per oil barrel remain around \$135, losses at airlines would reach \$6.1 billion or even higher - if oil prices reached \$150 or more<sup>2</sup>.

According to public information, the increase in fuel prices caused over 12 airlines worldwide to discontinue operations in the first 6 months of 2008, and many airlines have announced various cost-cutting measures, including significant reduction in number of flights, grounding of aircraft and termination of employees.

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<sup>2</sup> IATA data refer only to scheduled international traffic. Domestic traffic is excluded. All data are preliminary and represent reports by airlines obtained prior to the publication date, as well as IATA estimates as to missing information. Source of Data: IATA Press Release, No 26, 02 June 2008

According to IATA information, in June 2008 the average annual growth of international passenger traffic over June of 2007 slowed down by 3.8%. Load factor in passenger aircraft decreased in June 2008 to 77.6%, compared to 78.8% in June 2007.

**To item 6.2 – Traffic in the Israeli airline industry**

According to data from the Central Bureau of Statistics, in April-June 2008, some 608 thousand tourists entered Israel by air - a 35% increase over the corresponding period last year. Furthermore, this quarter saw 934 thousand Israelis leave the country by air, an 11% increase over the corresponding period last year. The increase is due, *inter alia*, to the fact that the Passover holiday was in the second quarter in 2008.

**To item 6.3 – Fluctuations of jet fuel prices and to item 9.5.1 – Raw materials and suppliers - fuel**

In the quarter ended June 30, 2008, market prices of jet fuel rose by 89.7% over the corresponding period last year. The average price of jet fuel for the Company, after hedging, increased by 79% over the same period last year. In this quarter, fuel expenses constitute 38.5% of turnover (26.3% in the second quarter of 2007). The information below regarding market prices refers to prices of jet fuel in the Mediterranean Region, as quoted by Platts<sup>3</sup>. For further information, see item 6.1, 6.2 and 6.5 of the Board of Directors' report on the state of corporate affairs.

The Company purchases fuel from four suppliers in Israel, chosen by open bid. In the quarter ending June 30 2008 the Company purchased some 35% of its fuel purchases for the quarter from a single supplier (the Paz Company).

On June 30 2008 the Company held jet fuel reserves, purchased from suppliers in Israel and abroad, to the amount of \$8.3 million.

**To item 6.4 – Fluctuations in foreign currency exchange rates**

Group results are affected by several currencies. Fluctuations in USD exchange rates vs. other currencies may improve or erode Group profitability.

As of June 30, 2008, the USD/NIS exchange rate declined by 21.1% compared to June 30, 2007, and by 12.8% compared to December 31, 2007.

As of June 30, 2008, the USD/Euro exchange rate declined by 14.7% compared to June 30, 2007, and by 6.8% compared to December 31, 2007. For further information, see item 3.4 of the Board of Directors' report on the state of corporate affairs

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<sup>3</sup> To the best of the Company's knowledge, Platts Corporation is a member of the McGraw-Hill Group, and has been providing information about the energy industry for over 75 years. The Company provides current information and analysis, *inter alia*, with regard to prices and international events in the oil, petro-chemical, natural gas and electric & nuclear power markets.

**To item 6.5 – Fluctuations in interest rates**

In order to finance aircraft acquisitions, the Company has obtained material loans at adjustable interest rates based on LIBOR rates. Changes in LIBOR interest rates may materially impact the Company's financing expenses.

In the quarter ended June 30, 2008, the average 3-month LIBOR interest rate declined by 16.4% compared to the first quarter of 2008, and declined by 48.7% compared to the corresponding period last year. For further information, see item 6.3 of the Board of Directors' report on the state of corporate affairs

3. **Passenger aircraft operating area**

**To item 7.1.4 - Developments in the Markets of its Areas of Activity, or Changes in the Characteristics of its Customers,**

**To item 7.1.10 - Competitive Structure in Areas of Activity and Changes Therein,**

**To item 7.2 – Services in Areas of Activity**

The expansion trend and increased competition continue on routes to and from Israel, along with continued implementation of the "Open Sky" policy initiated by the Ministry of Transportation, as reflected in the following changes:

- In the second quarter, various airlines increased their weekly frequencies on different routes to and from Israel, most notably:
  - Turkish Airlines on the route between Tel Aviv and Turkey (from 18 to 25 weekly flights);
  - Air Canada on the route between Tel Aviv and Canada (from 5 to 6 weekly flights);
  - CSA on the route between Tel Aviv and Czech Republic (from 7 to 9 weekly flights);
  - Hapag Fly, owned by German corporation TUI, on routes between Tel Aviv and Germany (from 5 to 8 weekly flights);
  - Russian airline Transaero, on the route between Tel Aviv and Moscow (from 14 to 20 weekly flights);
  - KD AVIA airline, on the route between Tel Aviv and Kaliningrad, Russia (from 3 to 6 weekly flights).
- ClickAir, a subsidiary of Iberia, started operating 3 scheduled weekly flights between Tel Aviv and Barcelona, starting in April 2008.
- Sky Europe started operating a weekly low-cost flight between Tel Aviv and Bratislava, starting in July 2008.
- In June 2008, a new aviation agreement was signed by Israel and Italy. The agreement ratifies the understandings reached in April, making them permanent and allowing for two designated carriers per side for each city pair, along with an increase in weekly frequency per side from 20 to 26. Furthermore, the restriction on number of weekly flights by Israeli carriers on the route to Milan has been removed.
- Pursuant to the flight agreement signed in May 2008 between Israel and

South Korea, Korean Air has announced its intention to resume passenger flights on the route between Tel Aviv and Seoul starting in September 2008, in addition to operating two weekly cargo flights on this route.

- In June 2008, the Interior Committee of the Knesset confirmed the mutual waiver of visas between Israel and Russia. Elimination of the need for visas would become effective in three months. Subsequently, significant growth in passenger traffic is expected on this route. Israir and Arkia have announced their intention to operate charter flights to Moscow.
- In conjunction with Company strategy to optimize the flight schedule, the Company announced discontinuation of direct flights to Miami starting in September 2008 due, *inter alia*, to the increase in fuel cost on this direct route.
- In July 2008, a new MOU was signed by Israel and Ukraine. According to the MOU, each side may have 2 designated carriers on the route between Tel Aviv and Kiev, and one designated carrier on other routes agreed, starting in the winter of 2008/2009, to operate up to 9 weekly flights in the winter of 2008/2009 and 10 weekly flights starting in the summer of 2009.

Pursuant to item 7.1.10(d) of the annual report and the report for the first quarter of 2008, the second quarter of 2008 saw a 17% increase in total passengers at Ben Gurion airport, with operations of scheduled airlines growing by 15% and operations of charter airlines growing by 25%. In total, charter traffic at Ben Gurion airport accounted for 24.2% of total traffic, compared to 22.6% in the same period last year.

Capacity of foreign scheduled airlines (including scheduled flights of Arkia and Israir) grew by 24%, and capacity of charter airlines grew by 26% over the same period last year.

The Company increased its seat supply (ASK) in the second quarter of 2008 by 14% over the corresponding period in the previous year.

**To item 7.1.5 - Technological changes which may materially impact the operating area**

**To item 7.2 – Services in operating area**

**To item 7.4 – New services**

Pursuant to items 7.1.5 and 7.6.2 of the annual report and the report for the first quarter of 2008 with regard to transition of the Company to using the AMADEUS reservation system, in the second quarter of 2008 work started on Phase II of the transition to the AMADEUS reservation system as part of replacement of the service system at the airport (DCS).

The reservation system on the Company's website has been upgraded and branded "I FLY", so as to allow users to simply select their travel destination and date, to obtain reliable information about the lowest prices available for said date and for adjacent dates and to make their reservation. The website also allows users to upgrade, to select seating on board, to check in and to select their meal. This upgrade was made possible by the transition to the AMADEUS system.

Furthermore, in the second quarter the design phase started for the resource planning system using ERP technology.

Subsequent to items 7.2 and 7.4 of the financial statements for the first quarter of 2008, with regard to signing a code share agreement with American Airlines, this agreement became effective in July 2008 for flights operated starting in September 2008. The agreement would allow Company passengers to benefit from an extensive network of dozens of prime destinations in North America as well as from maximum flexibility in selecting flight routes and dates, relying on the Company's network of direct destinations in North America and Europe.

Pursuant to item 7.2(c) of the annual report, in August 2008 Israil announced that it would be suspending its flights on the route to New York starting on September 13, 2008.

#### **To item 7.4 – New services**

Pursuant to item 7.4 of the annual report and the report for the first quarter of 2008, with regard to cooperation with Home Check In corporation, the service has been expanded to cover passengers on Sun Dor flights as well, starting in June 2008.

The Company intends to operate in the summer of 2008 some 80 flights to various destinations adapted for children, which include various attractions, under the concept of "ELALCHIK hosts the Looney Tunes Active".

#### **To item 7.11 – Aircraft fleet in the area of passenger aircraft activity**

On July 17, 2008, the Company entered into agreements to sell two Boeing 767-200 aircraft made in 1983 which it owns. One aircraft will be acquired by an airline in the Philippines and the other – by a Singapore investment company. The proceeds to the Company are \$6.5 million per aircraft – for a total of \$13 million. The proceeds for one aircraft were paid in full soon after the signing date, and as for the other aircraft, a down payment of \$650 thousand was paid, with the balance payable upon delivery of the aircraft. The aircraft will be delivered to the buyers in September 2008.

The Company is expected to record in its financial statements for the third quarter of 2008 pre-tax capital gain of US \$9 million from sale of these two aircraft. These transactions were made pursuant to review of the current aircraft fleet and to the Company's "EL AL 2010" strategic plan which covers, inter alia, replacement and refurbishment of the aircraft fleet.

#### 4. **Cargo aircraft operating area**

##### **To item 8.1.3 (a) – Global cargo transport volume**

According to reports by IATA, the second quarter of 2008 saw a 2.8% increase in global cargo transport volume by cargo airplane over the corresponding period in 2007, i.e. a growth rate lower than expected by IATA estimates (5%),

due to the increase in fuel prices and the decrease in air transport in Asia due to the earthquake in china and the weak economy in Japan. Nevertheless, we are unable to estimate whether this data changes expectations as to the overall annual growth rate for 2008.

According to data from the Airport Authority, the second quarter of 2008 saw a 3.2% increase in cargo transport volume by cargo aircraft at Ben Gurion airport, compared to the corresponding period in 2007, which is in excess of IATA forecast, which called for a 4.8% annualized growth rate.

**To item 8.7 - Competition**

**To item 8.7.1 – Competition in operating area**

**To item 8.2 – Services in operating area**

Pursuant to item 8.7.1.e and the end of item 8.2 of the annual report, we should note that the Group estimates its share of cargo transport in the second quarter of 2008, out of total air cargo flown to and from Israel (including cargo flown on board passenger aircraft and mail operations, except for cargo flown on sixth freedom operations) stood at 32.8%. The decrease in Company share of cargo transport is primarily due to the decrease in agricultural exports and to discontinuation of EL AL cargo aircraft flights to the Far East starting in May 2008.

5. **Details concerning the two areas of activity**

**To item 9.4.2 – Employed workers**

Pursuant to item 9.4.2 of the annual report and the report for the first quarter of 2008, the following is an update table showing the company's work roll as of June 30, 2008:

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
Permanent employees	3,787	3,521
Temporary employees	2,383	2,408 (annual average)
Total employees	6,170	5,929

**To item 9.4.16 – Executives and senior management**

Pursuant to the report as of March 31, 2008 with regard to extension of the management agreement between the Company and Knafaim Holdings Ltd., the controlling shareholder of the Company (hereinafter: "Knafaim") for a 6-month term from January 09, 2008 through July 09, 2008, the Securities Authority informed the Company in early June 2008 of its position whereby the transaction may not be approved pursuant to Regulation 1(1) of the Corporate Regulations (Easements for transactions with interested parties), 2000 – and that it must be re-approved as a contract between a public company and its controlling shareholder with regard to terms of office and employment (hereinafter: "the Authority's position"). Due to the Authority's position, the

Company issued on June 10, 2008 an immediate report postponing the original meeting. On July 03, 2008, the Company's Audit Committee and Board of Directors approved the contract as per the above – as indicated in the Company's immediate report dated July 08, 2008 – and further called for a Special General Meeting of the Company on August 13, 2008 to approve the aforementioned transaction (hereinafter: "the meeting"). The meeting resolved to approve extension of the Company's management agreement with Knafaim as set forth above, under the same terms and conditions, retroactively for said 6-month term – effective through July 09, 2008.

As the Company reported on August 06, 2008, its Board of Directors resolved to increase compensation for public members of the Board as follows: Compensation for participation in meetings and annual compensation for public Board members at the Company would be payable at the amount set for companies of similar rating (Grade D) in the Amendment to the Corporate Regulations (Rules with regard to compensation and expense reimbursement for public Board members), 2000 – published on March 06, 2008 ("the compensation regulations"). The compensation amounts would be increased effective from April 1, 2008. The aforementioned set amount (as recently increased in an amendment to the compensation regulations) is, as of the date of said resolution, at NIS 59,100 for annual compensation and NIS 2,200 for compensation for participation in meetings. Note that prior to the aforementioned date, public Board members were eligible to receive annual compensation and compensation for participation in meetings at the amounts set forth in the compensation regulations prior to the amendment.

As reported by the Company on August 12, 2008, upon this said date Mr. Shimon Katzenelson, a public Board member, announced his resignation due to his intensive work load overseas.

#### **To item 9.11.2 – Regulatory arrangements**

The Ministry of Transportation presented to the Company a proposed amendment to the Airport Authority Regulations (Fees), which is to be presented by the Government to the Knesset's Economy Committee, involving a significant increase in outgoing passenger fees as well as fees payable by airlines operating out of Ben Gurion airport, including the Company, by an average increase of 51%. The Company contacted the Ministry of Transportation and expressed its objection to the proposed amendment; various airlines operating out of Ben Gurion airport, the Foreign Airline Panel and IATA have also made similar contact. Adoption of the proposed amendment, as it currently stands, may negatively impact the Company's financial results due to the increased expenses for fees and services as a result of the aforementioned increase.

The Company's assessment with regard to increased expenses due to enactment of the aforementioned legislation may constitute forward-looking information, as defined in the Securities Act, based on Company assumptions and forecasts. Therefore, the actual outcome of enactment of the aforementioned legislation

amendment or the extent of its impact, if enacted, on Company operations may materially differ from the outcome expected or implied by this information.

**To item 9.11.12 – Security arrangements**

**To item 9.18.13 – Cost of maintaining flight security**

On May 27, 2008, the Company filed a claim with the Supreme Court of Justice against the Government of Israel, the Minister of Finance, the Deputy Prime Minister and the Minister of Transportation and Road Safety, along with other respondents, whereby the Company requests that the Court instruct the respondents to justify why they would not fully implement Government Resolution 3024 dated January 27, 2008, concerning an increase in State contribution towards security expenses of Israeli airlines as well as change in the State's scheduled civilian aviation policy and designation of additional designated carriers. The Company also filed for an injunction to prevent the State from partially executing the aforementioned resolution (i.e. the part involving the change in scheduled aviation policy). The claim was transferred to respondents for their response and no interim injunction was handed down.

In the second quarter of 2008, the Ministry of Finance issued a new Security Pricelist for services provided by the Company to Israeli airlines on passenger flights. Due to disagreements among Israeli airlines, discussions are being held as to the manner and nature of these services to be further provided.

**To item 9.14 – Legal proceedings**

On May 29, 2008, the Company received at its head office a request to conduct an arbitration proceeding along with a claim letter (hereinafter: "the arbitration request") filed with the International Court of Arbitration of the International Chamber of Commerce in Paris by Sabre Inc. (a US-registered corporation, hereinafter: "Sabre") and by Sabre Marketing Nederland BV (a corporation registered in the Netherlands) with regard to the cooperation agreement signed by the Company and Sabre in 2001 (hereinafter: ("the agreement")).

Pursuant to the agreement, a joint company was established, owned by the Company and Sabre, engaged in providing flight reservation services and associated services. According to the agreement, legal proceedings concerning the agreement are to be conducted in accordance with ruled of the International Court of Arbitration to be heard by a single arbitrator in London, pursuant to essential laws of Israel.

In the claim letter, Sabre alleges that the Company is in breach of the agreement by replacing its previous reservation system with a new international reservation system. Remedies requested in the claim letter include enforcement of the agreement and provision of exclusive rights to marketing of the distribution system. Alternatively, monetary damages are claimed including, inter alia, damages amounting to \$36 million for breach of contract as well as \$67 million for impact to reputation.

The Company is reviewing the request for arbitration and the claim letter, and their potential impact, and is preparing to take on this proceeding. Company management believes, based on legal counsel, that the aforementioned claim amount is significantly exaggerated. These financial statements include a provision in respect of this claim.

**To item 9.14.2 – Legal proceedings**

Pursuant to item 9.14.2 of the annual report with regard to the class action suit dated 1999 with regard to exchange rates for passenger fees, in July 2008 a compromise agreement was reached in said class action suit, whereby the parties acknowledged that existence of two exchange rates in a single transaction is not feasible, and that the Company would continue to attempt having regulations on this matter amended. Under the compromise agreement, the class action suit against the Company would be withdrawn in exchange for payment of NIS 275,000 to be paid to the plaintiff's counsel, including full expenses and legal fees of counsel representing the plaintiffs. The compromise agreement is subject to approval by the Court, which as of the date of this report has yet to be received.

**EL AL Israel Airlines Ltd.**  
**Board of Directors' Report on the State of Corporate Affairs**  
**For the period ended June 30, 2008**

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We hereby present the Board of Directors' report on the state of corporate affairs for the period ended June 30, 2008.

EL AL Israel Airlines Ltd. (hereinafter: "the Company") finished the 3 months ended June 30, 2008 with a loss of \$11.2 million, compared to income of \$16.6 million in the corresponding period last year.

The second quarter of 2008 was shadowed by the global crisis in the airline industry, which caused many airlines to curtail or discontinue operations. The reasons for this included a sharp rise (80%) in jet fuel prices over the corresponding period last year and the economic slow-down in the USA and in other regions.

In Israel, additional reasons included continued devaluation of the USD vs. the NIS (by 16%) and further competition from foreign airlines, who increased their seat supply at Ben Gurion Airport by 24% over the corresponding period last year.

Notwithstanding the above, the Company continued to pursue its investment plan based on the "EL AL 2010" strategic plan, investing a total of \$44 million in the reported quarter, including payments on account of new aircraft amounting to \$24 million.

Company sales in the second quarter of this year increased by 23% over the corresponding period last year, amounting to \$557 million.

Gross income in the second quarter of 2008 amounted to \$71.8 million, 12.9% of turnover, whereas in the corresponding period last year, gross income amounted to \$99.5 million, 22% of turnover.

Net cash from current operations in the second quarter this year amounted to \$68.0 million, and the balance of cash and short-term investments as of June 30, 2008 amounted to \$285.2 million.

Shareholders' equity as of June 30, 2008 amounted to \$333.9 million, compared to \$318.8 million as of December 31, 2007.

## **1. General**

### **1.1 IFRS data update**

In the first quarter of 2008, the Company started preparing its financial statements in accordance with International Financial Reporting Standards (IFRS). The transition date to international standards, as defined in Accounting Standard no. 29 by the Israeli Accounting Standards Board, was January 1, 2007. As a result of transition to IFRS-based reporting, the Company presented its financial statements for the reported period, as well as comparison figures for the 6-month and 3-month periods ended June 30, 2007 and for the year ended December 31, 2007 in accordance with international standards. The information presented in the Board of Directors' report and comparison figures are presented in accordance with international standards.

As for overall accounting implications and adjustments required due to transition from reporting based on Israeli GAAP to IFRS-based reporting, see Notes 1b and 9 to the Company's interim financial statements as of June 30, 2008.

**1.2 The Company and its business environment**

The Company acts as the State of Israel's designated air carrier for most international routes operating to and from Israel.

The primary activity of the Company and its subsidiaries is the transport of passengers and cargo, including baggage and mail, by way of scheduled flights, as well as passenger transport via charter flights, between Israel and abroad. The Company also deals in the leasing of aircraft, in providing security services and general and comprehensive maintenance services at Ben Gurion Airport for aircraft belonging to other airlines, in the sale of duty free items, and via investee companies - in ancillary activities, primarily the manufacture and supply of food to its planes and the management of a number of overseas travel agencies.

The business environment in which the Company operates is the civil, international and tourist aviation market to and from Israel, which is characterized by seasonality and a high level of competition, which grows fiercer at times of surplus capacity.

The Company has two operating segments:

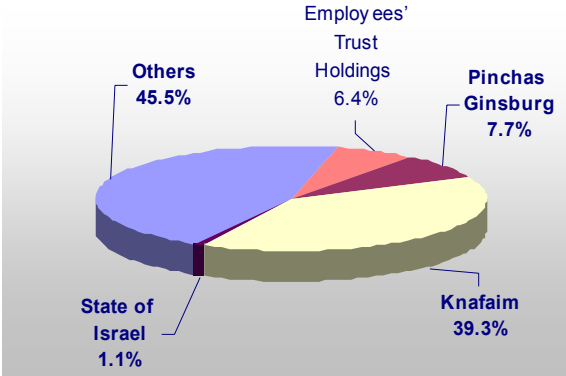
- a. **Air transportation in passenger aircraft** - in this segment the Group transports passengers as well as cargo (including mail and baggage) in the belly of passenger aircraft, as well as provides ancillary services, such as: Sale of duty-free items and charter flights.
- b. **Air transport in cargo aircraft** - in this segment the Group transports cargo in cargo aircraft and provides ancillary services.

**1.3 Holdings of Company shareholders**

As of June 30, 2008, holdings in the Company are as follows: Knafaim Holdings Ltd. ("Knafaim") - 39.3%; Pinchas Ginsburg - 7.7%; Employees' Trust Holdings - 6.4%; the State of Israel - 1.1%; others - 45.5%.

For further details on the Company's privatization, see Note 1b of the December 31 2007 Periodic Report.

