

# **EL AL ISRAEL AIRLINES LTD.**

## **FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2009 (unaudited)**

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SECTION A - UPDATE OF CHAPTER A TO 2008 ANNUAL REPORT

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**Update to Chapter A (Description of Corporate Business)<sup>1</sup>**  
**of the 2008 Periodic Report ("Periodic Report")**  
**of EL AL Israel Airlines Ltd. ("the Company")**

**The following are updates to Chapter A - a Description of Corporate Business**

**General**

Changes to international standards (IFRS)

Starting from the first quarter of 2009, the Company implemented changes in accounting policy in its Financial Statements deriving from the implementation of new standards and interpretations of International Financial Reporting Standards (IFRS), which came into effect on the Financial Statements dates, including IFRS 8 "Operating Segments", IAS-1 (Revised) "Presentation of Financial Statements, IFRIC 13 "Customer Loyalty Plans" and the revision to IAS 19 "Employee Benefits", in the framework of a project of improvements to IFRS, 2008.

For further details regarding the standards and the impact of their application to the Group's Financial Statements, see Notes 2.c, 7 and 8 to the Company's September 30 2009 Financial Statements.

**To Item 3.4 – Changes in Interested Parties' Holdings**

On September 15 2009 Leviim Properties Ltd. (hereinafter: "Leviim Properties"), under the control of attorney Yehuda (Yudi) Levi, Deputy Chairman of the Company's Board of Directors, announced that it had become a Company interested party following the purchase of 1,755,036 shares in a private transaction. On October 11 2009 Leviim Properties informed the Company that it had ceased being an interested party after transferring its entire holdings to A.L. Aviation Properties Ltd. in a private