**Ratio of Company Share Holdings  
As of June 30, 2008 (Undiluted):**



**2. 2. Financial data (consolidated reports)**

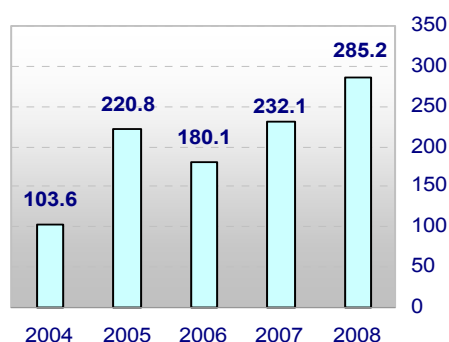
	<b>30.06.2008</b>	<b>31.12.2007</b>	<b>change</b>	
	<b>in</b>	<b>in</b>	<b>in</b>	
	<b>thousands</b>	<b>thousands</b>	<b>thousands</b>	<b>%</b>
	<b>US dollars</b>	<b>US dollars</b>	<b>US dollars</b>	
<b>Assets</b>				
Cash and short-term investments	285,244	267,303	17,941	7%
Trade accounts receivable	174,176	143,617	30,559	21%
Receivables and other current assets	25,788	22,254	3,534	16%
Current derivative financial instruments	112,241	25,530	86,711	340%
Prepaid expenses	33,919	25,096	8,823	35%
Inventory	16,775	15,981	794	5%
Long-term bank deposits	2,531	2,207	324	15%
Investees	2,366	2,268	98	4%
Investments in another company	1,760	1,715	45	3%
Long-term derivative financial instruments	23,901	7,570	16,331	216%
Fixed assets	1,286,152	1,285,752	400	0%
Intangible assets	6,803	4,388	2,415	55%
	<b>1,971,656</b>	<b>1,803,681</b>	<b>167,975</b>	<b>9%</b>
<b>Equity &amp; liabilities</b>				
Short-term bank borrowings	73,195	66,316	6,879	10%
Trade accounts payable	193,683	167,420	26,263	16%
Payables and other current liabilities	70,121	47,185	22,936	49%
Current accruals	99,798	89,621	10,177	11%
Dividend proposed for payment	-	3,008	(3,008)	
Current derivative financial instruments	592	-	592	
Current liability for employee benefits	87,988	87,578	410	0%
Deferred income	287,637	188,751	98,886	52%
Long-term loans from financial institutions	685,652	713,793	(28,141)	(4%)
Accrued severance pay, net	41,875	54,751	(12,876)	(24%)
Long-term loans from others	228	423	(195)	(46%)
Long-term derivative financial instruments	2,537	1,415	1,122	79%
Long-term accruals	16,533	-	16,533	
Deferred income taxes	77,901	64,576	13,325	21%
Shareholders' equity	333,916	318,844	15,072	5%
	<b>1,971,656</b>	<b>1,803,681</b>	<b>167,975</b>	<b>9%</b>

**2.1 The primary changes in assets, liabilities and shareholders' equity as of June 30, 2008 compared to December 31, 2007 are as follows:**

- Increase in balance of cash, cash equivalents and short-term deposits amounting to \$17.9 million, primarily due to positive cash flow from current operations in the first 6 months of 2008 amounting to \$109.2 million, offset by investments in fixed assets and other investments amounting to \$66.5 million and loan repayment amounting to \$22.5 million.
- Increase in trade accounts receivable, primarily due to increase in passenger sales offset by a decrease in cargo sales.
- Increase in current and long term derivative financial instruments, due to increase in fair value of jet fuel and exchange rate hedging transactions – see sections 6.2 and 6.4 of the Board of Directors' report below.

- Increase in prepaid expenses, primarily due to prepaid commissions due to increase in passenger sales.
- The increase in intangible assets is primarily due to payments on account of the new AMADEUS reservation system and the ERP system.
- Increase in trade accounts payable is due to expanded operations and the increase in jet fuel prices, as well as due to revaluation of the Euro and NIS vs. the USD.
- Increase in payable and other current liabilities, which is primarily due to increase in airport taxes payable due to increase in passenger sales and to increase in interest expenses payable due to the increase in Company loans.
- Increase in current and long term accruals, primarily due to an accrual made by the Company in the first quarter of 2008, amounting to a \$20 million (capitalized amount) with regard to an inquiry by the Antitrust Division of the US Department of Justice into the air cargo sector – see Note 5b1 to the interim financial statements as of June 30, 2008.
- Decrease in dividend proposed for payment is due to dividend payment in January 2008.
- Increase in prepaid income primarily due to increase in sales of flight tickets not yet utilized.
- The balance of long-term loans (including current maturities) decreased due to current repayments of long-term loans.
- Decrease in long term liabilities in accrued severance pay, primarily due to decrease in liability for early retirement programs due to Company contributions, and increase in balance of severance pay reserves due to contributions and recording of return on them.
- Increase in deferred income taxes liabilities, net is primarily due to increase in fair value of financial transactions designated as hedges, offset by deferred tax revenues recorded by the Company in the reported period due to the loss for the period.
- Increase in Company shareholders' equity, primarily due to increase in capital reserve in respect of cash flow hedges recognized directly in equity, offset by the loss for the period.

**Cash and cash equivalents and  
short-term investments  
as of June 30  
(in millions of dollars)**



As of June 30, 2008, the Company has a working capital deficit amounting to \$164.9 million, compared to a working capital deficit of \$150.1 as of December 31, 2007. The Company's current ratio as of June 30, 2008 is 79.7%, compared to 76.9% as of December 31, 2007. The increase in working capital deficit is primarily due to increase in unearned revenues due to increase in sale of flight tickets not yet utilized as well as to increase in trade accounts payables,

offset by increase in trade accounts receivables, cash and short-term deposits and derivative financial instruments.

The working capital deficit arises from the Company's current liabilities, which include two major components: Unearned revenues from sale of flight tickets as well as current maturities of long-term loans. These components, typical of current business cycles, are included under current liabilities and explain most of the working capital deficit.

### 3. Analysis of EL AL operating business results

#### 3.1 Market data

Passenger and cargo traffic at Ben Gurion Airport	Apr - Jun 2008	Apr - Jun 2007	change	
	in thousands	in thousands	in thousands	%
Incoming tourists *	608	452	156	35%
Departing Israelis *	934	838	96	11%
Cargo import - tons **	35	33	2	8%
Cargo export - tons **	48	47	1	0%

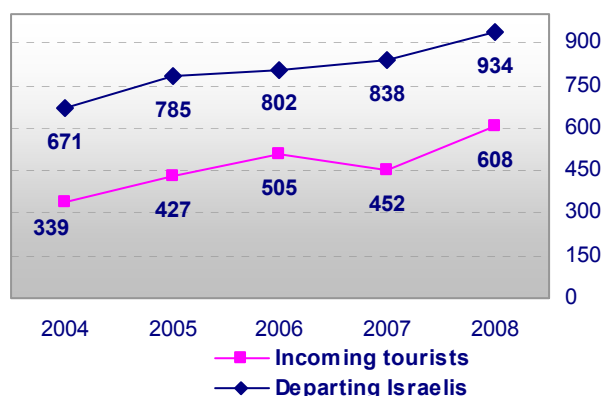
  

Passenger and cargo traffic at Ben Gurion Airport	Jan - Jun 2008	Jan - Jun 2007	change	
	in thousands	in thousands	in thousands	%
Incoming tourists *	1,065	819	246	30%
Departing Israelis *	1,561	1,479	82	6%
Cargo import - tons **	74	66	8	11%
Cargo export - tons **	103	101	2	1%

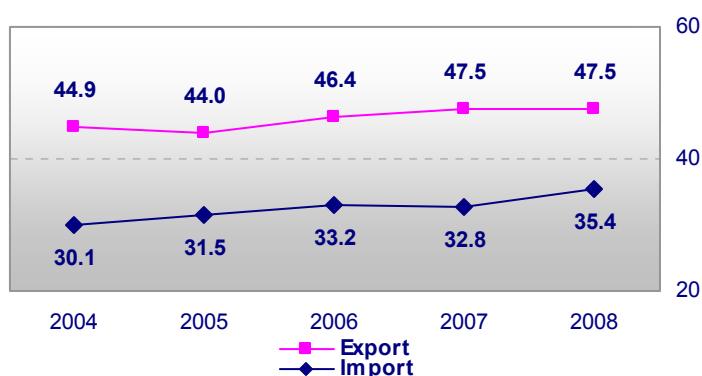
\* Source: Central Bureau of Statistics.

\*\* Excluding cargo in transit.

#### Incoming tourists and departing Israelis, in the second quarter of the years (in thousands):



**Import and export of cargo by air to and from Israel,  
in the second quarters of the years (in thousands):**



### 3.2 Company Operating Data

	Apr - Jun 2008	Apr - Jun 2007	change
Passenger leg (scheduled and chartered) - in thousands	987	895	10%
RPK (scheduled) - in millions	4,430	4,147	7%
ASK (scheduled) - in millions	5,463	4,795	14%
Load factor (scheduled)	81.1%	86.5%	(6%)
The Company's market share (scheduled and chartered)	33.8%	36.9%	(8%)
Flown cargo, in thousand tons	28	36	(24%)
RTK - in millions	141	203	(31%)
Weighted flying hours (including leased equipment) - in thousands (*)	42.9	40.5	6%
<u>Average man-years (EI AL only):</u>			
Permanent	3,790	3,529	7%
Temporary	2,410	2,287	5%
<b>Total</b>	<b>6,200</b>	<b>5,816</b>	<b>7%</b>

	Jan - Jun 2008	Jan - Jun 2008	change
Passenger leg (scheduled and chartered) - in thousands	1,844	1,678	10%
RPK (scheduled) - in millions	8,350	7,872	6%
ASK (scheduled) - in millions	10,325	9,317	11%
Load factor (scheduled)	80.9%	84.5%	(4%)
The Company's market share (scheduled and chartered)	37.5%	39.1%	(4%)
Flown cargo, in thousand tons	64	74	(14%)
RTK - in millions	337	407	(17%)
Weighted flying hours (including leased equipment) - in thousands (*)	84.1	79.7	6%
<u>Average man-years (EI AL only):</u>			
Permanent	3,741	3,547	5%
Temporary	2,346	2,259	4%
Total	6,087	5,806	5%
Aircraft in operation - end of period - number of units	36	35	1
Average age of owned fleet at the end of the period - in years	15.3	15.3	0

**Legend:**

Passenger leg – one-way flight voucher.

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

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

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

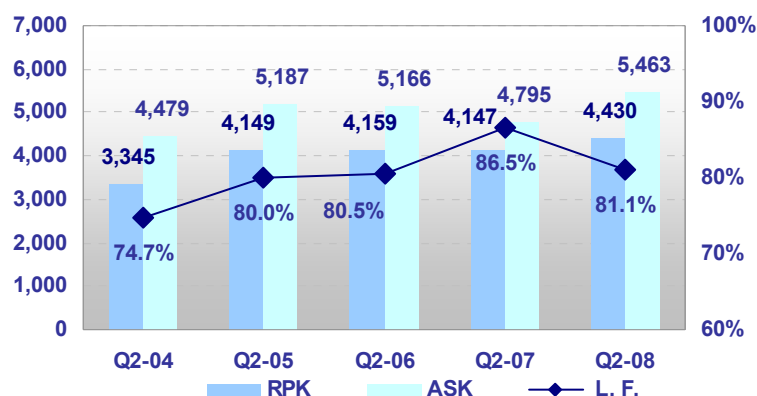
Passenger Load Factor (passenger occupancy) – revenue passenger kilometers as percentage of available seat kilometers.

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

Aircraft weightings: Boeing 757/767 = 1.0; Boeing 747 = 2.0; Boeing 777 = 1.6; Boeing 737 = 0.6.

These weightings have been determined based on estimated total expenses by aircraft type, and are consistently used to calculate weighted flight hours as an indicator of extent of flight operations.

**Operational benchmarks, in the second quarter:  
(in millions)**



**3.3 Profit and loss data**

For the three-month period ended June 30, 2008 (consolidated reports):

	2008		2007		in	
	in thousands US dollars	% of operating revenues	in thousands US dollars	% of operating revenues	in thousands US dollars	%
Operating revenues	557,022	100%	452,807	100%	104,215	23%
Operating expenses	485,205	87.1%	353,309	78.0%	131,896	37%
<b>Gross profit</b>	71,817	12.9%	99,498	22.0%	(27,681)	(28%)
Selling expenses	60,577	10.9%	51,228	11.3%	9,349	18%
General and administrative expenses	26,172	4.7%	21,909	4.8%	4,263	19%
Other operating expenses (income), net	2,740	0.5%	(758)	(0.2%)	3,498	
<b>Operating profit (loss) before financing</b>	(17,672)	(3.2%)	27,119	6.0%	(44,791)	
Financing expenses	(13,328)	(2.4%)	(8,514)	(1.9%)	(4,814)	57%
Financing income	16,455	3.0%	4,010	0.9%	12,445	310%
<b>Profit (Loss) before income taxes</b>	(14,545)	(2.6%)	22,615	5.0%	(37,160)	
Income taxes	3,264	0.6%	(6,063)	(1.3%)	9,327	
<b>Profit (Loss) after taxes</b>	(11,281)	(2.0%)	16,552	3.7%	(27,833)	
Company's equity in results of affiliates, net	42	0.0%	47	0.0%	(5)	(11%)
<b>Profit (Loss) for the period</b>	<b>(11,239)</b>	<b>(2.0%)</b>	<b>16,599</b>	<b>3.7%</b>	<b>(27,838)</b>	

**The primary factors influencing the business results for the three month period ending June 30 2008, compared to the same period last year are:**

- Increase in operating revenues is primarily due to increase in passenger revenues due to higher number of passengers flown and average revenue per passenger-kilometer. Other revenues also increased, primarily due to provision of maintenance services to external entities. Cargo revenues decreased due to discontinuation of cargo aircraft operations to the Far East in the reported period.
- In the second quarter of 2008, the Company's operating expenses increased over the corresponding period last year, primarily due to an increase in jet fuel expenses and salary expenses as set forth below, as well as due to an increase in other operating expenses, primarily due to the increase in number of passengers flown by the Company and to the devaluation of the USD vs. other currencies.
- Salary expenses in the second quarter of 2008 increased, primarily due to revaluation of the NIS vs. the USD by an average 16% over the same period last year – which led to increase in NIS-denominated salary expenses in USD terms, as well as in balance sheet liabilities in respect of employee benefits, and as a result of the increase in average headcount in the quarter, due to expanded operation in the reported period compared to the same quarter last year. For impact of changes in NIS/USD exchange rates on Company liabilities, see section 3.4 below.
- Company jet fuel expenses increased from \$119.1 million in the second quarter of 2007 to \$214.4 million in the reported quarter – an 80% increase. This is after hedging reimbursement of \$22.0 million in the second quarter of 2008 (compared to hedging reimbursement amounting to \$2.7 million in the same period last year). Increase in fuel expenses is primarily due to a 79% increase in effective jet fuel price for the Company. In the second quarter of 2008, fuel expenses accounted for 38.5% of Company turnover, compared to 26.3% in the corresponding period last year. For hedging of jet fuel prices, see section 6.2 below.

- Selling expenses increased, primarily due to increase in salary and advertising expenses as well as increase in distribution expenses, primarily due to increase in passenger revenues. However, the rate of distribution expenses decreased, including selling expenses as percentage of turnover, compared to the previous quarter last year.
- General and administrative expenses increased, primarily due to increase in salary expenses, but their percentage out of turnover in the reported period remained essentially unchanged compared to the same period last year.
- In the reported period, the Company recorded other net expenses amounting to \$2.7 million – primarily due to revaluation of the NIS vs. the USD, which increased Company liabilities for early retirement programs. On the other hand, in the second quarter of 2007 the Company recorded other net revenues amounting to \$0.8 million due to refunds received from Boeing Corp. in respect of settlement between the parties offset by expenses in respect of early retirement program.
- The increase in financing expenses in the second quarter of 2008 over the same period last year is primarily due to exchange rate differentials due to devaluation of the USD vs. the NIS and Euro. Interest expenses for loans remained essentially unchanged, due to a decline in LIBOR interest rates, offset by an increase in Company loans.
- Financing income for the Company increased, primarily due to increase in fair value and receipts from exchange rate and interest rate hedging transactions executed by the Company, which were not recognized as hedging instruments in terms of accounting. For hedging of exchange rates and interest rates, see sections 6.3 and 6.4 below.
- In the second quarter of 2008, the Company recorded a tax benefit amounting to \$3.3 million, compared to tax expenses of \$6.1 million in the same period last year, due to a pre-tax loss in the reported period, compared to pre-tax income in the same period last year.

### Profit and loss data

For the six-month period ended June 30, 2008 (consolidated reports):

	<u>Jan - Jun</u> 2008		<u>Jan - Jun</u> 2007		<u>change</u>	
	in thousands US dollars	% of operating revenues	in thousands US dollars	% of operating revenues	in thousands US dollars	%
Operating revenues	1,028,488	100.0%	841,441	100.0%	187,047	22%
Operating expenses	899,979	87.5%	681,570	81.0%	218,409	32%
<b>Gross profit</b>	128,509	12.5%	159,871	19.0%	(31,362)	(20%)
Selling expenses	116,569	11.3%	93,585	11.1%	22,984	25%
General and administrative expenses	51,087	5.0%	45,032	5.4%	6,055	13%
Other operating expenses (income),net	24,114	2.3%	(6,619)	(0.8%)	30,733	
<b>Operating profit (loss) before financing</b>	(63,261)	(6.2%)	27,873	3.3%	(91,134)	
Financing expenses	(28,743)	(2.8%)	(22,150)	(2.6%)	(6,593)	30%
Financing income	19,135	1.9%	6,978	0.8%	12,157	174%
<b>Profit (Loss) before income taxes</b>	(72,869)	(7.1%)	12,701	1.5%	(85,570)	
Income taxes	12,932	1.3%	(3,415)	(0.4%)	16,347	
<b>Profit (Loss) after taxes</b>	(59,937)	(5.8%)	9,286	1.1%	(69,223)	
Company's equity in results of affiliates, net	98	0.0%	91	0.0%	7	8%
<b>Profit (Loss) for the period</b>	(59,839)	(5.8%)	9,377	1.1%	(69,216)	

**The primary factors influencing the business results for the six month period ending June 30 2008, compared to the same period last year are:**

- Increase in operating revenues is primarily due to increase in passenger revenues due to higher number of passengers flown and average revenue per passenger-kilometer. Other revenues also increased, primarily due to provision of maintenance services to external entities.
- In the first half of 2008, operating expenses for the Company increased over the same period last year, primarily due to rising fuel prices, expanded operations and devaluation of the USD vs. the NIS and Euro. Other operating expenses also increased, primarily due to expanded Company operations and devaluation of the USD.
- The increase in jet fuel expenses from \$220.5 million in the first half of 2007 to \$378.4 million in the first half of 2008 is primarily due to rising fuel prices. Jet fuel expenses in the first half of 2008 accounted for 36.8% of Company turnover, compared to 26.2% in the corresponding period last year.
- The increase in Company salary expenses is primarily due to devaluation of the USD vs. the NIS and Euro - which increased NIS-denominated salary expenses in USD terms, as well as due to increase in average headcount due to expanded operations.  
For impact of changes in NIS/USD exchange rates on Company provisions, see section 3.4 below.
- Selling expenses in the first half of 2008 increased, primarily due to increase in salary due to USD devaluation and expanded operations, and increase in distribution expenses due to expanded operations.
- General and administrative expenses increased, primarily due to increase in salary expenses as set forth above; however their percentage out of total turnover in the reported period decreased compared to the same period last year.
- In the reported period, the Company recorded other net expenses amounting to \$24.1 million, compared to other net revenues amounting to \$6.6 million in the first 6 months of 2007. Most of the expenses in the reported period are due to a provision made by the Company in the first quarter of 2008, amounting to \$20 million (capitalized) due to an inquiry by the Antitrust Division of the US Department of Justice into air cargo transportation services; other expenses were recorded due to revaluation of the NIS vs. the USD - which increased Company liabilities in respect of early retirement programs. On the other hand, in the first half of 2007 the Company recorded revenues due to reimbursement received from Boeing Corp. and from vacating a leased property at Heathrow Airport, offset by a provision for an early retirement program.
- The increase in financing expenses is primarily due to exchange rate differentials due to devaluation of the USD vs. other currencies.
- Financing revenues of the Company increased, primarily due to increase in fair value of exchange rate hedging transactions executed by the Company and recognized in the income statement.
- In the first half of 2008, a tax benefit was recorded amounting to \$12.9 million - compared to tax expenses amounting to \$3.4 million in the first half of 2007 - due

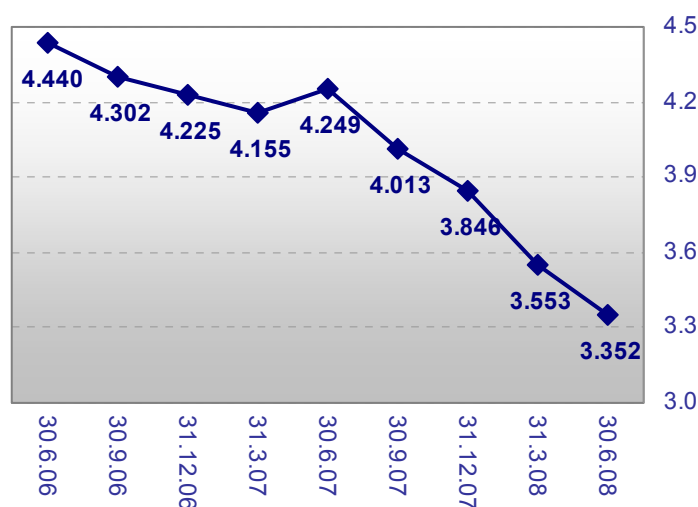
to pre-tax loss in the reported period compared to pre-tax income in the same period last year.

### **3.4 Impact of exchange rate changes on Company liabilities in respect of employee benefits**

In the 3-month period ended June 30, 2008, the NIS was revaluated against the USD by 5.7%, compared to a devaluation of 2.3% in the corresponding period last year.

In the first half of 2008, the NIS was revaluated against the USD by 12.8%, compared to a devaluation of 0.6% in the corresponding period last year.

**Changes in US Dollar exchange rate:**



The Company has net liabilities in respect of employee benefits, primarily retirement programs, sick pay and paid leave payout, amounting to \$93 million as of June 30, 2008.

Since most of these liabilities are NIS-denominated, whereas the Company's functional currency is USD, these liabilities should be translated into USD, which causes differentials due to changes in the NIS/USD exchange rate. Changes in exchange rates are not uni-directional, and cause revenues or expenses to be recorded in the Company's financial statements. These revenues or expenses do not impact cash flow or operating costs of the Company in the short-term. In order to compare business results of the Company over time, these revenues or expenses should be excluded.

In the quarter ended June 30, 2008, expenses were recorded for this item amounting to \$4.7 million, compared to the corresponding period last year, when expenses for this item decreased by \$1.3 million.

In the first half of 2008, expenses were recorded for this item amounting to \$10.5 million, compared to the corresponding period last year, when expenses for this item were recorded amounting to \$0.8 million.

The following details the Company's business results, neutralized from the influence of the exchange rate on the liability component due to employee-employer relations, as described above:

Three-month period ended June 30,	<u>Before</u>		<u>After</u>	
	<u>neutralizing the exchange-rate effect</u>			
	<u>on the accrued severance pay</u>			
	2008	2007	2008	2007
	(in thousands US dollars)			
Operating expenses	485,205	353,309	483,158	353,738
Gross profit	71,817	99,498	73,864	99,069
Gross profit rate	12.9%	22.0%	13.3%	21.9%
Selling, general and administrative expenses	86,749	73,137	86,492	73,153
Other operating expenses (income),net	(2,740)	758	(348)	(53)
Operating profit (loss) before financing	(17,672)	27,119	(12,976)	25,863
Operating profit (loss) rate before financing	(3.2%)	6.0%	(2.3%)	5.7%
Net profit (loss) for the period	(11,239)	16,599	(6,543)	15,343
Net profit (loss) for the period rate	(2.0%)	3.7%	(1.2%)	3.4%

Six-month period ended June 30,	<u>Before</u>		<u>After</u>	
	<u>neutralizing the exchange-rate effect</u>			
	<u>on the accrued severance pay</u>			
	2008	2007	2008	2007
	(in thousands US dollars)			
Operating expenses	899,979	681,570	895,333	680,782
Gross profit	128,509	159,871	133,155	160,659
Gross profit rate	12.5%	19.0%	12.9%	19.1%
Selling, general and administrative expenses	167,656	138,617	167,070	138,400
Other operating expenses (income),net	(24,114)	6,619	(18,860)	6,437
Operating profit (loss) before financing	(63,261)	27,873	(52,775)	28,696
Operating profit (loss) rate before financing	(6.2%)	3.3%	(5.1%)	3.4%
Net profit (loss) for the period	(59,839)	9,377	(49,353)	10,200
Net profit (loss) for the period rate	(5.8%)	1.1%	(4.8%)	1.2%

**3.5 Segment reporting**

Below is information by geographic segment, on consolidated basis:

<b>Three-month period ended:</b>					
<b>30.06.2008</b> <b>-(unaudited)</b>	<b>North America</b>	<b>Europe</b>	<b>Central Asia &amp; Far East</b>	<b>Rest of the world</b>	<b>Total</b>
	<b>(in millions US dollars)</b>				
Segmental income *	197.5	265.8	71.5	12.7	547.4
Income not attributed to segments					9.6
Total income					557.0
Segmental operating profit (loss)*	(3.2)	29.3	5.0	1.8	32.8
Cross-segmental expenses, net					(50.5)
Loss from operations before financing expenses					(17.7)
% of segmental income	(1.6%)	11.0%	7.0%	13.9%	
<b>30.06.2007</b> <b>-(unaudited)</b>					
Segmental income *	166.8	194.7	76.1	9.2	446.8
Income not attributed to segments					6.0
Total income					452.8
Segmental operating profit	17.2	37.6	2.9	3.0	60.6
Cross-segmental expenses, net					(33.5)
Profit from operations before financing expenses					27.1
% of segmental income	10.3%	19.3%	3.8%	32.4%	
<b>Six-month period ended:</b>					
<b>30.06.2008</b> <b>-(unaudited)</b>	<b>North America</b>	<b>Europe</b>	<b>Central Asia &amp; Far East</b>	<b>Rest of the world</b>	<b>Total</b>
	<b>(in millions US dollars)</b>				
Segmental income *	355.4	468.1	162.4	25.2	1,011.1
Income not attributed to segments					17.4
Total income					1,028.5
Segmental operating profit (loss)	(2.8)	45.1	13.2	3.7	59.1
Cross-segmental expenses, net					(122.4)
Loss from operations before financing expenses					(63.3)
% of segmental income	(0.8%)	9.6%	8.1%	14.6%	
<b>30.06.2007</b> <b>-(unaudited)</b>					
Segmental income *	296.3	355.1	154.9	19.0	825.3
Income not attributed to segments					16.1
Total income					841.4
Segmental operating profit	17.3	56.7	11.0	5.8	90.8
Cross-segmental expenses, net					(63.0)
Profit from operations before financing expenses					27.9
% of segmental income	5.8%	16.0%	7.1%	30.8%	

For year ended:					
31.12.2007 -(audited)	North America	Europe	Central Asia & Far East	Rest of the world	Total
	(in millions US dollars)				
Segmental income *	674.7	822.3	356.8	42.1	1,895.9
Income not attributed to segments					36.5
Total income					1,932.5
Segmental operating profit	56.7	144.1	33.4	11.2	245.4
Cross-segmental expenses, net					(150.7)
Profit from operations before financing expenses					94.7
% of segmental income	8.4%	17.5%	9.4%	26.7%	

\* Income is attributed to geographical sectors by flight destination.

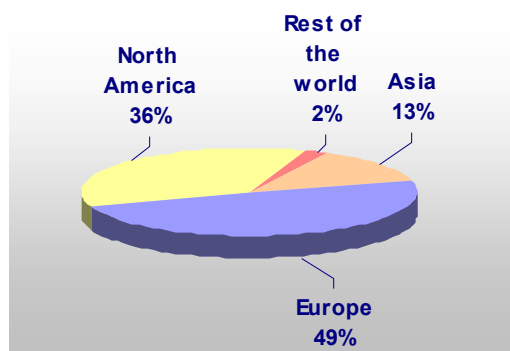
In the reported period, revenues increased in the North America, Europe and Rest of the World sectors over the corresponding period last year; however, operating income at these segments decreased compared to the same period last year, primarily due to increase in operating expenses, as set forth in section 3.3 of the Board of Directors' report above.

In the Central Asia and Far East sector revenues decreased, but operating income increased, primarily due to discontinuation of cargo aircraft operations to Far East destinations, which are heavy on fuel consumption and imbalanced in terms of cargo traffic volume.

In the first half of 2008, revenues in all sectors increased over the same period last year. However, operating income decreased, except for in the Central Asia and Far East sector, as set forth above.

Note that the increase in un-attributed cross-segment expenses, from \$63 million in the first half of 2007 to \$122 million in the first half of 2008, is primarily due to other expenses amounting to \$24.1 million (primarily due to a provision made by the Company in respect of an inquiry into cargo air transport services, amounting to \$20 million) in the reported period, compared to other revenues amounting to \$6.6 million generated by the Company in the same period last year, due to increase in payroll expenses not attributed to sectors, as set forth in section 3.3 of the Board of Directors' report, and to higher prices for fixed un-attributed expenses.

#### **Breakdown of revenues attributed to geographic sectors APR-JUN 2008:**



**4. Seasonality**

Passenger traffic at Ben Gurion airport is highly seasonal. Most of the activity is in the summer months, with the peak being in July-September. Winter months (January-March) see low volume of passenger traffic, but higher cargo shipping of agricultural produce to Europe in that period.

**5. Liquidity and Sources of Financing**

**Cash flow movements in the 6-month and 3-month periods ended June 30, 2008 compared to the corresponding periods last year are:**

	<b>Apr - Jun 2008 in thousands US dollars</b>	<b>Apr - Jun 2007 in thousands US dollars</b>	<b>change in thousands US dollars</b>
Cash flows from operating activities	68,040	72,143	(4,103)
Cash flows used for investing activities	(125,731)	(67,615)	(58,116)
Cash flows used for financing activities	(12,987)	17,334	(30,321)
Net decrease in cash	(70,678)	21,862	(92,540)

	<b>Jan - Jun 2008 in thousands US dollars</b>	<b>Jan - Jun 2007 in thousands US dollars</b>	<b>change in thousands US dollars</b>
Cash flows from operating activities	109,197	103,998	5,199
Cash flows used for investing activities	(81,123)	(102,113)	20,990
Cash flows used for financing activities	(25,195)	10,904	(36,099)
Net decrease in cash	2,879	12,789	(9,910)

In the quarter ended June 30, 2008, the Company generated a cash flow from operating activities amounting to \$68.0 million (compared to \$72.1 million in the corresponding period last year.) This decrease is primarily due to the loss in the reported period, compared to income in the corresponding period last year, offset by deposit of proceeds from option warrants exercised in the severance pay reserve – made in the corresponding period last year.

In the second quarter of 2008, the Company used \$125.7 million in investing activities (compared to \$67.6 million used in the same period last year), primarily due to investment in short-term deposits of \$80.1 million (\$55.1 million in the same period last year) and to investment in fixed and intangible assets of \$45.9 million, of which \$23.6 million on account of new aircraft acquisition (\$16.4 million in the same period last year).

In the second quarter of 2008, the Company used \$13.0 million for financing activities, primarily repayment of long-term loans amounting to \$13.8 million (compared to \$17.3 million derived from financing activities in the same quarter last year, primarily from proceeds from exercise of option warrants into shares amounting to \$31.6 million, offset by repayment of long-term loans amounting to \$13.6 million).

In the first half of 2008, the Company generated cash from operating activities amounting to \$109.2 million (compared to \$104.0 million in the same period last year).

The growth in cash flow from operating activities in the first half of 2008, over the same

period last year, despite the move from income in the first half of 2007 to a loss in the first half of 2008, is primarily due to deposit of proceeds from exercise of option warrants in a severance pay reserve made in the corresponding period last year, as well as to non-cash flow expenses incurred by the company in the reported period, primarily provision for a claim in the field of cargo air transport services, as well as to a more modest increase in trade accounts receivables and prepaid expenses.

In the first half of 2008, the Company used \$81.1 million in investing activities (compared to \$102.1 million used in the same period last year), primarily due to investment in short-term deposits of \$15.1 million (\$68.4 million in the same period last year) and to investment in fixed and intangible assets of \$66.5 million, of which \$26.6 million on account of new aircraft acquisition (\$37.6 million in the same period last year).

In the first half of 2008, the Company used \$25.2 million in financing activities, primarily repayment of long-term loans amounting to \$22.5 million and dividend payment amounting to \$3.1 million (compared to \$10.9 million generated by the Company from financing operations in the corresponding period last year, primarily from proceeds from exercise of option warrants into shares amounting to \$31.8 million, offset by repayment of long-term loans amounting to \$20.1 million).

Cash and cash equivalents and short-term investments as of June 30, 2008 amounted to \$285.2 million, compared to \$267.3 million as of December 31, 2007 (as of June 30, 2007 - \$232.1 million).

## **6. Qualitative Reporting on exposure to and management of market risks**

### **6.1 The Company's Policy Regarding the Management of Market Risks, Those Responsible for their Management, Means of Supervision and Policy Realization**

The Company has a Board of Directors Committee for the purpose of managing market risks led by the Chairman of the Finance, Budget and Balance Sheet Committee, Mr. Nadav Palti, which is responsible for determining the Company's policy for covering existing exposure, The CFO is responsible for executing the policy and reporting to the Market Risk Management Committee.

The Market Risk Management Committee sets the future jet fuel consumption frameworks to be covered via financial hedging. In addition, from time to time the Committee examines the need to invest in derivatives, to diminish the exposure from interest risks and currency risks.

Over the course of the account period, the Company continued to implement corporate policy as regards market risk management and supervisory measures, as described in the Report of the Board of Directors on the State of the Corporation's Affairs dated December 31 2007 and in the Notes to the Financial Statements of that date.

Between January 1 2008 and the publishing of this Report, the Company held regular meetings of the Risk Management Committee, a Board of Directors subcommittee. In these meetings the Company management discussed the Company's status in the matter exposure related to fuel, interest and rates of exchange.

A decision was reached as part of said discussions not to deviate from existing policy

For details on the policy implemented, see Items 6.2, 6.3 and 6.4 below.

For details of impact subsequent to the balance sheet date, see section 11b below.

**6.2 Hedging of jet fuel prices**

Below is information on positions with regard to hedging transactions of jet fuel prices maintained by the Company as of June 30, 2008:

	Type of transaction	Period	Transaction's currency	Fair value in thousand US dollars
HJFP	Financial instruments	Up to One year	US dollar	101,578
HJFP	Financial instruments	Over One year	US dollar	23,401
Total			US dollar	124,979

Some of the jet fuels hedging instruments were designated as hedges. For further details, see Note 1n to the financial statements as of June 30, 2008.

**6.3 Hedging of loan interest rates**

The Company enters into transactions with banks in Israel in order to hedge exposure in its long-term credit portfolio due to interest rate changes. No further transactions took place in the reported period.

In accounting terms, some of the aforementioned financial instruments were not designated as hedging transactions, while others were so designated.

After the aforementioned hedges, as of June 30, 2008, some 55% of the Company's outstanding loan balance bears fixed interest. The percentage of Company loans bearing fixed interest is gradually decreasing, for a term of up to 5 years.

The fair value of interest hedging instruments as of June 30, 2008 is a net negative amount of \$2.6 million, which is primarily presented in the financial statements under the non-current liabilities item "derivative financial instruments".

For further information with regard to these transactions, see Notes 1m3 and 1n to the interim financial statements as of June 30, 2008.

**6.4 Hedging of exchange rates**

In 2007, the Company entered into multiple financial transactions aimed at hedging against decrease in USD/NIS exchange rates in 2008. These transactions are not designated, in accounting terms, as hedging transactions.

The fair value of these instruments as of June 30, 2008 is \$10.7 million, presented in the financial statements under the current assets item "derivative financial instruments".

For details of impact subsequent to the balance sheet date, see section 11a below.

**6.5 Reporting of sensitivity analysis**

Below is a sensitivity analysis of the fair value of financial instruments sensitive to potential changes in the risk factors to which they are exposed.

This sensitivity analysis was prepared relative to the fair value of said financial instruments as of June 30, 2008.

**Below are tables for sensitivity tests of instruments sensitive to changes in market prices:**

**a. Sensitivity to change in USD/NIS exchange rate - in thousands of dollars:**

	Gain (loss) from changes		Fair value	Gain (loss) from changes	
	Increase 10%	Increase 5%		Decrease 5%	Decrease 10%
	3.687 NIS/\$	3.520 NIS/\$	3.352 NIS/\$	3.184 NIS/\$	3.017 NIS/\$
Cash and cash equivalents	(998)	(525)	10,987	580	1,220
Short-term investments	(790)	(415)	8,695	459	965
Trade accounts receivable	(26)	(14)	290	15	32
Receivables and other current assets	(575)	(302)	6,327	334	703
Current derivative financial instruments	(969)	(509)	10,663	563	1,184
Long-term bank deposits	(230)	(121)	2,531	134	281
<b>Total financial Assets</b>	<b>(3,588)</b>	<b>(1,886)</b>	<b>39,493</b>	<b>2,084</b>	<b>4,385</b>
Short-term bank borrowings	40	21	(445)	(23)	(49)
Trade accounts payable	2,439	1,282	(26,840)	(1,416)	(2,980)
Payables and other current liabilities	869	457	(9,564)	(505)	(1,062)
accruals	4,568	2,401	(50,277)	(2,653)	(5,583)
Current liability for employee benefits	7,702	4,048	(84,769)	(4,473)	(9,413)
<b>Total financial liabilities</b>	<b>15,618</b>	<b>8,209</b>	<b>(171,895)</b>	<b>(9,070)</b>	<b>(19,087)</b>
Exposure in linkage balance sheet due to surplus financial liabilities over financial assets *	12,030	6,323	(132,402)	(6,986)	(14,702)

\* Excluding exposure due to impact of changes in exchange rates on liabilities in respect of long-term employee benefits, as set forth in section 3.4.

**b. Sensitivity to change in USD/Euro exchange rate - in thousands of dollars:**

	Gain (loss) from changes		Fair value	Gain (loss) from changes	
	Increase 10%	Increase 5%		Decrease 5%	Decrease 10%
	0.697 Euro/\$	0.667 Euro/\$	0.634 Euro/\$	0.602 Euro/\$	0.571 Euro/\$
Cash and cash equivalents	(641)	(351)	7,095	377	783
Trade accounts receivable	(932)	(510)	10,307	548	1,137
Receivables and other current assets	(273)	(150)	3,024	161	334
<b>Total financial Assets</b>	<b>(1,846)</b>	<b>(1,011)</b>	<b>20,426</b>	<b>1,086</b>	<b>2,254</b>
Short-term bank borrowings	77	42	(851)	(45)	(94)
Trade accounts payable	1,997	1,093	(22,099)	(1,175)	(2,438)
Payables and other current liabilities	275	150	(3,037)	(161)	(335)
<b>Total financial liabilities</b>	<b>2,349</b>	<b>1,286</b>	<b>(25,987)</b>	<b>(1,381)</b>	<b>(2,867)</b>
Exposure in linkage balance sheet due to surplus financial liabilities over financial assets*	503	275	(5,561)	(296)	(614)

\* Excluding exposure due to impact of changes in exchange rates on liabilities in respect of long-term employee benefits, as set forth in section 3.4.

**c. Sensitivity of jet fuel hedges to changes in jet fuel prices - in millions of dollars:**

In accordance with model principles, jet fuel hedging instruments have been grouped by similar reaction to market factors, since no material information, required for understanding the Company's exposure to market risk, is lost due to such grouping.

Type of instrument	Gain from changes *		Fair value	Loss from changes *	
	Increase 10%	Increase 5%		Decrease 5%	Decrease 10%
	4.437 \$/gallon	4.236 \$/gallon	4.034** \$/gallon	3.832 \$/gallon	3.631 \$/gallon
<b>Fuel hedging transactions</b>	<b>32.3</b>	<b>13.2</b>	<b>125.0</b>	<b>(26.2)</b>	<b>(51.7)</b>

\* Most of the gain or loss from changes to fair value is to be recognized directly in equity, rather than in the income statement.

\*\* The price of jet fuel in the Mediterranean region as of June 30, 2008, used to calculate the fair value of the Company's jet fuel hedging transactions.

**d. Sensitivity of interest hedges to changes in market interest rates - in thousands of dollars:**

In accordance with model principles, interest rate hedging instruments have been grouped by similar reaction to market factors (SWAP transactions with Knock-Out not designated as hedges, IRS transactions designated as hedges, IRS transactions not designated as hedges), since no material information, required for understanding the Company's exposure to market risk, is lost due to such grouping

Type of instrument	Gain from changes		Fair value *	Loss from changes	
	Increase 10% in interest rate	Increase 5% in interest rate		Decrease 5% in interest rate	Decrease 10% in interest rate
SWAP transactions with KNOCK OUT - not designated for defense	2,162	1,328	(948)	(687)	(1,165)
IRS transactions - designated for defense	1,026	514	152	(1,037)	(518)
IRS transactions - not designated for defense	5,826	3,186	(848)	(2,428)	(4,706)
Cylinder transactions - not designated for defense	376	189	(985)	(383)	(191)
<b>Total</b>	<b>9,390</b>	<b>5,217</b>	<b>(2,629)</b>	<b>(4,535)</b>	<b>(6,580)</b>

\* Fair value calculated according to LIBOR market interest rates as of the balance sheet date, as follows: 3-month LIBOR: 2.78%, 6-month LIBOR: 3.11% and 12-month LIBOR - 3.31% - as the case may be and as per specific transactions.

\*\* The change in fair value of such instruments designated as hedges will be recognized directly in equity, rather than in the income statement.

**e. Sensitivity of USD/NIS exchange rate hedge to change in market exchange rates - in thousands of dollars:**

Type of instrument	Loss from changes		Fair value NIS/\$	Gain from changes	
	Increase 10% in exchange rate	Increase 5% in exchange rate		Decrease 5% in exchange rate	Decrease 10% in exchange rate
	3.687	3.520	3.352	3.184	3.017
Cylinder transactions - not designated for defense	(5,755)	(2,936)	10,663	2,983	5,979

**7. Critical accounting estimates**

In applying the Company's accounting policy, management is sometimes required to exercise accounting judgment with regard to estimates and assumptions which affect the amounts presented in the financial statements.

For information about critical accounting estimates, see Note 2 to the Company's interim financial statements as of June 30, 2008.

**8. Linkage basis report**

Below is the linkage basis report, on consolidated basis, as of June 30, 2008:

	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>Assets</b>						
Cash and cash equivalents	63,617	10,987	7,095	7,850	-	89,549
Short-term investments	187,000	8,695	-	-	-	195,695
Trade accounts receivable	153,958	290	10,307	9,621	-	174,176
Receivables and other current assets	16,181	6,327	3,024	256	-	25,788
Current derivative financial instruments	101,578	10,663	-	-	-	112,241
Prepaid expenses	-	-	-	-	33,919	33,919
Inventory	-	-	-	-	16,775	16,775
Long-term bank deposits	-	2,531	-	-	-	2,531
Investees	1,229	-	-	-	1,137	2,366
Investments in another company	1,760	-	-	-	-	1,760
Long-term derivative financial instruments	23,901	-	-	-	-	23,901
Fixed assets	-	-	-	-	1,286,152	1,286,152
Intangible assets	-	-	-	-	6,803	6,803
	<b>549,224</b>	<b>39,493</b>	<b>20,426</b>	<b>17,727</b>	<b>1,344,786</b>	<b>1,971,656</b>
<b>Liabilities &amp; Equity</b>						
Short-term bank borrowings	(71,899)	(445)	(851)	-	-	(73,195)
Trade accounts payable	(131,102)	(26,840)	(22,099)	(13,642)	-	(193,683)
Payables and other current liabilities	(57,143)	(9,564)	(3,037)	(377)	-	(70,121)
Current accruals	(49,521)	(50,277)	-	-	-	(99,798)
Current derivative financial instruments	(592)	-	-	-	-	(592)
Current liability for employee benefits	(3,713)	(82,281)	(1,196)	(798)	-	(87,988)
Deferred income	-	-	-	-	(287,637)	(287,637)
Long-term loans from financial institutions	(685,652)	-	-	-	-	(685,652)
Accrued severance pay, net	(6,870)	(27,208)	(969)	(6,828)	-	(41,875)
Long-term loans from others	(228)	-	-	-	-	(228)
Long-term derivative financial instruments	(2,537)	-	-	-	-	(2,537)
Long-term accruals	(16,533)	-	-	-	-	(16,533)
Deferred income taxes	-	-	-	-	(77,901)	(77,901)
Shareholders' equity	-	-	-	-	(333,916)	(333,916)
	<b>(1,025,790)</b>	<b>(196,615)</b>	<b>(28,152)</b>	<b>(21,645)</b>	<b>(699,454)</b>	<b>(1,971,656)</b>
<b>Monetary assets, net of monetary liabilities (monetary liabilities, net of monetary assets)</b>	<b>(476,566)</b>	<b>(157,122)</b>	<b>(7,726)</b>	<b>(3,918)</b>	<b>645,332</b>	<b>-</b>

Below is the linkage basis report, on consolidated basis, as of June 30, 2007:

	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>Assets</b>						
Cash and cash equivalents	136,238	17,328	962	4,419	-	158,947
Short-term investments	63,500	9,628	-	-	-	73,128
Trade accounts receivable	152,399	94	17,722	19,332	-	189,547
Receivables and other current assets	20,326	5,198	721	1,508	-	27,753
Current derivative financial instruments	9,875	-	-	-	-	9,875
Prepaid expenses	-	-	-	-	31,053	31,053
Inventory	-	-	-	-	19,331	19,331
Long-term bank deposits	-	1,895	-	-	-	1,895
Investees	1,229	-	-	-	1,142	2,371
Investments in another company	1,887	-	-	-	-	1,887
Long-term derivative financial instruments	10,205	-	-	-	-	10,205
Fixed assets	-	-	-	-	1,144,093	1,144,093
Intangible assets	-	-	-	-	3,539	3,539
	<b>395,659</b>	<b>34,143</b>	<b>19,405</b>	<b>25,259</b>	<b>1,199,158</b>	<b>1,673,624</b>
<b>Liabilities &amp; Equity</b>						
Short-term bank borrowings	(100,740)	(517)	(507)	(109)	-	(101,873)
Trade accounts payable	(107,251)	(24,336)	(18,146)	(11,515)	-	(161,248)
Payables and other current liabilities	(26,669)	(27,531)	(4,055)	(2,478)	-	(60,733)
Current accruals	(46,882)	(29,041)	-	-	-	(75,923)
Dividends offered for payment	(87)	(414)	-	-	-	(501)
Current liability for employee benefits	(3,444)	(63,361)	(1,128)	(752)	-	(68,685)
Deferred income	-	-	-	-	(250,719)	(250,719)
Long-term loans from financial institutions	(548,816)	-	-	-	-	(548,816)
Accrued severance pay, net	(12,517)	(44,434)	(6,547)	(3,654)	-	(67,152)
Long-term loans from others	(564)	-	-	-	-	(564)
Deferred income taxes	-	-	-	-	(53,172)	(53,172)
Shareholders' equity	-	-	-	-	(284,238)	(284,238)
	<b>(846,970)</b>	<b>(189,634)</b>	<b>(30,383)</b>	<b>(18,508)</b>	<b>(588,129)</b>	<b>(1,673,624)</b>
<b>Monetary assets, net of monetary liabilities (monetary liabilities, net of monetary assets)</b>	<b>(451,311)</b>	<b>(155,491)</b>	<b>(10,978)</b>	<b>6,751</b>	<b>611,029</b>	<b>-</b>

Below is the linkage basis report, on consolidated basis, as of December 31, 2007:

	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>Assets</b>						
Cash and cash equivalents	63,447	18,020	842	4,361	-	86,670
Short-term investments	172,000	8,633	-	-	-	180,633
Trade accounts receivable	99,917	422	20,653	22,625	-	143,617
Receivables and other current assets	12,263	3,912	4,235	1,844	-	22,254
Current derivative financial instruments	21,881	3,649	-	-	-	25,530
Prepaid expenses	-	-	-	-	25,096	25,096
Inventory	-	-	-	-	15,981	15,981
Long-term bank deposits	-	2,207	-	-	-	2,207
Investees	1,228	-	-	-	1,040	2,268
Investments in another company	1,715	-	-	-	-	1,715
Long-term derivative financial instruments	7,570	-	-	-	-	7,570
Fixed assets	-	-	-	-	1,285,752	1,285,752
Intangible assets	-	-	-	-	4,388	4,388
	<b>380,021</b>	<b>36,843</b>	<b>25,730</b>	<b>28,830</b>	<b>1,332,257</b>	<b>1,803,681</b>
<b>Liabilities &amp; Equity</b>						
Short-term bank borrowings	(65,017)	(292)	(1,007)	-	-	(66,316)
Trade accounts payable	(98,059)	(26,902)	(27,645)	(14,814)	-	(167,420)
Payables and other current liabilities	(37,492)	(3,783)	(3,492)	(2,418)	-	(47,185)
Current accruals	(47,666)	(41,955)	-	-	-	(89,621)
Dividends offered for payment	-	(3,008)	-	-	-	(3,008)
Current liability for employee benefits	(10,361)	(75,439)	(1,067)	(711)	-	(87,578)
Deferred income	-	-	-	-	(188,751)	(188,751)
Long-term loans from financial institutions	(713,793)	-	-	-	-	(713,793)
Accrued severance pay, net	(6,489)	(37,985)	(6,536)	(3,741)	-	(54,751)
Long-term loans from others	(423)	-	-	-	-	(423)
Long-term derivative financial instruments	(1,415)	-	-	-	-	(1,415)
Deferred income taxes	-	-	-	-	(64,576)	(64,576)
Shareholders' equity	-	-	-	-	(318,844)	(318,844)
	<b>(980,715)</b>	<b>(189,364)</b>	<b>(39,747)</b>	<b>(21,684)</b>	<b>(572,171)</b>	<b>(1,803,681)</b>
<b>Monetary assets, net of monetary liabilities (monetary liabilities, net of monetary assets)</b>	<b>(600,694)</b>	<b>(152,521)</b>	<b>(14,017)</b>	<b>7,146</b>	<b>760,086</b>	<b>-</b>

## **9. Disclosure in the Board of Directors Report on the Matter of the Approval of the Financial Statements**

The Company's controlling body is its Board of Directors. Board members as of the approval of these Financial Statements are: Prof. Israel (Izzy) Borovich – Chairman of the Board, Ms. Tamar Moses Borovitz – Deputy Chairperson, Nadav Palti – Chairman of the Finance, Budget and Balance Committee, Ami Sagis, Yair Rabinowitch – Director from the public, Amnon Lipkin-Shahak, Eran Ilan and Yehuda Levi.

Several committees operate in the framework of the Board of Directors, among them the Audit Committee, the Market Risk Management Committee, the Human Resources and Appointments Committee as well as the Finance, Budget and Balance Committee which numbers four members, among them a director from the public. The four committee members have accounting and financial capabilities as defined in the Companies Law of 1999 and the resulting regulations.

A draft of the Financial Statements is sent to the Board members for advance study.

The Finance, Budget and Balance Committee convenes for an extensive and in-depth

discussion on the Financial Statement draft with the Company Auditor present. The CEO and CFO present the Financial Statements to the Committee members in great detail, including detailed financial analyses of the Company's performance in the reported period. The Committee studies the material issues in the financial reporting, including material transactions not part of the regular course of business – in the event that such exist, the critical estimates and assessments implemented in the Financial Statements, the likelihood of the data, accounting policy implemented and changes thereof, if any, implementation of the full disclosure principle in the Financial Statements as well as various aspects of supervision and risk management.

When complex or essential issues are at stake, special Finance, Budget and Balance Committee meetings are held on the subject at hand, with the Auditor's participation.

The Committee holds discussions on the Financial Statements placed before it, which include questions addressed to the Company executives present and the Auditor. In addition, the Auditor is asked to present the Committee members with his remarks – if such exist, on subjects including the accounting policy implemented and special issues that arose throughout the audit.

The committee reaches a decision to recommend that the Company's Board of Directors approve the Financial Statements, subject to modifications, changes and additions – if such are required by the Committee members.

The Financial Statements are presented to the Board members in a separate meeting, with the participation of the CEO, CFO and other senior Company executives as well as the Auditor.

In this forum as well, a discussion is held on the Statements, including questions addressed to the Auditor and to the Company's management, and the issues particular to the reported period are presented. The Board of Directors' decision whether to approve the Financial Statements is reached at the conclusion of discussions.

**10. Explanation of the issue to which the Company's independent auditors draw attention in their review letter of the interim financial statements**

The Company's independent auditors draw attention, in their review letter of the interim financial statements, to Note 5 of the interim financial statements with regard to legal proceedings against the Company.

Although the aforementioned issue does not cause any change to the standard independent auditors wording, attention must be drawn due to its potential material impact on the Company.

**11. Events subsequent to the balance sheet date**

- a. Subsequent to the balance sheet date (June 30, 2008) and through soon before approval of the report for the second quarter of 2008 (August 11, 2008), the NIS was devaluated against the USD by NIS 0.21.

The expected impact of the NIS/USD devaluation for July 2008 is a decrease in cash flow expenses amounting to \$1 million. However, the Company has USD exchange rate hedging transactions (see section 6.4 of the Board of Directors' report above), whose fair value is expected to decrease due to the NIS/USD devaluation.

Furthermore, the NIS/USD devaluation reduces the Company's NIS-denominated liabilities in USD terms (see section 3.4 of the Board of Directors' report above),

thereby reducing its salary and financing expenses.

The expected impact of the NIS/USD devaluation for July 2008 is a decrease in these accounting expenses amounting to \$3 million.

The Company does not enter into hedging transactions for this expense, which is essentially an accounting expense.

Note that the impact of exchange rates on business results of the next quarter will be determined by actual exchange rates during the whole quarter and at its end (September 30, 2008).

- b. As of the balance sheet date (June 30, 2008), jet fuel price in the Mediterranean Region was \$4.034 per gallon.

Subsequent to the balance sheet date, jet fuel prices decreased significantly, and soon prior to approval of the report for the second quarter of 2008 (August 11, 2008), the price was \$3.29 per gallon.

The effective price payable by the Company for fuel consumption (after hedging returns) in July-August is 9% lower than the effective price it paid in June 2008.

However, the fair value of jet fuel hedging devices is expected to decrease as a result of the above.

Subsequent to the balance sheet date, the Company continued implementation of its hedging policy, and entered into further transactions not reflected in this report.

- c. For other events subsequent to the balance sheet date, see Note 10 to the interim financial statements as of June 30, 2008.

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**Prof. Israel (Izzy) Borovich**  
**Chairman of the Board of Directors**

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**Haim Romano**  
**Chief Executive Officer**

**August 13, 2008**

**EL AL Israel Airlines Ltd.**

**Condensed Interim Consolidated Financial Statements**  
**As of June 30, 2008**

**(Unaudited)**

**EL AL Israel Airlines Ltd.**

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Brightman, Almagor, Zohar  
1 Azrieli Center  
Tel Aviv, 67021  
PO Box 16593  
Tel Aviv 61164  
Telephone: +972 (3) 608 5555  
Fax: +972 (3) 609 4022  
info@deloitte.co.il  
www.deloitte.co.il

To:  
The Board of Directors,  
EL AL Israel Airlines Ltd.  
Ben-Gurion Airport

Dear Sir/Madam,

**Re: Review of condensed interim consolidated financial statements (unaudited) as of June 30, 2008 and for the 6-month and 3-month periods then ended**

At your request, we have reviewed the condensed interim consolidated financial statements of EL AL Israel Airlines Ltd. (hereinafter: "the Company") as of June 30, 2008, as well as the condensed interim consolidated income statements, statements of changes to shareholders' equity and consolidated cash flow statements for the 6-month and 3-month periods then ended.

Our review was conducted as per the procedures established by the Israeli CPA Association. These procedures included, inter alia: Reading the aforementioned financial statements; reading minutes of shareholder meetings and of meetings of the board of directors and its committees; and clarification sessions with people in charge of financial and accounting issues.

We have been provided with reports of other CPAs reviewing the condensed interim financial statements of consolidated companies whose assets constitute 0.8% of total assets included in the condensed interim consolidated balance sheet as of June 30, 2008, and whose revenues constitute 4.7% of total revenues included in the condensed interim consolidated income statements for the 6-month and 2-month periods ended June 30, 2008.

Since the review performed is of limited scope, and does not constitute a check under commonly accepted audit standards, we do not express our opinion of the summary interim financial statements.

In the course of our review, including review of other CPA's reports, we have not become aware of any issue indicating that material changes would be required to the aforementioned financial statements in order for them to be deemed as proper interim financial statements in accordance with International Accounting Standard IAS 34 "Interim Financial Reporting" and in accordance with provisions of Chapter 4 of the Securities Regulations (Periodic and Immediate Statements), 1970.

We wish to draw your attention to Note 5 with regard to legal proceedings against the Company.

**Sincerely yours,**  
Brightman Almagor & Co. CPAs

Tel Aviv, August 13, 2008

**EL AL Israel Airlines Ltd.****Condensed consolidated balance sheet**

	<u>As of June 30</u>		<u>As of December 31</u>
	<u>2008</u>	<u>2007</u>	<u>2007</u>
	<u>Unaudited</u>		<u>Audited</u>
	<u>USD in thousands</u>		
<b><u>Assets</u></b>			
<b><u>Current assets</u></b>			
Cash and cash equivalents	89,549	158,947	86,670
Short-term deposits	195,695	73,128	180,633
Trade receivables	174,176	189,547	143,617
Other accounts receivable	25,788	27,753	22,254
Derivative financial instruments	112,241	9,875	25,530
Prepaid expenses	33,919	31,053	25,096
Inventory	16,775	19,331	15,981
	<u>648,143</u>	<u>509,634</u>	<u>499,781</u>
<b><u>Non-current assets</u></b>			
Long-term deposits with banks	2,531	1,895	2,207
Investment in affiliated companies	2,366	2,371	2,268
Investment in another company	1,760	1,887	1,715
Derivative financial instruments	23,901	10,205	7,570
Fixed assets	1,286,152	1,144,093	1,285,752
Other assets	6,803	3,539	4,388
	<u>1,323,513</u>	<u>1,163,990</u>	<u>1,303,900</u>
	<u>1,971,656</u>	<u>1,673,624</u>	<u>1,803,681</u>

The notes to the interim financial statements are an integral part thereof.

**EL AL Israel Airlines Ltd.**  
**Condensed consolidated balance sheet**

	As of June 30		As of December 31
	2008	2007	2007
	Unaudited		Audited
	USD in thousands		
<b><u>Liabilities and shareholders' equity</u></b>			
<b><u>Current liabilities</u></b>			
Short-term borrowings and current maturities	73,195	101,873	66,316
Trade payables	193,683	161,248	167,420
Other accounts payable	70,121	60,733	47,185
Provisions	99,798	75,923	89,621
Proposed dividend payable	-	-	3,008
Derivative financial instruments	592	501	-
Liabilities in respect of employee benefits	87,988	68,685	87,578
Unearned revenues	287,637	250,719	188,751
	813,014	719,682	649,879
<b><u>Non-current liabilities</u></b>			
Long-term loans from financial institutions	685,652	548,816	713,793
Liabilities in respect of employee benefits	41,875	67,152	54,751
Long-term loans from others	228	564	423
Derivative financial instruments	2,537	-	1,415
Long-term provisions	16,533	-	-
Deferred taxes	77,901	53,172	64,576
	824,726	669,704	834,958
<b>Total Liabilities</b>	1,637,740	1,389,386	1,484,837
<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 former controlling shareholder	237,122	229,560	237,122
Capital reserve in respect of share-based payment	5,060	3,513	4,464
Capital reserve in respect of cash flow hedging	82,701	5,376	8,341
Accumulated deficit	(173,986)	(137,230)	(114,102)
	333,916	284,238	318,844
	1,971,656	1,673,624	1,803,681

**Prof. Israel (Izi) Borowitz**  
**Chairman of the Board of**  
**Directors**

**Chaim Romano**  
**CEO**

**Nissim Malchi**  
**CFO**

Ben-Gurion Airport, August 13, 2008

Certification date of interim financial statements

The notes to the interim financial statements are an integral part thereof.

**EL AL Israel Airlines Ltd.****Condensed interim consolidated income statement**

	<b>For the 6-month period ended June 30</b>		<b>For the 3-month period ended June 30</b>		<b>For the year ended December 31</b>
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>	<b>2007</b>
	<b>Unaudited</b>		<b>Unaudited</b>		<b>Audited</b>
	<b>USD in thousands</b>				
Operating revenues	1,028,488	841,441	557,022	452,807	1,932,450
Operating expenses	899,979	681,570	485,205	353,309	1,517,695
<b>Gross income</b>	<u>128,509</u>	<u>159,871</u>	<u>71,817</u>	<u>99,498</u>	<u>414,755</u>
Selling expenses	116,569	93,585	60,577	51,228	230,886
General and administrative expenses	51,087	45,032	26,172	21,909	91,619
Other operating expenses (revenues), net	24,114	(6,619)	2,740	(758)	(2,423)
	<u>191,770</u>	<u>131,998</u>	<u>89,489</u>	<u>72,379</u>	<u>320,082</u>
<b>Operating income (loss) before financing expenses/revenues</b>	(63,261)	27,873	(17,672)	27,119	94,673
Financing expenses	(28,743)	(22,150)	(13,328)	(8,514)	(56,062)
Financing revenues	19,135	6,978	16,455	4,010	19,469
<b>Income (loss) before taxes on revenue</b>	(72,869)	12,701	(14,545)	22,615	58,080
Tax benefit (taxes on income)	12,932	(3,415)	3,264	(6,063)	(13,586)
<b>After-tax income (loss)</b>	(59,937)	9,286	(11,281)	16,552	44,494
Company share of income of affiliated companies, net	98	91	42	47	332
<b>Income (loss) for the period</b>	<u>(59,839)</u>	<u>9,377</u>	<u>(11,239)</u>	<u>16,599</u>	<u>44,826</u>
<b>Basic earnings (loss) per NIS 1 par value share, in USD</b>	<u>(0.12)</u>	<u>0.02</u>	<u>(0.02)</u>	<u>0.04</u>	<u>0.09</u>
<b>Number of shares used for calculation (in thousands) - basic</b>	<u>495,719</u>	<u>418,161</u>	<u>495,719</u>	<u>434,246</u>	<u>476,289</u>
<b>Diluted earnings (loss) per NIS 1 par value share, in USD</b>	<u>(0.12)</u>	<u>0.02</u>	<u>(0.02)</u>	<u>0.03</u>	<u>0.09</u>
<b>Number of shares used for calculation (in thousands) - diluted</b>	<u>495,719</u>	<u>418,161</u>	<u>495,719</u>	<u>495,721</u>	<u>495,934</u>

The notes to the interim financial statements are an integral part thereof.

**EL AL Israel Airlines Ltd.**  
**Condensed interim statement of changes to shareholders' equity**

	Share capital	Share premium	Capital reserve from transactions with former controlling shareholder	Capital reserve in respect of share-based payment	Capital reserve in respect of cash flow hedging	Accumulated deficit	Total
	\$ in thousands						
<b>The 6 months ended June 30, 2008 (unaudited):</b>							
Balance as of January 1, 2008	155,012	28,007	237,122	4,464	8,341	(114,102)	318,844
Gain from cash flow hedges recognized directly in equity	-	-	-	-	(1) 74,360	-	74,360
Loss for the period	-	-	-	-	-	(59,839)	(59,839)
<b>Total recognized revenues and expenses</b>	-	-	-	-	74,360	(59,839)	14,521
Benefit value of employee stock option program	-	-	-	596	-	-	596
Adjustments for dividends distributed	-	-	-	-	-	(45)	(45)
	-	-	-	596	-	(45)	551
<b>Balance as of June 30, 2008</b>	<u>155,012</u>	<u>28,007</u>	<u>237,122</u>	<u>5,060</u>	<u>82,701</u>	<u>(173,986)</u>	<u>333,916</u>

**The 6 months ended June 30, 2007 (unaudited):**

Balance as of January 1, 2007	131,536	904	218,498	2,582	4,149	(146,607)	211,062
Gain from cash flow hedges recognized directly in equity	-	-	-	-	(2) 1,227	-	1,227
Net income for period	-	-	-	-	-	9,377	9,377
<b>Total recognized revenues and expenses</b>	-	-	-	-	1,227	9,377	10,604
Benefit value of employee stock option program	-	-	-	931	-	-	931
Receipts on account of Government of Israel debt	-	-	11,062	-	-	-	11,062
Exercise of option warrants into shares	23,476	27,103	-	-	-	-	50,579
	23,476	27,103	11,062	931	-	-	62,572
<b>Balance as of June 30, 2007</b>	<u>155,012</u>	<u>28,007</u>	<u>229,560</u>	<u>3,513</u>	<u>5,376</u>	<u>(137,230)</u>	<u>284,238</u>

(1) Net of tax impact amounting to \$26,709 thousand.

(2) Net of tax impact amounting to \$409 thousand.

The notes to the interim financial statements are an integral part thereof.

**EL AL Israel Airlines Ltd.****Condensed interim statement of changes to shareholders' equity**

	Share capital	Share premium	Capital reserve from transactions with former controlling shareholder	Capital reserve in respect of share-based payment	Capital reserve in respect of cash flow hedging	Accumulated deficit	Total
	\$ in thousands						
<b>The 3 months ended June 30, 2008 (unaudited):</b>							
Balance as of April 1, 2008	155,012	28,007	237,122	4,736	13,577	(162,747)	275,707
Gain from cash flow hedges recognized directly in equity	-	-	-	-	(1) 69,124	-	69,124
Loss for the period	-	-	-	-	-	(11,239)	(11,239)
<b>Total recognized revenues and expenses</b>	-	-	-	-	69,124	(11,239)	57,885
Benefit value of employee stock option program	-	-	-	324	-	-	324
<b>Balance as of June 30, 2008</b>	<u>155,012</u>	<u>28,007</u>	<u>237,122</u>	<u>5,060</u>	<u>82,701</u>	<u>(173,986)</u>	<u>333,916</u>
<b>The 3 months ended June 30, 2007 (unaudited):</b>							
Balance as of April 1, 2007	131,681	1,140	218,498	3,104	3,932	(153,829)	204,526
Gain from cash flow hedges recognized directly in equity	-	-	-	-	(2) 1,444	-	1,444
Net income for period	-	-	-	-	-	16,599	16,599
<b>Total recognized revenues and expenses</b>	-	-	-	-	1,444	16,599	18,043
Benefit value of employee stock option program	-	-	-	409	-	-	409
Receipts on account of Government of Israel debt	-	-	11,062	-	-	-	11,062
Exercise of option warrants into shares	23,331	26,867	-	-	-	-	50,198
	<u>23,331</u>	<u>26,867</u>	<u>11,062</u>	<u>409</u>	<u>-</u>	<u>-</u>	<u>61,669</u>
<b>Balance as of June 30, 2007</b>	<u>155,012</u>	<u>28,007</u>	<u>229,560</u>	<u>3,513</u>	<u>5,376</u>	<u>(137,230)</u>	<u>284,238</u>

(1) Net of tax impact amounting to \$24,743 thousand.

(2) Net of tax impact amounting to \$481 thousand.

The notes to the interim financial statements are an integral part thereof.

**EL AL Israel Airlines Ltd.****Condensed interim statement of changes to shareholders' equity**

	Share capital	Share premium	Capital reserve from transactions with former controlling shareholder	Capital reserve in respect of share-based payment	Capital reserve in respect of cash flow hedging	Accumulated deficit	Total
	\$ in thousands						
<b>For the year ended December 31, 2007 (audited)</b>							
Balance as of January 1, 2007	131,536	904	218,498	2,582	4,149	(146,607)	211,062
Gain from cash flow hedges recognized directly in equity	-	-	-	-	(1) 4,192	-	4,192
Net income for the year	-	-	-	-	-	44,826	44,826
<b>Total recognized revenues and expenses</b>	-	-	-	-	4,192	44,826	49,018
Receipts on account of Government of Israel debt	-	-	18,624	-	-	-	18,624
Exercise of option warrants into shares	23,476	27,103	-	-	-	-	50,579
Benefit value of employee stock option program	-	-	-	1,882	-	-	1,882
Dividends distributed	-	-	-	-	-	(9,313)	(9,313)
Dividends declared	-	-	-	-	-	(3,008)	(3,008)
	23,476	27,103	18,624	1,882	-	(12,321)	58,764
<b>Balance as of December 31, 2007</b>	<u>155,012</u>	<u>28,007</u>	<u>237,122</u>	<u>4,464</u>	<u>8,341</u>	<u>(114,102)</u>	<u>318,844</u>

(1) Net of tax impact amounting to \$1,090 thousand.

The notes to the interim financial statements are an integral part thereof.

**EL AL Israel Airlines Ltd.****Summary interim consolidated cash flow statement**

	For the 6-month period ended June 30		For the 3-month period ended June 30		For the year ended December 31
	2008	2007	2008	2007	2007
	Unaudited		Unaudited		Audited
	<b>USD in thousands</b>				
<b>Cash flows from continuing operations</b>					
Income (loss) for the period	(59,839)	9,377	(11,239)	16,599	44,826
Appendix A - Adjustments required for presentation of cash flow from current operations	169,036	117,133	79,279	77,867	210,704
	109,197	126,510	68,040	94,466	255,530
Deposit of proceeds from option warrant exercise in reserve for severance pay, for coverage of past liabilities	-	(22,512)	-	(22,323)	(24,376)
<b>Net cash from current operations</b>	<b>109,197</b>	<b>103,998</b>	<b>68,040</b>	<b>72,143</b>	<b>231,154</b>
<b>Cash flow used for investment operations</b>					
Acquisition of fixed assets (including general engine overhauls and payment on account of aircraft)	(63,739)	(37,484)	(44,405)	(16,281)	(248,558)
Proceeds from realized fixed assets	423	197	264	81	504
Investment in intangible assets	(2,744)	(88)	(1,493)	(88)	(644)
Increase in short-term deposits, net	(15,062)	(68,446)	(80,065)	(55,128)	(175,951)
Investment in deposits – service providers	-	(58)	-	(32)	(131)
Repayment of deposits – service providers	-	-	-	-	245
Investment in long-term deposits	(135)	(206)	(103)	(72)	(398)
Realized long-term deposits	134	129	71	62	225
Dividends received, net of share of affiliates' income	-	-	-	-	12
Repayment of investment in fixed assets	-	3,843	-	3,843	3,843
<b>Net cash used in investment operations</b>	<b>(81,123)</b>	<b>(102,113)</b>	<b>(125,731)</b>	<b>(67,615)</b>	<b>(420,853)</b>
<b>Cash flow used in investment operations</b>					
Proceeds from exercise of option warrants into shares	-	31,820	-	31,624	31,820
Long-term loans received from financial institutions	-	-	-	-	219,420
Long-term loans repaid to financial institutions	(22,347)	(18,846)	(13,842)	(12,972)	(101,267)
Other long-term loans received	-	-	-	-	98
Other long-term loans repaid	(200)	(1,234)	(91)	(620)	(2,309)
Payment in respect of loan-related expenses	-	-	-	-	(7,570)
Increase (decrease) in short-term credit, net	405	(836)	946	(698)	(668)
Dividends paid	(3,053)	-	-	-	(9,313)
<b>Net cash from (used in) financing operations</b>	<b>(25,195)</b>	<b>10,904</b>	<b>(12,987)</b>	<b>17,334</b>	<b>130,211</b>
<b>Increase (decrease) in cash and cash equivalents, net</b>	<b>2,879</b>	<b>12,789</b>	<b>(70,678)</b>	<b>21,862</b>	<b>(59,488)</b>
<b>Cash and cash equivalents balance at start of period</b>	<b>86,670</b>	<b>146,158</b>	<b>160,227</b>	<b>137,085</b>	<b>146,158</b>
<b>Cash and cash equivalents balance at end of period</b>	<b>89,549</b>	<b>158,947</b>	<b>89,549</b>	<b>158,947</b>	<b>86,670</b>

The notes to the interim financial statements are an integral part thereof.

**EL AL Israel Airlines Ltd.****Condensed interim consolidated cash flow statement**

	For the 6-month period ended June 30		For the 3-month period ended June 30		For the year ended December 31
	2008	2007	2008	2007	2007
	Unaudited		Unaudited		Audited
	USD in thousands				
<b><u>Appendix A - Adjustments required for presentation of cash flows from regular operations</u></b>					
<b><u>Revenues and expenses not involving cash flow:</u></b>					
Depreciation and amortization (including disposal of accessories, disused components and consumables used)	64,265	66,164	33,005	32,174	135,777
Adjustment of value of long-term deposits	(368)	18	(161)	41	(198)
Share of income of affiliated companies	(98)	(91)	(42)	(47)	-
Deferred taxes	(13,383)	3,381	(3,715)	6,006	13,877
Increase (decrease) in liabilities in respect of employee benefits and in provisions	19,608	(4,639)	(12,145)	(6,863)	22,347
Net capital loss (gain) from realized fixed assets	(327)	1,563	(219)	(58)	1,440
Adjustment of value of other long- term loans	(8)	(4)	(5)	2	(20)
Benefit value of employee stock option program	596	931	324	409	1,882
Loss (gain) from adjustment of fair value of derivatives recognized in income statement	(260)	(14,489)	(1,057)	(1,570)	(19,867)
<b><u>Changes in asset and liability items:</u></b>					
(Increase) decrease in trade receivables	(30,559)	(57,003)	16,065	(22,503)	(11,073)
Decrease increase in other accounts receivable	(3,534)	(3,398)	(2,485)	(1,331)	2,100
Increase in prepaid expenses	(8,823)	(12,574)	(2,034)	(5,660)	(6,617)
(Increase) decrease in inventory	(794)	(2,141)	1,000	(404)	1,209
Increase in trade payables	26,263	16,258	15,712	12,305	22,430
Increase in other accounts payable	17,572	14,783	6,153	6,175	1,011
Increase in unearned revenues	98,886	108,374	28,883	59,191	46,406
	<u>169,036</u>	<u>117,133</u>	<u>79,279</u>	<u>77,867</u>	<u>210,704</u>

**Appendix B – Non-cash  
transactions**

Government of Israel deposit to reserve for employee severance pay	-	11,062	-	11,062	18,624
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Free Translation of the Hebrew Language Financial Report - **Hebrew Wording Binding**

Dividends declared and paid subsequent to the balance sheet date	-	-	-	-	(3,008)
Exercise of option warrants presented as liability	-	18,759	-	18,574	18,759

**Appendix C – Cash payment of interest and taxes**

Interest payments	15,683	14,382	7,970	6,360	48,657
Interest receipts	(13,458)	(6,857)	(8,650)	(3,978)	(21,211)
Tax payments – advances in respect of extraneous expenses	77	40	43	26	244
Dividend receipts	-	-	-	-	345

The notes to the interim financial statements are an integral part thereof.

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 1 - Significant accounting policies**

**a. Definitions**

<b>The Company -</b>	EL AL Israel Airlines Ltd.
<b>The Group -</b>	The Company and its investee companies.
<b>Related parties -</b>	As defined in IAS 24.
<b>Interested parties -</b>	As defined in Securities Regulations (Compilation of Annual Financial Statements), 1993.
<b>Controlling shareholders -</b>	As defined in the Securities Law, 1968 and regulations thereof.
<b>CPI</b>	- The Consumer Price Index, as published by the Central Bureau of Statistics.
<b>USD</b>	- US Dollar.
<b>Consolidated companies -</b>	Companies in which the Company has control (as defined in IAS 27), directly or indirectly, whose financial statements are wholly consolidated with the Company's financial statements.
<b>Affiliated companies -</b>	Companies in which the Company has material influence, and the Company's investment in which, directly or indirectly, is included in the financial statements based on the equity method.
<b>Investee companies -</b>	Consolidated and affiliated companies.
<b>Other company -</b>	A company owned by the Company in which the latter has no control or material influence.

**b. Implementation of International financial reporting standards (IFRS)**

- (1) Statement regarding implementation of International financial reporting standards (IFRS)  
The Group's condensed interim consolidated financial statements (hereinafter: "interim statements") have been compiled in accordance with International Financial Reporting Standards (IFRS) and clarifications there to issued by the International Accounting Standards Board (IASB), as required for compilation of interim financial statements in accordance with IAS 34 "Interim financial reporting" (hereinafter: "IAS 34"). The significant accounting policies listed below have been consistently applied for all reported periods presented in these condensed interim consolidated financial statements, as well as for compiling the opening balance sheet in accordance with IFRS, as set forth in section 2 below.
- (2) Initial adoption of IFRS  
In accordance with provisions of Accounting Standard no. 29 "Adoption of IFRS" by the Israeli Accounting Standards Board (hereinafter: "Standard 29"), starting on January 1, 2008, the Group applied IFRS and clarifications there to issued by the International Accounting Standards Board (IASB).

Therefore, these interim financial statements as of June 30, 2008 and for the 6-month and 3-month periods then ended, are compiled in accordance with IFRS and clarifications there to issued by the International Accounting Standards Board (IASB), as required for compiling condensed interim financial statements in accordance with IAS 34.

In these financial statements, the Company has applied provisions of IFRS 1 "Initial adoption of IFRS" (hereinafter: "IFRS 1"), which stipulate transition provisions for initial reporting in accordance with IFRS. In accordance with provisions of IFRS 1, the Group's transition date to IFRS-based reporting, as defined in IFRS 1, is January 1, 2007 (hereinafter: "the transition date"), and the balance sheet as of said date is the opening balance sheet in accordance with IFRS (hereinafter: "the opening balance sheet").

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 1 - Significant accounting policies (continued)**

**b. Implementation of International financial reporting standards (IFRS) (continued)**

**(2) Initial adoption of IFRS (continued)**

In these interim financial statements, the Company has applied retroactively to all reported periods presented those IFRS standards issued by the compilation date of the interim consolidated financial statements, or which are expected to become effective y December 31, 2008. For easements elected by the Group in applying the transition provisions in accordance with IFRS 1 – see Note 9g below.

Prior to adopting IFRS, the Group compiled its financial statements in accordance with generally accepted accounting principles in Israel ("Israeli GAAP"). The Company's latest annual financial statements in accordance with generally accepted accounting practices in Israel have been compiled as of December 31, 2007 and for the year then ended. The comparison figures for this period were re-stated in these financial statements in accordance with IFRS.

See Note 9 for material differences between IFRS-based reporting and Israeli GAAP-based reporting, in as much as these apply to the Group.

**(3)** These interim financial statements are compiled in accordance with provisions of Chapter 4 of the Securities Regulations (Periodic and immediate reports), 1970 – with the exception of regulations which prohibit application of IFRS or of provisions allowed in accordance there with.

**(4)** These condensed interim financial statements should be perused in conjunction with the Company's annual financial statements as of December 31, 2007 and for the year then ended, including their accompanying Notes, in as much as data included therein is not in contrast to financial statements which would have been included in accordance with IFRS.

**c. Basis of preparation**

These financial statements have been prepared on the historical cost basis except for the following:

- The following assets and liabilities, which are measured at fair value: financial instruments measured at fair value, derivative financial instruments.
- Non-current assets held for sale, presented at their carrying amount or at their fair value net of selling costs, whichever is lower.
- Inventory, presented at its cost or net realization value, whichever is lower.
- Fixed assets and intangible assets, presented at cost net of accumulated depreciation and amortization or at its recoverable amount, whichever is lower.
- Liabilities in respect of employee benefits, as set forth in Note 1v.

**d. Foreign Currency**

**(1) Functional and presentation currency**

The financial statements of each Group company are compiled in the currency of the major economic environment in which it operates (hereinafter: "the functional currency"). For the purpose of financial statement consolidation, the financial standing and results of each Group company are presented in USD, which is the Company's functional currency. The Company's consolidated financial statements are presented in USD. For exchange rates and changes thereto during the periods presented, see Note 1x.

**EL AL Israel Airlines Ltd.**

**Notes to condensed consolidated financial statements**

An appendix to the financial statements provides a translation of the financial statements into NIS, as per provisions of IAS 21.

**(2) Translation of transactions in currencies other than the functional currency**

When compiling the financial statements of each Group company, transactions executed in currencies other than said company's functional currency (hereinafter: "foreign currency") are recorded at the exchange rates effective as of the transaction date. Upon each balance sheet date, monetary items denominated in foreign currency are translated using the exchange rate effective as of that date; non-monetary items measured at fair value and denominated in foreign currency are translated using the exchange rate effective as of the date on which fair value is determined; non-monetary items measured at historical cost are translated using the exchange rate effective as of the date of the transaction involving the non-monetary item.

**(3) Recognition of exchange rate differentials**

Exchange rate differentials are recognized in the income statement in the period in which they were generated.

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 1 - Significant accounting policies (continued)**

**e. Consolidated financial statements**

The Group consolidated financial statements include the financial statements of the Company and of entities directly or indirectly controlled by the Company. Control exists whenever the Company has the power to direct the financial and operational policies of an investee company in order to derive benefits from its operations.

For the sake of consolidation, all inter-company transactions, balances, revenues and expenses are fully eliminated.

**f. Investments in affiliated companies**

An affiliated company is an entity in which the Group has material influence and which is not a consolidated company. Material influence is the power to participate in decision making with regard to financial and operational policies of the affiliated company, which does not constitute control or joint-control of said policies.

Results, assets and liabilities of affiliated companies are included in the Company's consolidated financial statements based on the equity accounting method.

Gain or loss generated from transactions between the Company or a consolidated company and an affiliated company of the Group are eliminated based on the Group's share of rights in said affiliated company.

**g. Cash and cash equivalents**

Cash and cash equivalents include bank deposits available for immediate withdrawal as well as limited term deposits whose use is unrestricted and whose term to maturity, at the time of investment, is up to three months.

**h. Inventory**

Inventory is presented at the lower of its cost and net realization value. The cost of inventory includes all purchasing cost and other cost incurred in getting the inventory to its current location and status.

Cost is determined using the weighted moving average method.

**i. Fixed assets**

Fixed assets are tangible items held for use in providing services or for leasing to others which are expected to be used for more than one period.

The Company presents its fixed asset items using the cost model as follows:

Fixed asset items are presented in the balance sheet at cost, net of accumulated amortization and net of accumulated impairment, if any. The cost included the acquisition cost of the asset, as well as cost which is directly attributable to getting the asset to the location and state required for its operation in the manner intended by management. The cost of qualifying assets also includes credit cost to be capitalized.

**EL AL Israel Airlines Ltd.**

**Notes to condensed consolidated financial statements**

Fixed assets are amortized separately for each component of depreciable fixed asset item having a significant cost relative to the total item cost. Amortization is calculated systematically, using the straight line method over the expected useful life of the item components, starting on the date on which the asset is ready for its intended use, accounting for the expected residual value at the end of its useful life.

The following are depreciation rates for Company aircraft relative to cost (after deduction of residual value):

<b><u>Aircraft</u></b>	<b><u>Annual depreciation rate</u></b>
777	4.8%
747-400	5.7%
747-200	4.7%
767	8.0%
757	4.8%
737	4.2%

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 1 - Significant accounting policies (continued)**

**i. Fixed Assets (continued)**

The cost of overhauling aircraft engines is recognized as an asset on the balance sheet, amortized over the period of economic benefit expected from said overhaul (based on estimated number of engine hours).

The residual value, amortization method and useful life of the asset are reviewed by Company management at the end of each fiscal year. Changes are treated as changes to estimates by means of "hence forward".

Assets under a financial lease are amortized over their expected useful life on equivalent basis of owned assets, or over the lease term if it is shorter.

For application of IAS 36 "Impairment of assets" – see Note 1k below.

Gain or loss generated from sale or obsolescence of an asset is determined by the difference between proceeds from its sale and its carrying amount, and are recognized in the income statement.

The cost of accessories and spare parts included with fixed assets is determined using the weighted moving average method.

Accessories and spare parts attributed to a specific fleet are amortized over the average remaining life time of said fleet. Accessories and spare parts not attributed to a specific fleet are amortized at a fixed annual rate.

Accessories and spare parts with no movement or slow movement are included at depreciated values according to management estimate.

**j. Intangible assets**

Rights to use of security equipment are included at their cost to the Company, and are amortized using the straight line method based on the anticipated period of economic use, subject to impairment review. The lifetime estimate and amortization method are reviewed at the end of each reporting year, with the impact of changes to the estimate treated on hence-forward basis.

Software is included at its cost to the Company and is amortized using the straight line method based on its expected period of economic use.

**k. Impairment of tangible and intangible assets**

Upon each balance sheet date, the Group reviews the book value of its tangible and intangible assets in order to determine if there are any indications of impairment of said assets. If any such indications exist, the asset's recoverable amount is estimated in order to determine the impairment loss, if any. If the recoverable amount for a single asset cannot be estimated, the Group estimates the recoverable amount of the cash-producing unit to which the asset belongs.

The recoverable amount is the higher of the asset sale price less cost of sale and its use value. When estimating the use value, future cash flows are discounted to their present value using a pre-tax discount rate which reflects the current market estimates for time value of money and for asset-specific risks for which the future cash flow estimate has not been adjusted.

**EL AL Israel Airlines Ltd.**

**Notes to condensed consolidated financial statements**

If the recoverable amount for an asset (or for a cash-generating unit) is estimated to be lower than its carrying amount, the carrying amount of the asset (or of the cash-generating unit) is depreciated down to its recoverable amount. Impairment loss is immediately recognized as an expense in the income statement.

Company management believes that recoverable amounts for aircraft should be reviewed relative to their amortized cost after grouping aircraft fleets, and that it is incorrect to review the recoverable amount of each aircraft individually relative to its amortized cost.

The Company, having grouped the aircraft fleets as set forth above, has determined that for each aircraft group, the recoverable amount exceeds the amortized cost of said aircraft group upon that date. Therefore, no provision for impairment of aircraft was made in these financial statements.

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 1 - Significant accounting policies (continued)**

**I. Financial assets**

**(1) General**

Financial assets are recognized in the Group balance sheet when the Group becomes party to contractual terms of said instrument.

Investment in financial assets is initially recognized at cost, including transaction cost, except for financial assets recognized at fair value in the income statement, whose additional acquisition cost is recognized in the income statement.

The Group's financial assets are categorized as follows. This categorization depends on the nature and objective of the financial asset and is determined upon initial recognition of said financial assets:

- Financial assets measured at fair value in the income statement
- Loans and accounts receivable.

**(2) Financial assets measured at fair value in the income statement**

Financial assets are classified as "financial assets measured at fair value in the income statement" when such assets are held for trading or when they are designated as financial assets measured at fair value in the income statement.

A financial asset is classified as held for trading if it is a derivative not designated nor effective as a hedging instrument.

The Group's financial assets under this category include derivative instruments not intended for use as hedging instruments, or which are not effective as such. These derivatives include certain derivatives based on the price of jet fuel, on interest rates and on exchange rates which are not designated as hedging instruments.

Financial assets measured at fair value in the income statement are presented at fair value. Any gain or loss due to change in fair value, including due to exchange rates, are recognized in the income statement in the period in which the change has occurred.

**(3) Loans and accounts receivable**

The Group's financial assets in this category include trade receivables, deposits and other accounts receivable at fixed or fixable installments which have no quote on an active market. Loans and accounts receivable are measured at amortized cost using the effective interest method, net of any impairment. Interest revenues are recognized using the effective interest method, except for short-term trade receivables and other accounts receivable – when interest amounts to be recognized in respect there of are not material.

**(4) Impairment of financial assets**

Financial assets, except for those classified as financial assets measured at fair value in the income statement, are reviewed for indications of impairment upon each balance sheet date. Such impairment occurs when there is objective evidence that expected future cash flow from investment in such asset has been negatively impacted due to one or more events which have occurred subsequent to initial recognition of the financial asset.

**EL AL Israel Airlines Ltd.**

**Notes to condensed consolidated financial statements**

Indications of impairment may include:

- Significant financial challenges to debtor;
- Failure to make current principal or interest payments;
- Expectation that the debtor would become bankrupt or would re-structure their debt.

For financial assets presented at amortized cost, impairment equal to the difference between the financial asset's carrying amount and the present value of future cash flow expected there from, discounted using its original effective interest rate, is recognized.

If in a subsequent period, the loss due to impairment of a financial asset decreases, and said decrease is objectively related to an event occurring after recognition of impairment, then the impairment loss previously recognized is reversed, in whole or in part, in the income statement. Such reversal is limited in amount, so that the carrying amount of investment in the asset upon reversal of impairment loss would not exceed the amortized cost of the asset as of that date - had no impairment been previously recognized.

As for trade receivables, their carrying amount is decreased, if necessary, using a provision for doubtful debt. The provision is specifically calculated. When trade receivables are not collectable, they are written off against the provision account. Collection, in subsequent periods, of amounts previously written off are credited against the provision account. Changes in carrying amount of the provision account are recognized in the income statement.

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 1 - Significant accounting policies (continued)**

**m. Financial liabilities and equity instruments issued by the Group**

**(1) Classification as financial liability or equity instrument**

Non-derivative financial instruments are classified as a financial liability or as an equity instrument, based on the nature of their underlying contractual terms.

An equity instrument is any contract indicating a residual right to Group assets, after deduction of all Group liabilities. Equity instruments issued by the Company are stated at their issuance proceeds net of expenses directly related to issuance of said instruments.

Group financial liabilities are stated and measured based on the following classification:

- Financial liabilities measured at fair value in the income statement.
- Other financial liabilities.

**(2) Option warrants for purchase of Company shares**

Proceeds from issuance of option warrants for purchase of Company shares, which confer upon their owners the right to purchase a set number of ordinary shares in return for a variable cash amount, are stated under current liabilities and are classified as liabilities measured at fair value in the income statement. As the Company has issued option warrants whose exercise price is not denominated in its functional currency (the exercise price is NIS-denominated and linked to the Consumer Price Index), the exercise price is deemed to be a variable amount.

**(3) Financial liabilities measured at fair value in the income statement**

Group financial liabilities in this category include certain interest rate and exchange rate derivatives not designated as hedging instruments, as well as option warrants for purchase of Company shares, as set forth above.

Financial liabilities measured at fair value in the income statement are stated at fair value. Any gain or loss due to change in fair value is recognized in the income statement. Transaction costs are charged to the income statement upon initial recognition.

**(4) Other financial liabilities**

Other financial liabilities include credit and loans, trade receivables and other accounts receivable. Such liabilities are initially recognized at fair value, net of transaction costs. Subsequent to initial recognition, other financial liabilities are measured at amortized cost using the effective interest method.

**n. Derivative financial instruments and hedging accounting**

**(1) General**

The Company uses a range of derivative financial instruments to manage exposure to changes in price of jet fuel, interest rates and foreign currency exchange rates.

**EL AL Israel Airlines Ltd.**

**Notes to condensed consolidated financial statements**

Derivative financial instruments are initially recognized at their fair value upon the contracting date and at each subsequent balance sheet date. Changes to the fair value of derivative financial instruments are generally recognized in the income statement. The timing of recognition in the income statement of changes in fair value of derivative financial instruments designated as hedging, when such hedging is effective and meets all conditions for qualification as a hedging relationship, depends on the nature and type of hedging, as set forth below.

The balance sheet classification of derivative financial instruments is determined based on the contractual term of the derivative financial instruments. If the remaining contractual term of the derivative is longer than 12 months, the derivative is stated as a non-current item on the balance sheet; if the remaining term is shorter than 12 months, the derivative is classified as a current item.

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 1 - Significant accounting policies (continued)**

**n. Derivative financial instruments and hedging accounting (continued)**

**(2) Hedge accounting**

The Company applies cash hedge accounting, and to this end it has designated certain derivative financial instruments in respect of exposure to jet fuel prices and to interest rate changes.

In order to hedge jet fuel prices, the Company has entered into multiple transactions in respect of expected fuel purchases for terms of up to 2 years from the balance sheet date.

In order to reduce exposure to adjustable interest rates applicable to Company loans. To this end, the Company has entered into multiple contracts designated to fix interest rates. Interest hedging instruments used by the Company are aligned with repayment schedules of the loans they are designated to hedge in the related periods.

The hedging relationships are documented by the Company upon contracting the hedging transaction. This documentation identifies the hedging instrument, hedged item, hedged risk, hedging strategy applied as well as a review of the fit of this strategy to overall Group policy for each hedge type. Furthermore, starting on the start date of hedge relationship and throughout its term, the Company documents the degree to which the hedging instrument is effective in offsetting exposure to changes in cash flow due to the hedged risk for the hedged item.

The effective portion of changes in value of financial instruments designated as cash flow hedges is immediately recognized in equity under "Capital reserve in respect of cash flow hedging", and the non-effective portion is immediately recognized in the income statement.

Cash flow hedge accounting is discontinued when the hedging instrument expires, is sold or realized or when the hedging relationship no longer meets the minimum hedging conditions. Subsequent to discontinuation of hedge accounting, the amounts recognized in shareholders' equity are recognized in the income statement when the hedged item or the hedged anticipated transaction are recognized in the income statement.

**o. Revenue recognition base and commission attribution to agents**

- (1)** Revenues from sale of flight tickets are included as unearned revenues under current liabilities until the service is provided or up to 2 years from the sale date, whichever is earlier.

Air passenger revenues also include revenues where the service is provided by the Company, whereas flight tickets are sold by other airlines.

Furthermore, air passenger revenues also include revenues due to code share agreements with other airlines. In such cases, when the service is provided by the other airlines, whereas the sale is made by the Company - revenues are stated on net basis.

- (2)** Air cargo revenues are recognized in the income statement when the service is provided.

**EL AL Israel Airlines Ltd.**

**Notes to condensed consolidated financial statements**

- (3) Agent commissions referring to revenues not yet recognized are included in the financial statements under "pre-paid expenses", and will be recognized as selling expenses in the income statement concurrently with revenue recognition.
- (4) Interest revenues are accumulated periodically, accounting for the principal to be repaid and using the effective interest method.

**p. Engine maintenance and refurbishment expenses**

Maintenance and engine refurbishment expenses (which do not constitute an overhaul) as set forth above in Note 1i are recognized in the income statement upon actual execution of the engine maintenance or refurbishment work.

In cases where the Company has entered into agreements of an insurance nature, the Company records expenses as specified in the insurance agreements, and the cost of refurbishment is incurred by the insurer.

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 1 - Significant accounting policies (continued)**

**q. Expenses for securing Company services**

Company contribution to government expenses for securing company services are recognized in the income statement when incurred, based on the Company's share of said expenses.

**r. Leases**

**(1) General**

Lease agreements are classified as financial leases when terms of the contract transfer all material risk and rewards arising from ownership to the lessee. Other leases are classified as operational leases.

- (2)** Rental fee expenses in respect of operational leases (primarily aircraft leases) are recognized based on the straight line method over the lease term. In lease agreements where no leasing fee, or a reduced leasing fee, is paid at the start of the leasing period and where other benefits are obtained from the lessor, the Company recognizes expenses based on the straight line method over the lease term.

**s. Provisions**

**(1) General**

Provisions are recognized when the Group has a legal or implied obligation due to a past event, where use of reliably measurable economic resources is expected to discharge the said obligation.

The amount recognized as provision reflects management's best estimate of the amount to be required for settling the current obligation upon the balance sheet date, accounting for risk and uncertainty associated with said obligation. When the provision is measured using expected cash flows for settlement of the obligation, the carrying amount of the provision is the present value of expected cash flows. The interest rate used by the Company to discount a provision in respect of an inquiry by the US Antitrust Division (as set forth in Note 5b1) is 3.7%.

When the amount required to settle the current obligation, in whole or in part, is expected to be reimbursed by a third party, the Group recognized an asset, in respect of said reimbursement, up to the amount of the provision recognized, only when it is virtually certain that such indemnification would be received and when it may be reliably measured.

**(2) Liabilities in respect of frequent flyer programs**

The provision is calculated using the estimated effective cost to the Company arising from usage of benefits conferred under these programs, using the estimated likelihood of benefit utilization. The effective cost is based on estimated relative weight, according to management, of marginal expenses which the Company may incur, and of loss of alternative revenues due to rejection of paying passengers upon realization of the aforementioned benefits.

For publication of IFRIC 13, see Note 1y1c.

**(3) Lawsuits**

These financial statements include appropriate provisions with regard to lawsuits filed against Group companies which Group management believes would not be rejected or eliminated, although Group companies contest these claims.

**EL AL Israel Airlines Ltd.**

**Notes to condensed consolidated financial statements**

These lawsuits are treated in accordance with IAS 37. Pursuant to these provisions, provisions are included in respect of claims likely to materialize (probability higher than 50%), which Group management believes, based on advice of legal counsel, to be appropriate to the circumstances of each and every case.

**t. Share-based payments**

Share-based payments to employees, settled using Group equity instruments, are measured at fair value upon their grant date. The Company measures, upon the grant date, the fair value of equity instruments granted by using the Black & Scholes model. When the granted equity instruments do not vest until employees complete a specified period of service, the Company recognizes the share-based payment agreements in its financial statements over the vesting period against an increase in shareholders' equity, under "Capital reserve in respect of share-based payment". Upon each balance sheet date, the Company estimates the number of equity instruments expected to vest. Change in estimate relative to prior periods is recognized in the income statement over the remaining vesting period.

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 1 - Significant accounting policies (continued)**

**u. Taxes on revenue**

**(1) General**

Expenses (revenues) in respect of taxes on revenue include all current taxes, as well as total change in deferred tax balances, except for deferred taxes arising from transactions recognized in equity.

**(2) Current taxes**

Current tax expenses are calculated based on taxable revenue of the Company and consolidated companies during the reported period. The taxable revenue differs from income before taxes on revenue, due to inclusion or exclusion of revenue and expense items which are taxable or deductible in different reporting periods, or which are not taxable or deductible. Assets and liabilities in respect of current taxes were calculated based on the tax rates and taxation legislation enacted, or effectively enacted, by the balance sheet date.

**(3) Deferred taxes**

Group companies generate deferred taxes in respect of temporary differences between the value of assets and liabilities for tax purposes and their carrying amount in the financial statements. The deferred tax balances (assets or liabilities) are calculated using the tax rates expected upon their realization, based on the tax rates and taxation legislation enacted, or effectively enacted, by the balance sheet date. Deferred tax liabilities are usually recognized in respect of all temporary differences between the value of assets and liabilities for tax purposes and their carrying amount in the financial statements. Deferred tax assets are recognized in respect of all deductible temporary differences up to the amount for which taxable revenue is expected to allow for utilization of the deductible temporary difference.

In calculating deferred taxes, taxes which would apply in case of realization of investments in investees are not accounted for, since the Group intends to hold and develop said investments. In addition, the company did not account for deferred taxes for profit distribution in said companies, since dividends are tax exempt.

Deferred tax assets and liabilities are stated on offset basis, when an enforceable legal right exists to offset tax assets against tax liabilities, and when they refer to taxes on revenue imposed by the same tax authority, where the Group intends to settle the tax assets and liabilities on net basis. The Company and several consolidated companies are jointly assessed for taxes on revenue, therefore deferred tax assets and deferred tax liabilities of said companies are presented on offset basis.

**v. Employee benefits**

**(1) Post-employment benefits**

Post-employment benefits at the Group include: Pension, severance pay liability, adjustment pay to executives, redemption of sick pay and certain benefits to Company retirees. Some post-employment Company benefits are defined contribution plans and some – defined benefit plans. Expenses in respect of Company liability to deposit funds

**EL AL Israel Airlines Ltd.**

**Notes to condensed consolidated financial statements**

to a defined contribution plan are recognized in the income statement upon provision of employment services for which the Company is liable to make said deposit.

Expenses in respect of defined benefit plans are recognized in the income statement based on the projected unit credit method, using an actuarial estimation prepared upon each balance sheet date. The present value of Company obligations in respect of defined benefit plans is determined by discounting expected future cash flows expected from the plan using market yield of government bonds denominated in the currency in which plan benefits are to be paid, and having a term to maturity approximately equal to the expected plan settlement date.

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 1 - Significant accounting policies (continued)**

**v. Employee benefits (continued)**

**(1) Post-employment benefits (continued)**

Actuarial gain or loss in excess of 10% over the present value of the obligation in respect of a defined benefit plan and the fair value of plan assets as of the start of the period, whichever is higher, are amortized over the remaining average service duration expected for employees who participate in the plan.

Company liability in respect of a defined benefit plan, presented on the Company balance sheet, includes the present value of the liability in respect of defined benefit, plus actuarial gain (less actuarial loss) yet to be realized, net of the fair value of plan assets.

**(2) Other long-term employee benefits**

Other long-term employee benefits are benefits expected to be utilized or payable in a period over 12 months from the end of the period in which the service qualifying for the benefit was rendered.

Other employee benefits at the Company include part of the liability in respect of paid leave and the anniversary bonus. These benefits are recognized in the income statement using the Projected Unit Credit Method, using actuarial estimates prepared upon each balance sheet date. The present value of Company obligations in respect of these investments is determined by discounting expected future cash flows expected from the plan using market yield of government bonds denominated in the currency in which benefits are to be paid, and having a term to maturity approximately equal to their expected settlement date.

Actuarial gain and loss in respect of other long-time employee benefits are recognized in the income statement when generated.

**(3) Short-term employee benefits**

Short-term employee benefits are benefits expected to be utilized or payable in a period within 12 months from the end of the period in which the service qualifying for the benefit was rendered.

Short-term employee benefits at the Company include Company liability in respect of wages, bonuses and part of the liability in respect of paid leave. These benefits are recognized in the income statement when generated. The benefits are measured on a non-capitalized basis. The difference between the short-term benefits to which an employee is eligible and the amount paid for them is recognized as a liability.

**(4) Early retirement plans**

Company liability in respect of early retirement plans are recognized in the income statement when the Company is committed to a formal employment termination plan, including, at least, the site, position and estimated number of employees to be terminated, the benefits to which terminated employees are eligible and the date on which the plan would be executed. Furthermore, the time until implementation is complete should be such that material changes to the plan are unlikely. The benefit amount is determined using the discount rate for government bonds.

**EL AL Israel Airlines Ltd.**

**Notes to condensed consolidated financial statements**

**w. Earnings per share**

The Company calculates basic earnings per share, for income or loss attributed to holders of Company shares by dividing the income or loss attributed to holders of Company ordinary shares (the numerator) by the weighted average number of ordinary shares outstanding (the denominator) during the reported period.

In order to calculate diluted earnings per share, the Company adjusts the earnings or loss attributed to holders of ordinary shares, and the weighted average number of shares outstanding, for impact of all potentially dilutive shares.

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 1 - Significant accounting policies (continued)****x. Exchange rates and linkage basis**

- (1) Balances in foreign currency, or linked to foreign currency, are included in financial statements according to official exchange rate published by the Bank of Israel as of the date of the balance sheet.
- (2) Balances linked to the Consumer Price Index are presented using the most recent known CPI value upon the balance sheet date.
- (3) Below are data for USD exchange rates and CPI in Israel:

	As of June 30		As of December 31
	2008	2007	2007
CPI (in points)	195.62	186.7	191.2
USD/NIS exchange rate	3.352	4.249	3.846
USD/EUR exchange rate	0.634	0.744	0.680

**Change in %:**

	For the 6-month period ended June 30		For the 3-month period ended June 30		For the year ended December 31
	2008	2007	2008	2007	2007
Consumer Price Index	2.3	1.0	2.2	1.2	3.4
USD/NIS exchange rate	(12.8)	0.6	(5.7)	2.3	(9.0)
USD/EUR exchange rate	(6.8)	(2.0)	-	(0.9)	(10.4)

**y. New financial reporting standards and clarifications published**

- (1) Information regarding standards, standard revisions and clarifications published and which are not yet effective, which the Company has not adopted by means of early adoption, which may be applicable to the Group -

**(a) IAS 1 (Revised) – Presentation of Financial Statements**

The standard sets forth the presentation required in financial statements, and provides details of a general framework for the outline of a financial statement as well as the minimum content to be included in such statement. In the revision of this standards, changes were made to the current presentation format of financial statements, and presentation and disclosure requirements with regard to financial statements have been expanded, including presentation of an additional statement included in the financial statements, named "statement of comprehensive income", as well as the addition of a balance sheet as of the start of the earliest period presented in the financial statements in case of change in accounting policy by means of retroactive application, in cases of re-statement and in cases of re-classification.

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**Notes to condensed consolidated financial statements**

The standard will apply to reporting periods starting on January 01, 2009. The standard allows for early adoption.

At this time, Group management is unable to estimate the impact of application of this standard on its financial statements.

**(b) IFRS 8 - Operating Segments**

The standard, which supersedes IAS 14, sets forth how a corporation is to report information by segment in its annual financial statements. *Inter alia*, the standard stipulates that the company's segment reporting shall be based on information used by company management for evaluation of segment performance, and for making decisions with regard to resource allocation to the different operating segments. The standard would apply for annual reporting periods starting on January 01, 2009 with retroactive adjustment of comparison figures for prior reporting periods. The standard allows for early adoption.

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 1 - Significant accounting policies (continued)**

**y. New financial reporting standards and clarifications published (continued)**

- (1)** Information regarding standards, standard revisions and clarifications published and which are not yet effective, which the Company has not adopted by means of early adoption, which may be applicable to the Group – (continued)

**(c) IFRIC 13 – Customer Loyalty Programs**

This clarification stipulates that transaction for sale of flight tickets, wherein the company awards its customers with points in a frequent flyer club, which may be used in the future for flight tickets, shall be treated as multi-component transactions, and the payment received from the customer will be allocated to its different components based on the fair value of the credit award. The proceeds attributed to the award shall be recognized as revenue when the credit awards are cashed and the company is liable to provide the rewards.

Provisions of this clarification apply to annual reporting periods starting on January 01, 2009. Early adoption is possible.

At this Group management is unable to estimate the impact of implementation of this clarification on its financial standing and operating results.

**(d) Improvements to International Financial Reporting Standards 2008**

In May 2008, the IASB published a series of improvements to International Financial Reporting Standards.

These improvements include revisions to some of the standards, which modify the way different items are stated, recognized and measured in the financial statements. Furthermore, some terminology corrections were made which have a negligible impact, if any, on the financial statements.

Most of the revisions will become effective starting on annual reporting periods starting on January 01, 2009 or later, with optional early adoption. Most of the revisions would be applied by way of retroactive adjustment of comparison figures.

These revisions include several revisions which, under applicable circumstances, may impact the financial statements. The main such revisions are new or revised requirements with regard to:

- Revision of IFRS 5 "Non-current assets held for sale and discontinued operations" which stipulates that company assets and liabilities will be classified as held for sale when the parent company is committed to execute a plan to sell controlling rights to the company, even when it intends to maintain rights which do not confer control.

Company management estimates that application of this revision would have no impact on Group financial statements.

- Revision to IAS 28 "Investments in Associates", which stipulates that impairment of an investment in an associate will be treated as impairment of

**EL AL Israel Airlines Ltd.**

**Notes to condensed consolidated financial statements**

a single asset, and that the impairment amount may be reversed in subsequent periods.

This revision will apply to annual reporting periods starting on January 01, 2009. The revision allows for early adoption, including application of revisions referring to section 4 of IAS 32 "Financial Instruments: Presentation", to section 1 of IAS 31 "Interests in Joint Ventures" and to section 3 of IFRS 7 "Financial Instruments: Disclosures". This revision may be applied by means of "hence forward".

Company management estimates that application of this revision would have no impact on Group financial statements.

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**Note 1 - Significant accounting policies (continued)**

**y. New financial reporting standards and clarifications published (continued)**

- (1) Information regarding standards, standard revisions and clarifications published and which are not yet effective, which the Company has not adopted by means of early adoption, which may be applicable to the Group – (continued)

**(d) Improvements to International Financial Reporting Standards 2008 (continued)**

- Revision of IAS 38 "Intangible Assets", which stipulates that payments for advertising and sales promotion activities shall be recognized as an asset until the date on which the entity has access to goods purchased, or in case of services – the date said services are rendered.

This revision will apply to annual reporting periods starting on January 01, 2009. This revision will be applied retroactively. This revision allows for early adoption.

At this time, Group management is unable to estimate the impact of application of this revision on its financial statements.

- (e) In May 2008, the IASB published revisions to IFRS 1 and to IAS 27 "Consolidated Financial Statements".

In these revisions, a company initially adopting IFRS may use "deemed cost" for stating investment in investees in the company's solo financial statements upon the transition date to international standards. Furthermore, the requirement with regard to dividends received in respect of investment stated at cost has been modified, such that said dividends would always be recognized in the income statement.

The aforementioned revisions will become effective with annual financial statements for periods starting on January 01, 2009. Early adoption is possible.

The Company is reviewing potential implications of the aforementioned revisions.

- (2) Below are details of standards, revisions and clarifications published and which are not yet in effect, which may apply to the Group:

- (a) Revision to IFRIC 2 "Share-based Payments – Vesting Conditions and Cancellations".
- (b) IFRIC 15 "Agreements for Construction of Real Estate".
- (c) IFRIC 16 "Hedges of a Net Investment in a Foreign Operation".
- (d) IAS 23 (Revised) "Borrowing Costs".
- (e) IFRS 3 (Revised) "Business Combinations".

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**Notes to condensed consolidated financial statements**

**Note 2 - Key sources for estimates of uncertainties**

**a. General**

In applying Group accounting policy, as set forth in Note 1 above, company management is sometimes required to exercise considerable judgment with regard to estimates and assumptions about 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 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.

**b. Key sources for estimates of uncertainties**

**(1) Provisions for legal proceedings**

As of June 30, 2008, there are pending claims against the Company amounting to a total of \$370 million. In addition, there are claims not quantified in monetary terms. A provision was made in respect of some of these claims in the amount of \$24.6 million. (The aforementioned claim and provision amounts exclude tax assessments issued to the Company – see sub-section 3 below). In order to review of the legal validity of the aforementioned claims, as well as to determine the probability of their realization to the Company's detriment, Company management relies on the opinion of legal and professional counsel. After the Company's counsel have formed their legal opinion and the Company's probability with regard to the claim subject, whether the Company would have to bear its outcome or may postpone it, Company management estimates the amount to be included in the financial statements, if any. Interpretation by the Company of the current legal position which differs from that of its legal counsel, different understanding by Company management of contracts as well as changes due to applicable legislation or addition of new facts – all may impact the value of the overall provision for legal proceedings pending against the Company, thereby materially impacting its financial standing and operating results.

**(2) Taxes on income**

The company has tax assessments for which the tax consequences are uncertain. The Company recognized liabilities in respect of tax consequences of these transactions, based on Management estimates, which rely on professional counsel with regard to timing and amount of the tax liability which may arise there from. When the tax consequence of such transactions differs from Management estimates, tax expenses would differ upon determination of the final assessment.

**(3) Employee benefits**

The present value of the Company's severance pay liability, as well as that of a pension plan and other employee benefits, is based on multiple data determined based on actuarial estimate, using multiple assumptions, including with regard to discount rate. Changes in actuarial assumptions may impact the carrying amount of the Company's severance pay and pension liabilities. The Company estimates the discount rate annually, based on the discount rate for government bonds. Other key assumptions are made based on prevailing

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market conditions, as well as on the Company's past experience. For further details of assumptions made by the Company, see Note 1v.

**(4) Aircraft impairment**

As set forth in Note 1k above, for any aircraft fleet where indications of impairment exist, the Company estimates the recoverable amount for said fleet. The recoverable amount is the higher of the aircraft sale price and its use value. In estimating the use value, the Company estimates the future cash flows, discounting them to their present value using a discount rate which reflects current market estimates. In so doing, the Company has relied on forecasts related, *inter alia*, to expected scope of operations, prices of flight tickets and of bills of lading, operating cost and future interest rates. Material changes to these estimates, or part thereof, may impact the recoverable amount of said aircraft.

**(5) Liabilities in respect of frequent flyer clubs**

The provision for frequent flyer clubs is calculated using the estimated effective cost to the Company arising from usage of benefits conferred under these programs, using the estimated likelihood of benefit utilization. The effective cost is based on estimated relative weight, according to management, of marginal expenses which the Company may incur, and of loss of alternative revenues due to rejection of paying passengers upon realization of the aforementioned benefits.

**Note 3** - **Seasonality**

Passenger traffic at Ben Gurion airport is highly seasonal. Most of the activity is in the summer months, with the peak being in July-September. Winter months (January-March) show reduced passenger traffic.

**Note 4** - **Fixed assets**

- a. On March 16, 2008, the Company signed an agreement with Boeing Corp., whereby it would acquire from Boeing four new 777-200 ER aircraft.

These aircraft, to be equipped with Rolls Royce engines, are expected to join the Company's mid- and long-range passenger aircraft fleet, with a 279 seat configuration. These aircraft will be delivered to the Company in January 2012, April 2012, November 2012 and January 2013.

Total acquisition cost for the four aircraft, including spare parts and required installations to adapt them to Company needs, amounts to \$540 million.

According to the agreement with Boeing, payment for each aircraft would start only two years prior to its scheduled delivery date to the Company. Therefore, at this time the Company has yet to make a final decision with regard to financing of this transaction, and the Company is reviewing its options.

Pursuant to terms of this agreement, the Company was granted an option to convert the aforementioned acquisition into new 777-300 ER aircraft (to be equipped with General Electric engines), with a 348 seat configuration. The Company may exercise its option no later than December 31, 2008. Exercise of said option involves changes to terms of the agreement, but aircraft delivery dates would remain unchanged.

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Furthermore, the agreement grants the Company another option to acquire two additional such aircraft, to be delivered to the Company in 2014 and 2015, in accordance with terms set forth in the agreement.

On April 30, 2008, the Company Board of Directors approved the aforementioned agreement. During the reported period, the Company made down payments for the aforementioned aircraft amounting to \$10.6 million (of which \$9.6 million in Q2 of 2008). Furthermore, for the option to acquire two additional aircraft, the Company paid a further \$2 million in Q2.

The Company is reviewing its current fleet and the required adjustments there to in view of the aforementioned agreement, other agreements to acquire aircraft (as reported by the Company) and its "EL AL 2010" business strategy.

- b.** On April 10, 2008, the Company signed an agreement with a Spanish airline, whereby 3 new 737-800 aircraft would be acquired. The aircraft are expected to be delivered in 2009. Total investment for acquisition of these 3 aircraft, including expected cost for putting them into service for the Company, is estimated at \$145 million. Self-financing is expected to amount to 15% of aircraft cost, with the balance financed by loans.

The aforementioned acquisition is in line with the Company's business strategy to gradually renew its aircraft fleet, in accordance with principles of the "EL AL 2010" strategic plan.

In the reported period, the Company paid \$15 million on account of these three aircraft (of which \$12 million in Q2 of 2008).

Subsequent to the balance sheet date, the Company paid an additional \$2 million on account of said aircraft.

- c.** On January 10, 2008, the Company signed an agreement to acquire a 747-400 passenger aircraft. The aircraft was manufactured in 1994, and will be delivered to the Company no later than December 2008.

The proceeds payable by the Company for said acquisition and for the cost of putting it into service for the Company, including cost of additions and installations to be made in order to adapt the aircraft for Company requirements, amount to \$50 million. The proceeds for acquisition of this aircraft is payable upon delivery of the aircraft.

Self financing is expected to amount to \$14 million, with the balance financed by loans, in accordance with a long-term credit agreement with a foreign bank.

Acquisition of this aircraft is in line with the Company's "EL AL 2010" business strategy, whereby the Company continues to review its procurement needs.

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**Notes to condensed consolidated financial statements**

**Note 5** - **Legal Proceedings**

**a. Class action suits**

In previous years, two claims were filed against the Company and awarded class action status by Courts of Law:

- (1) In October 1998, a claim against the Company was filed with the Nazareth District Court, along with a motion for class action status, amounting to NIS 230.4 million (\$69 million as of the balance sheet date). The claim makes reference to allegations of over-charging for flight tickets by travel agents due, according to the plaintiff, to use of inappropriate exchange rates. In 2002, the Court granted class action status to this lawsuit, for causes arising from the Consumer Protection Act. The Company filed a motion to appeal to the Supreme Court. Company management believes, based on opinion of its legal counsel, that the Company is not expected to be liable for this lawsuit. No provision was made in these financial statements in respect of this claim.
- (2) In September 1000, a claim was filed with the Tel Aviv District Court against the Company, against the Airport Authority and against Ophir Tours (a travel agency), along with a motion for class action status, amounting to NIS 21.7 million (\$6 million as of the balance sheet date). The plaintiff claims that the travel agent charged it with a passenger fee using an exchange rate higher than legally allowed for this purpose, which is the representative exchange rate, and that the Company is also liable for deeds of travel agents on this matter. In 2002, the Court granted class action status to this claim with regard to violation of a statutory obligation, based on Regulation 20 of the Civil Law Proceeding Regulations. The Company filed a motion to appeal to the Supreme Court.

In October 2005, a verdict was handed down with regard to ESHET, wherein the Supreme Court determined that class action suits are only possible by virtue of specific legislation providing for such an option, and that class action suits may not be filed for causes based on general statute by using Regulation 29 of the Civil Law Proceeding Regulations.

Consequently, the parties were required to file with the Court their position with regard to continued proceedings. The plaintiff informed the Court that it wished to continue the proceedings for causes arising from the Consumer Protection Act, which have not been approved by the District Court.

For details of a compromise agreed to with regard to this claim subsequent to the balance sheet date – see Note 10a.

**b. Legal proceedings relating to overseas anti-trust proceedings**

- (1) In February 2006, the Antitrust Division of the US Department of Justice ("the Antitrust Division") launched an open inquiry, along with other antitrust authorities in other countries, into allegations of price fixing with regard to certain surcharges to prices of cargo air transportation. Several air cargo transporters have announced that they had received grand jury orders with regard to this inquiry. On September 27, 2006, the Company received from the Antitrust Division a grand jury order demanding information and documents with regard to pricing practices and certain surcharges related to cargo transportation, since early 1999 and through the date of said order. The Antitrust Division has informed the Company that it is under inquiry as a suspect. The Company is cooperating with the inquiry, while conducting internal review of its cargo pricing practices. At this time, the Company is unable to estimate the outcome of the Antitrust

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Division inquiry, nor estimate its potential monetary impact. However, note that implications may include administrative or civilian proceedings and/or a criminal indictment, including fines and/or civilian liability. Also note that punishment for breach of antitrust legislation may be severe, both in terms of criminal liability and civilian liability.

On May 25, 2008, the Company Board of Directors resolved to make a provision in the financial statements amounting to \$20 million (capitalized) in respect of the aforementioned Antitrust Division inquiry. This decision was made in view of a potential agreed resolution under review with the US Department of Justice, and it was made for the sake of caution, without constituting any admission of liability.

- (2) In December 2006, the Company received a letter from the European Commission's Directorate General for Competition ("the Directorate"), delivered to Company offices in Germany, demanding information related to an inquiry conducted by the Directorate. The letter indicates that the information requirement is in conjunction with an inquiry conducted by the Directorate with regard to activities which allegedly impact competition in air cargo transportation services, and that the Directorate has information regarding extensive communications among airlines and other entities with regard to various surcharges and other issues, such as cargo transportation tariffs.

In the letter, the Company was required to provide data and documents related to the Company and its cargo operations since 1995. The Company has provided its response as requested by the Directorate's letter, while conducting internal review of its cargo pricing practices. At this time, the Company is unable to estimate the outcome of the Directorate's inquiry, nor estimate its potential monetary impact on the Company; hence no provision was made in these financial statements with regard to the aforementioned inquiry.

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 5 - Legal proceedings (continued)**

**b. Legal proceedings relating to overseas anti-trust proceedings (continued)**

**(2) (Continued)**

According to publications by the Directorate and by several foreign companies, in December 2007 the Directorate sent a "letter of claims" to several airlines with regard to the aforementioned inquiry, including claims of alleged breach of competitive statutes of the European Union. To date, the Company has not received the aforementioned letter of claims, and to the best of its knowledge it is not among the companies to which the letter of claims was sent.

However, note that implications may include an administrative proceeding against the Company, including a substantial fine which may be imposed on the Company at the end of said proceeding.

**(3)** The aforementioned proceedings related to inquiries by antitrust authorities may materially impact the Company, due to fines which said authorities may impose – which could be significant.

**(4)** In late February 2007, the Company received a civilian claim filed with the New York Court of Law, with regard to prices of cargo air transportation services.

In the aforementioned claim, to which the Company is named as defendant along with 38 other airlines, which are alleged to have colluded in coordinating prices of cargo air transportation services since 2000, in violation of competitive and other statutes in Europe and in the USA.

The claim was filed on behalf of entities which purchase cargo air transportation services, directly or indirectly, in Europe and in the USA, and includes a motion for class action status. The claim includes demand of unspecified damages and other remedies.

The Company has joined a joint defense team along with other defendant airlines, which has filed several preliminary motions with the Court, including a motion to dismiss the claim.

Due to the preliminary stage of this proceeding, the Company is unable to estimate its implications or monetary impact on the Company; hence no provision in respect of this claim was made in these financial statement.

**c. Material legal proceedings added in the reported period**

**(1)** In May 29, 2008, the Company received at its head office a request to conduct an arbitration proceeding along with a claim letter (hereinafter: "the arbitration request") filed with the International Court of Arbitration of the International Chamber of Commerce in Paris by Sabre Inc. (a US-registered corporation) and by Sabre Marketing Nederland B.V. (a corporation registered in the Netherlands) with regard to the cooperation agreement signed by the Company and Sabre in 2001 (hereinafter: "the Agreement").

Pursuant to the agreement, a joint company (Sabre Israel Ltd.) was established by the Company and by Sabre Inc., engaged in providing flight reservation services and associated services.

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According to the agreement, legal proceedings concerning the agreement are to be conducted in accordance with ruled of the International Court of Arbitration to be heard by a single arbitrator in London, pursuant to essential laws of Israel.

In the claim letter, Sabre alleges that the Company is in breach of the agreement by replacing its previous reservation system with a new international reservation system. Remedies requested in the claim letter include enforcement of the agreement and provision of exclusive rights to marketing of the distribution system. Alternatively, monetary damages are claimed including, inter alia, damages amounting to \$36 million for breach of contract as well as \$67 million for impact to reputation.

Company management believes, based on legal counsel, that the aforementioned claim amount is significantly exaggerated. These financial statements include a provision in respect of this claim.

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**Notes to condensed consolidated financial statements**

**Note 5** - **Legal proceedings (continued)**

**c. Material legal proceedings added in the reported period (continued)**

- (2) A claim was filed with the Tel Aviv District Court by a passenger, who claims that her flight from Madrid to Tel Aviv was delayed to a strike at Ben Gurion airport, which she alleges the Company has failed to address, thereby causing her expenses, distress and loss of time.

The plaintiff has filed a motion for class action status, representing all affected passengers whose flights were delayed by the aforementioned strike, estimated by the plaintiff at 3,000 passengers. The plaintiff claims that the Company should be liable to pay each class member their actual expenses as well as non-monetary damages amounting to NIS 3.500.

Company management believes, based on opinion of its legal counsel, that the Company is not expected to be liable for this lawsuit. These financial statements do not include a provision in respect of this claim.

**Note 6** - **Taxes on revenue**

According to the Adjustment Act and to Income Tax Regulations (Rules for Accounting by Companies in Foreign Investment and Certain Partnerships and Determination of their Taxable Income), 1986 ("the USD regulations"), results for tax purposes of the Company and some of its subsidiaries are measured based on adjustment to the USD exchange rate.

The Company's major consolidated companies operating in Israel are subject to the Income Tax Act (Inflationary Adjustment), 1985 ("the Adjustment Act"), which stipulates measurement of results on a real basis, adjusted for changes in the Consumer Price Index.

On February 26, 2008, the Knesset enacted the Income Tax Act (Adjustments for inflation) (Amendment 20) (Restriction of applicability), 2008 ("the Amendment"), whereby the Inflationary Adjustment Act's applicability would cease in 2007 and provisions of the Act would no longer apply starting in 2008, other than transition provisions aimed at avoiding tax calculation distortions.

Pursuant to the amendment, in the 2008 tax year and later, revenues would no longer be adjusted for tax purposes to a real measuring base. Furthermore, fixed asset depreciation and carry-forward tax loss amounts would no longer be linked to the CPI, such that these amounts would be adjusted for the CPI at end of the 2007 tax year, and would no longer be linked to the CPI thereafter.

The USD regulations would continue to apply to the Company after discontinuation of the Adjustment Act.

**Note 7** - **Security expenses**

- a.** On January 27, 2008, the Israeli Government resolved as follows:

- (1) To increase the contribution by the State of Israel towards security expenses of Israeli airlines to 80% of total direct expenses in their current and future international routes (compared to the current 50% contribution).
- (2) To amend the decision by the Ministerial Committee on Social and Economic Issues, dated May 19, 2003, with regard to the Government of Israel policy with regard to scheduled airline routes. The previous decision stipulated that the Company would

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**Notes to condensed consolidated financial statements**

continue to be the Designated Carrier in all routes on which it was the designated carrier prior to publication of the Company's prospectus in 2003. The previous decision also included terms and considerations which allow the Minister of Transportation to revoke the Company's Designated Carrier status on a specific route, and/or to grant rights to another Israeli Designated Carrier on a specific route, and further stipulated that the policy would be reviewed if and when total air passenger traffic to Israel, both incoming and outgoing, would exceed 10.7 million passengers annually.

The Government resolution dated January 27, 2008 stipulated that the aforementioned guideline considerations would be cancelled, and in lieu, it stipulates that the Minister of Transportation, as part of his consideration of airline policy, and subject to his statutory rights, would consider granting rights to another Designated Carrier on scheduled airline routes, and would also consider revoking the Company's Designated Carrier status on a specific route.

The Company Board of Directors has resolved to accept the aforementioned Government decision, in view of the aforementioned increase in State contribution towards security expenses of Israeli airlines and based on the declaration included in the Government decision with regard to the trend of allowing Israeli airlines to compete, in as much as possible, under fair and equitable competition with foreign airlines – while recognizing the need for a robust Israeli airline industry.

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**Notes to condensed consolidated financial statements**

**Note 7 - Operating expenses (continued)**

- b. As of the date of approval of these financial statements, the Government has yet to confirm a budgetary source for funding of the aforementioned increase in contribution towards security expenses, hence it has yet to provide to the Company the additional contribution (30%) towards said expenses. In these financial statements, the additional contribution by the Government of Israel towards security expenses has not been accounted for.
- c. On May 27, 2008, the Company filed with the Supreme Court of Justice, a petition against the Government of Israel, the Minister of Finance, the Minister of Transportation and other respondents, due to the fact that the decision by the Government of Israel dated January 27, 2008 with regard to increased Government contribution towards the Company's security expenses, has yet to be executed.

**Note 8 - Operating segments**

Below is information by geographic segment, on consolidated basis:

	<u>North America</u>	<u>Europe</u>	<u>Asia-Pacific and Central Asia</u>	<u>Rest of the world</u>	<u>Total</u>
<u>USD in thousands</u>					
<b>For the 6-month period ended June 30, 2008 (unaudited):</b>					
Revenues -					
Segment revenues	<u>355,366</u>	<u>468,119</u>	<u>162,402</u>	<u>25,181</u>	1,011,068
Revenues not attributed to segments					17,420
Total revenues					<u>1,028,488</u>
Operating income -					
Segment operating income (loss)	<u>(2,831)</u>	<u>45,096</u>	<u>13,180</u>	<u>3,683</u>	59,128
Cross-segment expenses, net					(122,389)
Operating loss before financing					<u>(63,261)</u>
<b>For the 6-month period ended June 30, 2007 (unaudited):</b>					
Revenues -					
Segment revenues	<u>296,297</u>	<u>355,105</u>	<u>154,926</u>	<u>18,999</u>	825,327
Revenues not attributed to segments					16,114
Total revenues					<u>841,441</u>
Operating income -					
Segment operating income (loss)	<u>17,291</u>	<u>56,718</u>	<u>10,993</u>	<u>5,847</u>	90,849
Cross-segment expenses, net					(62,976)
Operating income before financing					<u>27,873</u>

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 8 - Operating segments (continued)**

Below is information by geographic segment, on consolidated basis:

	<u>North America</u>	<u>Europe</u>	<u>Asia-Pacific and Central Asia</u>	<u>Rest of the world</u>	<u>Total</u>
	<u>USD in thousands</u>				
<b>For the 3-month period ended June 30, 2008 (unaudited):</b>					
Revenues -					
Segment revenues	<u>197,469</u>	<u>265,751</u>	<u>71,525</u>	<u>12,701</u>	547,446
Revenues not attributed to segments					<u>9,576</u>
Total revenues					<u>557,022</u>
Operating income -					
Segment operating income (loss)	<u>(3,232)</u>	<u>29,277</u>	<u>4,986</u>	<u>1,768</u>	32,799
Cross-segment expenses, net					<u>(50,471)</u>
Operating loss before financing					<u>(17,672)</u>
<b>For the 3-month period ended June 30, 2007 (unaudited):</b>					
Revenues -					
Segment revenues	<u>166,819</u>	<u>194,715</u>	<u>76,077</u>	<u>9,162</u>	446,773
Revenues not attributed to segments					<u>6,034</u>
Total revenues					<u>452,807</u>
Operating income -					
Segment operating income (loss)	<u>17,196</u>	<u>37,570</u>	<u>2,896</u>	<u>2,965</u>	60,627
Cross-segment expenses, net					<u>(33,508)</u>
Operating income before financing					<u>27,119</u>
<b>For the year ended December 31, 2007 (audited)</b>					
Revenues -					
Segment revenues	<u>674,728</u>	<u>822,320</u>	<u>356,796</u>	<u>42,060</u>	1,895,904
Revenues not attributed to segments					<u>36,546</u>
Total revenues					<u>1,932,450</u>
Operating income -					
Segment operating income	<u>56,662</u>	<u>144,108</u>	<u>33,405</u>	<u>11,212</u>	245,387
Cross-segment expenses, net					<u>(150,714)</u>
Operating income before financing					<u>94,673</u>

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 9 - Financial information in accordance with International Financial Reporting Standards (IFRS)**

**a. Overview:**

Following the publication of Accounting Standard no. 29 "Adoption of International Financial Reporting Standards (IFRS)" in July 2006, the Company adopted IFRS standards starting on January 01, 2008.

In accordance with provisions of IFRS 1, concerning initial adoption of IFRS, and with the date selected by the Company for initial adoption of these standards, the first financial statements to be compiled by the Group in accordance with IFRS are the consolidated financial statements as of December 31, 2008 and for the year then ended. The Company's transition date to IFRS-based reporting, as defined in IFRS 1, is January 01, 2007 (hereinafter: "the transition date"), with the opening balance sheet being the one as of January 01, 2007 (hereinafter: "the opening balance sheet"). The Company's interim financial statements for 2008 are also compiled in accordance with IFRS, including their comparative figures.

Within the opening balance sheet, the Company acted as follows:

- Recognition of any asset or liability required to be recognized on the balance sheet under IFRS.
- Non-recognition of assets or liabilities which may not be recognized on the balance sheet under IFRS.
- Classification of asset, liability and shareholder equity items as per IFRS.
- Measuring all assets and liabilities recognized under IFRS.

IFRS 1 stipulates that application of IFRS in the opening balance sheet is to be retroactive. However, IFRS 1 sets forth several easements, for which no retroactive application is required. For the easements applied by the Company, see section (g) below.

Changes in accounting policy retroactively applied by the Company in the opening balance sheet in accordance with IFRS, compared to accounting policy based on Israeli generally accepted accounting practices have been directly recognized in retained earnings or in other items under the shareholders' equity group, as the case may be.

This Note has been compiled based on international accounting and financial reporting standards and clarifications there to as currently known, which have been published and will become effective or which may be adopted early on the Group's first annual reporting date in accordance with IFRS - December 31, 2008. As set forth in Note 1b2, Company management has made assumptions with regard to accounting policies expected to be applied when the first financial statements are compiled in accordance with IFRS for the year ending December 31, 2008.

IFRS standards which would be effective or which may be adopted in the financial statements for the year ending December 31, 2008 are subject to change and to further clarifications. Therefore, accounting policies applied for the reported periods would only be finally determined upon compiling the first financial statements based on IFRS, as of December 31, 2008.

Below are the consolidate balance sheets and consolidated shareholders' equity items as of January 01, 2007, June 30, 2007 and December 31, 2007 and the consolidated income statements for the 6-month and 3-month periods ended June 30, 2007 and for the year ended December 31, 2007 – compiled in accordance with IFRS. We also present the material adjustments required for transition from reporting in accordance with Israeli GAAP to reporting in accordance with IFRS.

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 9 - Financial information in accordance with International Financial Reporting Standards (IFRS)**  
**(continued)**

**b. Consolidated Balance Sheets**

**As of June 30, 2007**

	<u>Additional Information</u>	<u>Israeli Standards</u>	<u>Adjustme- nts</u>	<u>Classificati- ons</u>	<u>In accordance with IFRS</u>
<u>USD in thousands</u>					
<b><u>Current assets</u></b>					
Cash and cash equivalents		158,947	-	-	158,947
Short-term deposits		73,128	-	-	73,128
Trade receivables		189,547	-	-	189,547
Other accounts receivable	8	61,279	-	(33,526)	27,753
Derivative financial instruments	3	-	9,875	-	9,875
Deferred taxes	5	22,041	-	(22,041)	-
Prepaid expenses	8	-	-	31,053	31,053
Inventory		19,331	-	-	19,331
		<u>524,273</u>	<u>9,875</u>	<u>(24,514)</u>	<u>509,634</u>
<b><u>Non-current assets</u></b>					
Long-term deposits with banks		1,895	-	-	1,895
Investment in affiliated companies		2,371	-	-	2,371
Investment in other company		1,887	-	-	1,887
Derivative financial instruments	3	-	7,732	2,473	10,205
Fixed assets		1,144,268	-	(175)	1,144,093
Other intangible assets		3,364	-	175	3,539
		<u>1,153,785</u>	<u>7,732</u>	<u>2,473</u>	<u>1,163,990</u>
		<u>1,678,058</u>	<u>17,607</u>	<u>(22,041)</u>	<u>1,673,624</u>
<b><u>Current liabilities</u></b>					
Short-term credit and current maturities		101,873	-	-	101,873
Trade payables		161,248	-	-	161,248
Other accounts payable	4,8	457,730	-	(396,997)	60,733
Provisions	2,8	-	361	75,562	75,923
Derivative financial instruments	3	-	87	414	501
Liabilities in respect of employee benefits	1,8	-	(1,617)	70,302	68,685
Unearned revenues	8	-	-	250,719	250,719
		<u>720,851</u>	<u>(1,169)</u>	<u>-</u>	<u>719,682</u>
<b><u>Non-current liabilities</u></b>					
Loans from banking corporations		548,816	-	-	548,816
Liabilities in respect of employee benefits	1	85,283	(18,131)	-	67,152
Long-term loans from others		564	-	-	564
Deferred taxes	5	65,635	9,578	(22,041)	53,172
		<u>700,298</u>	<u>(8,553)</u>	<u>(22,041)</u>	<u>669,704</u>
<b><u>Shareholders' equity</u></b>					
		<u>256,909</u>	<u>27,329</u>	<u>-</u>	<u>284,238</u>
		<u>1,678,058</u>	<u>17,607</u>	<u>(22,041)</u>	<u>1,673,624</u>

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 9 - Financial information in accordance with International Financial Reporting Standards (IFRS) (continued)****b. Consolidated balance sheet (continued)**

		As of December 31, 2007				As of January 01, 2007				
		Additional Information	Israeli Standards	Adjustme- -nts	Classific- -ations	In accordance with IFRS	Israeli Standards	Adjustme- -nts	Classific- -ations	In accordance with IFRS
<b><u>Current assets</u></b>										
Cash and cash equivalents		86,670	-	-	86,670	146,158	-	-	146,158	
Short-term deposits		180,633	-	-	180,633	4,682	-	-	4,682	
Trade receivables		143,617	-	-	143,617	132,544	-	-	132,544	
Other accounts receivable	8	51,953	-	(29,699)	22,254	47,342	-	(21,382)	25,960	
Derivative financial instruments	3	-	21,881	3,649	25,530	-	5,810	-	5,810	
Deferred taxes	5	19,569	592	(20,161)	-	30,645	1,368	(32,013)	-	
Prepaid expenses	8	-	-	25,096	25,096	-	-	18,479	18,479	
Inventory		15,981	-	-	15,981	17,190	-	-	17,190	
		<u>498,423</u>	<u>22,473</u>	<u>(21,115)</u>	<u>499,781</u>	<u>378,561</u>	<u>7,178</u>	<u>(34,916)</u>	<u>350,823</u>	
<b><u>Non-current assets</u></b>										
Long-term deposits		2,207	-	-	2,207	1,836	-	-	1,836	
Investment in investees		2,268	-	-	2,268	2,280	-	-	2,280	
Investment in other company		1,715	-	-	1,715	1,829	-	-	1,829	
Derivative financial instruments	3	-	7,570	-	7,570	-	6,258	2,904	9,162	
Fixed assets		1,286,421	-	(669)	1,285,752	1,176,528	-	-	1,176,528	
Other intangible assets		3,719	-	669	4,388	3,455	-	-	3,455	
		<u>1,296,330</u>	<u>7,570</u>	<u>-</u>	<u>1,303,900</u>	<u>1,185,928</u>	<u>6,258</u>	<u>2,904</u>	<u>1,195,090</u>	
		<u>1,794,753</u>	<u>30,043</u>	<u>(21,115)</u>	<u>1,803,681</u>	<u>1,564,489</u>	<u>13,436</u>	<u>(32,012)</u>	<u>1,545,913</u>	

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 9 - Financial information in accordance with International Financial Reporting Standards (IFRS) (continued)****b. Consolidated balance sheet (continued)**

	As of December 31, 2007						As of January 01, 2007				
	Israeli Standards						In accordan ce with IFRS	Israeli Standards	Adjustments	Classifi- cations	In accordance with IFRS
	Additional Information	As previously reported	Impact of re- statement *	After re- statement	Adjustm- ents	Classific- ations					
<b><u>Current liabilities</u></b>											
Short-term credit and current maturities		66,316	-	66,316	-	-	66,316	105,100	-	-	105,100
Trade payables		167,420	-	167,420	-	-	167,420	144,990	-	-	144,990
Other accounts payable	4,8	407,842	7,435	415,277	-	(368,093)	47,185	332,691	19,930	(291,521)	61,100
Proposed dividend payable		3,008	-	3,008	-	-	3,008	-	-	-	-
Provisions	2,8	-	-	-	388	89,233	89,621	-	(138)	74,516	74,378
Derivative financial instruments	3	-	-	-	-	-	-	-	8,811	-	8,811
Liabilities in respect of employee benefits	1,8	-	-	-	(2,531)	90,109	87,578	-	(704)	74,660	73,956
Unearned revenues		-	-	-	-	188,751	188,751	-	-	142,345	142,345
		644,587	7,435	652,022	(2,143)	-	649,879	582,781	27,900	-	610,681
<b><u>Non-current liabilities</u></b>											
Loans from banking corporations		713,793	-	713,793	-	-	713,793	566,104	-	-	566,104
Liabilities in respect of employee benefits	1	70,936	-	70,936	(16,185)	-	54,751	126,171	(20,077)	-	106,094
Other long-term loans		423	-	423	-	-	423	730	-	-	730
Derivative financial instruments	3	-	-	-	2,369	(954)	1,415	-	1,861	-	1,861
Deferred taxes	5	72,510	(223)	72,287	12,450	(20,161)	64,576	74,603	6,790	(32,013)	49,380
		857,662	(223)	857,439	(1,366)	(21,115)	834,958	767,608	(11,426)	(32,013)	724,169
<b><u>Shareholders' equity</u></b>											
		292,504	(7,212)	285,292	33,552	-	318,844	214,100	(3,038)	-	211,062
		1,794,753	-	1,794,753	30,043	(21,115)	1,803,681	1,564,489	13,436	(32,013)	1,545,913

\* For re-statement under Israeli standards see Note 9e.

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 9 - Financial information in accordance with International Financial Reporting Standards (IFRS)**  
**(continued)**

**c. Consolidated income statements**

	<b>Additional Information</b>	<b>For the 6-month period ended June 30, 2007</b>			<b>In accordance with IFRS</b>
		<b>Israeli Standards</b>	<b>Adjustments</b>	<b>Classifications</b>	
<b>USD in thousands</b>					
Operating revenues		841,441	-	-	841,441
Operating expenses	1,3	695,001	(13,431)	-	681,570
<b>Gross income</b>		146,440	13,431	-	159,871
Selling expenses	1	93,461	124	-	93,585
General and administrative expenses	1,2	44,377	655	-	45,032
Other revenues, Net	7	-	-	(6,619)	(6,619)
<b>Operating income (loss) before financing revenues (expenses), net</b>		8,602	12,652	6,619	27,873
Financing expenses	3,4	(16,649)	-	(5,501)	(22,150)
Financing revenues	6	-	1,477	5,501	6,978
<b>Operating income (loss) after financing revenues (expenses), net</b>		(8,047)	14,129	6,619	12,701
Other revenues, Net	7	6,619	-	(6,619)	-
Income (loss) before taxes on revenue		(1,428)	14,129	-	12,701
Taxes on revenue		334	(3,749)	-	(3,415)
<b>Income (loss) after taxes on revenue</b>		(1,094)	10,380	-	9,286
Company share of results of investees, net		91	-	-	91
<b>Net income (loss) for period</b>		<u>(1,003)</u>	<u>10,380</u>	<u>-</u>	<u>9,377</u>
<b>Diluted earnings (loss) per NIS 1 par value ordinary share (in USD)</b>					
Basic earnings (loss) per share, net		<u>-</u>	<u>0.02</u>	<u>-</u>	<u>0.02</u>
Diluted earnings (loss) per share, net		<u>-</u>	<u>0.02</u>	<u>-</u>	<u>0.02</u>

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 9 - Financial information in accordance with International Financial Reporting Standards (IFRS)**  
**(continued)**

**c. Consolidated income statements (continued)**

		<b>For the 3-month Period Ended June 30, 2007</b>			
	<b>Additional Information</b>	<b>Israeli Standards</b>	<b>Adjustments</b>	<b>Classif- ications</b>	<b>In accordance with IFRS</b>
<b>USD in thousands</b>					
Operating revenues		452,807	-	-	452,807
Operating expenses	1,3	353,901	(592)	-	353,309
<b>Gross income</b>		98,906	592	-	99,498
Selling expenses	1	51,166	62	-	51,228
General and administrative expenses	1,2	21,887	22	-	21,909
Other revenues, Net	7	-	-	(758)	(758)
<b>Operating income before financing revenues (expenses), net</b>		25,853	508	758	27,119
Financing expenses	3,4	(8,255)	3,751	(4,010)	(8,514)
Financing revenues	6	-	-	4,010	4,010
<b>Operating income after financing revenues (expenses), net</b>		17,598	4,259	758	22,615
Other revenues, Net	7	758	-	(758)	-
<b>Pre-tax income</b>		18,356	4,259	-	22,615
Taxes on revenue		(5,770)	(293)	-	(6,063)
<b>Profit after taxes on revenue</b>		12,586	3,966	-	16,552
Company share of results of investees, net		47	-	-	47
<b>Net income for period</b>		12,633	3,966	-	16,599
<b>Diluted earnings per NIS 1 par value ordinary share (in USD)</b>					
Basic earnings per share, net		0.03	0.01	-	0.04
Diluted earnings per share, net		0.03	-	-	0.03

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 9 - Financial information in accordance with International Financial Reporting Standards (IFRS)**  
**(continued)**

**c. Consolidated income statements (continued)**

		<b>For Year Ended December 31, 2007</b>					
		<b>Israeli Standards</b>					
	<b>Additional Information</b>	<b>As previously reported</b>	<b>Impact of re-statement *</b>	<b>After re-statement</b>	<b>Adjustments</b>	<b>Classifications</b>	<b>In accordance with IFRS</b>
<b>USD in thousands</b>							
Operating revenues		1,932,450	-	1,932,450	-	-	1,932,450
Operating expenses	1,3	1,539,658	-	1,539,658	(21,963)	-	1,517,695
<b>Gross income</b>		392,792	-	392,792	21,963	-	414,755
Selling expenses	1	230,637	-	230,637	249	-	230,886
General and administrative expenses	1,2	90,781	-	90,781	838	-	91,619
Other revenues, Net	7	-	-	-	-	(2,423)	(2,423)
<b>Operating income before financing revenues (expenses), net</b>		71,374	-	71,374	20,876	2,423	94,673
Financing expenses	3,4	(33,393)	-	(33,393)	(5,581)	(17,088)	(56,062)
Financing revenues	6	-	(770)	(770)	3,151	17,088	19,469
<b>Operating income after financing revenues (expenses), net</b>		37,981	(770)	37,211	18,446	2,423	58,080
Other revenues, Net	7	2,423	-	2,423	-	(2,423)	-
<b>Pre-tax income</b>		40,404	(770)	39,634	18,446	-	58,080
Taxes on revenue		(9,001)	223	(8,778)	(4,808)	-	(13,586)
<b>Profit after taxes on revenue</b>		31,403	(547)	30,856	13,638	-	44,494
Company share of results of investees, net		332	-	332	-	-	332
<b>Net income for period</b>		31,735	(547)	31,188	13,638	-	44,826
<b>Loss per NIS 1 par value ordinary share (in USD)</b>							
Basic earnings per share, net		0.07	-	0.07	0.02	-	0.09
Diluted earnings per share, net		0.06	-	0.06	0.03	-	0.09

\* For re-statement under Israeli standards see Note 9e.

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 9 - Financial information in accordance with International Financial Reporting Standards (IFRS)**  
**(continued)**

**d. Reconciliation to equity**

<u>Additional Information</u>	<u>Share capital</u>	<u>Share premium</u>	<u>Capital reserve from transactions with 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>Accumulated deficit</u>	<u>Total</u>
<u>USD in thousands</u>							
<b><u>As of January 01, 2007</u></b>							
Israeli Standards	131,536	904	218,498	2,582	-	(139,420)	214,100
Reconciliation of severance-pay liabilities, Net							
Statement of hedging instruments at fair value	1	-	-	-	-	15,585	15,585
Statement of liabilities at fair value in respect of options issued	3	-	-	-	4,149	(2,945)	1,204
Statement of liabilities in respect of legal claims	4	-	-	-	-	(19,930)	(19,930)
	2	-	-	-	-	103	103
<b>In accordance with IFRS</b>	<b>131,536</b>	<b>904</b>	<b>218,498</b>	<b>2,582</b>	<b>4,149</b>	<b>(146,607)</b>	<b>211,062</b>
<b><u>As of June 30, 2007</u></b>							
Israeli Standards	155,012	9,248	229,560	3,513	-	(140,423)	256,910
Reconciliation of severance-pay liabilities, Net							
Statement of hedging instruments at fair value	1	-	-	-	-	14,811	14,811
Statement of liabilities at fair value in respect of options issued	3	-	-	-	5,376	7,411	12,787
Statement of liabilities in respect of legal claims	4	-	18,759	-	-	(18,759)	-
	2	-	-	-	-	(271)	(271)
<b>In accordance with IFRS</b>	<b>155,012</b>	<b>28,007</b>	<b>229,560</b>	<b>3,513</b>	<b>5,376</b>	<b>(137,230)</b>	<b>284,238</b>
<b><u>As of December 31, 2007</u></b>							
Israeli standards, as previously reported	155,012	9,248	243,787	4,464	-	(120,007)	292,504
Impact of re-statement *	-	-	(6,665)	-	-	(547)	(7,212)
Israeli standards, after re-statement	155,012	9,248	237,122	4,464	-	(120,554)	285,292
Reconciliation of severance-pay liabilities, Net							
Statement of hedging instruments at fair value	1	-	-	-	-	14,037	14,037
Statement of liabilities at fair value in respect of options issued	3	-	-	-	8,341	11,464	19,805
Statement of liabilities in respect of legal claims	4	-	18,759	-	-	(18,759)	-
	2	-	-	-	-	(290)	(290)
<b>In accordance with IFRS</b>	<b>155,012</b>	<b>28,007</b>	<b>237,122</b>	<b>4,464</b>	<b>8,341</b>	<b>(114,102)</b>	<b>318,844</b>

\* For re-statement under Israeli standards see Note 9e.

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 9 - Financial information in accordance with International Financial Reporting Standards (IFRS)**  
**(continued)**

- e. The financial statements as of December 31, 2007 and for the year then ended have been restated (in conjunction with Israeli standards), such that the capital reserve from transactions with an ex-controlling shareholder was reduced by \$6,665 thousand, against recording of a liability, pending clarification of the status of excess proceeds from option exercise deposited by the State in the employee severance pay fund beyond the "deficit" in the employee severance pay fund - as defined in the agreement signed on June 3, 2003 by the Company, the State and employee representatives. The impact on financing revenues for the year ended December 31, 2007 is a decrease of \$770 thousand, as well as a decrease of \$223 thousand in tax expenses.

**f. Additional Information**

- (1) Under Israeli GAAP, severance pay liabilities are recognized based on the full liability, assuming that all employees are terminated upon the balance sheet date under circumstances entitling them to receive full severance pay, regardless of discount rate, any future pay increase rate and future departures. In accordance with IFRS, all liabilities in respect of post-retirement benefits to employees and other long-term benefit plans are measured in accordance with provisions of IAS 19 "Employee benefits". Employee benefits which constitute defined benefit plans are measured, *inter alia*, based on actuarial estimates and discounted amounts. Furthermore, in accordance with IFRS, no severance pay provision is recorded in cases where the employee benefit would only be granted upon termination by the employer.

Provision for early retirement programs – in accordance with Israeli GAAP, provisions for early retirement programs are made in accordance with management expectations with regard to their realization. In accordance with IFRS, retirement programs are only recognized when a formal, detailed retirement program is in place which creates an irrevocable commitment on behalf of the Company.

Furthermore, in accordance with Israeli GAAP, a provision for paid leave is recognized based on the full liability, assuming that employees would utilize all their paid leave in the short term.

In accordance with IFRS, provisions for paid leave are made in accordance with expected paid leave utilization, and are measured based on actuarial estimates and capitalized amounts.

To date, the Company has recorded a provision for redemption of unutilized sick pay upon retirement, only for employees who have reached the age of 45 and using non-capitalized amounts. In accordance with IFRS, this provision was calculated in respect of all Company employees, based on actuarial estimates and using capitalized amounts.

The impact of the above on the balance sheet is a decrease in liabilities for employee benefit programs, net as of January 01, 2007, June 30, 2007 and December 31, 2007 amounting to \$20,781 thousand, \$19,748 thousand and \$18,716 thousand, respectively. Furthermore, deferred taxes receivable as of January 01, 2007, June 30, 2007 and December 31, 2007 were decreased by \$5,196 thousand, \$4,937 thousand and \$4,679 thousand, respectively.

The discount rate used for calculation of actuarial liabilities was determined using market returns of government bonds, since the Company believes there is no deep market of high-quality corporate bonds in Israel. The issue of the discount rate is under review, which may result in a decision that the appropriate discount rate in Israel is based on market returns of corporate bonds. Should such a decision be made, the calculated data presented in the Notes would change, since use of a higher discount rate would reduce

**EL AL Israel Airlines Ltd.**

**Notes to condensed consolidated financial statements**

actuarial liabilities and would increase the current interest cost in respect of actuarial liabilities.

- (2) According to Israeli GAAP, the Company recognizes a provision for contingent claims if use of economic resources to discharge the liability is probable. Under IFRS, a provision should be recognized if a liability is more likely than not to exist as of the balance sheet date. The provision under IFRS is determined by the amount which the Company estimates it would be willing to pay in order to settle the claim.

Therefore the following changes were made to the provision for legal claims as of January 01, 2007, June 30, 2007 and December 31, 2007: A decrease of \$138 thousand, an increase of \$361 thousand and an increase of \$388 thousand, respectively. Furthermore, the following changes were made to deferred tax liabilities as of January 01, 2007, June 30, 2007 and December 31, 2007: An increase of \$35 thousand, a decrease of \$90 thousand and a decrease of \$98 thousand, respectively.

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 9 - Financial information in accordance with International Financial Reporting Standards (IFRS)**  
**(continued)**

**f. Additional information (continued)**

- (3) Unlike Israeli GAAP, under IAS 39 all derivative financial instruments are recognized as assets or liabilities at their fair value. Changes to fair value would be recognized in the income statements (for instruments which do not meet the required conditions to be recognized as hedges) or in a capital reserve (for instruments designated as cash flow hedges which meet the required conditions to be recognized as hedges). Upon transition to IFRS, some of the jet fuel hedging transactions and some of the interest rate hedging transactions, designated by Company management as hedges, will be stated in the opening balance sheet at fair value, against a capital reserve. The change in fair value of these hedging transactions in subsequent periods will be charged to a capital reserve, for the effective portion of the hedging instrument, and to operating expenses or to financing expenses, as the case may be, in the income statement, for the non-effective portion.

Company management has decided that under IFRS, foreign currency hedging transactions and some jet fuel and interest rate hedging transactions will be treated as if not designated as hedges, therefore any change in fair value of said transactions in subsequent periods will be recognized under fuel expenses or financing expenses in the income statement, as the case may be.

Due to statement of fair value of all hedging instruments, as of January 01, 2007, June 30, 2007 and December 31, 2007, changes were made to financial and other asset items as well as to financial and other liability items included under current assets, non-current assets, current liabilities and non-current liabilities amounting to a net total of \$1,396 thousand, \$17,520 thousand and \$27,082 thousand, respectively.

Concurrently, a reserve for deferred taxes was recorded as of January 01, 2007, June 30, 2007 and December 31, 2007.

Furthermore, in respect of hedging transactions designated as hedges, a capital reserve was recorded as of January 01, 2007, June 30, 2007 and December 31, 2007 amounting to \$4,149 thousand, \$5,376 thousand and \$8,341 thousand, respectively.

- (4) Option warrants (Series 1) previously issued by the Company, whose exercise price is linked to the CPI and is not denominated in the Company's functional currency, constitute a financial liability since they have an adjustable exercise price. In accordance with provisions of IAS 32, the liability in respect of the aforementioned option warrants should be recorded in the opening balance sheet under other accounts payable (since their exercise date was in 2007) at fair value. Changes to fair value in subsequent periods were recognized under financing in the income statement for each period. Upon exercise of said option warrants, the aforementioned liability is added to the premium, such that shares resulting from exercise of these options are recorded at fair value.

As a result, the derivative financial instruments item under current liabilities (against decrease in retained earnings) as of January 01, 2007 increased by \$19,930 thousand.

The aforementioned option warrants have been exercised by June 2007.

- (5) In accordance with Israeli GAAP, assets and reserves in respect of deferred taxes have been classified as current or non-current assets, or as current or non-current liabilities, based on classification of the assets and/or liabilities for which they have been created.

**EL AL Israel Airlines Ltd.**

**Notes to condensed consolidated financial statements**

In accordance with IAS 1, assets and reserves in respect of deferred taxes are classified as a net, non-current asset or a reserve (as the case may be) even if their expected utilization date is within the short term.

Therefore, as of January 01, 2007, June 30, 2007 and December 31, 2007 amounts of \$32,013 thousand, \$22,041 thousand and \$20,161 thousand, respectively, were re-classified from deferred taxes receivable under current assets to deferred taxes under non-current liabilities.

- (6) According to Israeli GAAP, financing expenses and revenues are presented in the income statement as a single amount. In accordance with IFRS, financing expenses and revenues are to be presented separately.

As a result, for the 6-month and 3-month periods ended June 30, 2007 and for 2007, financing revenues amounting to \$5,501 thousand, \$4,010 thousand and \$17,088 thousand, respectively, have been presented separately.

- (7) In accordance with IFRS, other revenues and expenses would no longer be included as a separate item after financing revenues and expenses, as was the case under Israeli standards, but would be included under operating income. As a result, for the 6-month and 3-month periods ended June 30, 2007 and for 2007, other revenues, net amounting to \$6,619 thousand, \$758 thousand and \$2,423 thousand, respectively, were re-classified under operating income.

**EL AL Israel Airlines Ltd.**  
**Notes to condensed consolidated financial statements**

**Note 9 - Financial information in accordance with International Financial Reporting Standards (IFRS) (continued)**

**f. Additional information (continued)**

- (8) In accordance with IFRS, items which are not financial instruments under current assets were re-classified from other accounts receivable and were separately presented on the balance sheet.

Furthermore, under current liabilities, non-financial liabilities – unearned revenues were re-classified from other accounts payable. Furthermore, provisions and employee benefits were separately classified.

Derivative financial instruments were presented under a separate item of current assets, non-current assets, current liabilities and non-current liabilities, as the case may be.

**g. Easements with regard to retroactive application of IFRS standards adopted by the Company**

IFRS 1 sets forth several easements, for which no retroactive application is required. The Company has elected to apply the following easements to its opening balance sheet in accordance with IFRS as of January 1, 2007 ("the opening balance sheet").

**(1) Employee benefits -**

The Company applies the corridor approach to recognition of actuarial gains and losses, as per provisions of IAS 19. The Company has elected to recognize all actuarial gains and losses accumulated through January 1, 2007 under retained earnings.

**(2) Hedge accounting -**

Some interest hedging transactions, which constitute cash flow hedges and which meet hedging requirements of IAS 39, but do not meet specific designation and documentation requirements, were classified upon the transition date as hedging transactions. This is due to the fact that the Company has completed specific designation and documentation of said instruments' hedging ratios by the transition date.

**Note 10 - Events subsequent to the balance sheet date**

- a. In July 2008, a compromise agreement was signed with regard to the class action lawsuit concerning exchange rates of passenger fees, as set forth in Note 5a2 above. In this agreement, the parties recognized that existence of two exchange rates in a single transaction is not feasible, and that the Company would continue to strive to having regulations on this matter changed. Under the compromise agreement, the class action suit against the Company would be withdrawn in exchange for payment of NIS 275 to be paid to the plaintiff's counsel, including full expenses and legal fees of counsel representing the plaintiffs.

The compromise agreement is subject to approval by the Court, which as of the date of this report has yet to be received.

- b. On July 17, 2008, the Company entered into agreements to sell two Boeing 767-200 aircraft made in 1983 which it owns. One aircraft will be acquired by an airline in the Philippines and the other – by a Singapore investment company. The proceeds to the Company for each aircraft amount to \$6.5 million, for a total of \$13 million. The aircraft will be delivered to the buyers in September 2008.

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**Notes to condensed consolidated financial statements**

The proceeds for one aircraft were paid in full, and as for the other aircraft, a down payment of \$650 thousand was paid, with the balance payable upon delivery of the aircraft.

The Company is expected to record in its financial statements for Q3 of 2008 pre-tax capital gain of US \$9 million from sale of these two aircraft.

These transactions were made pursuant to review of the current aircraft fleet and to the Company's EL AL 2010 strategic plan which covers, inter alia, replacement and renewal of the aircraft fleet.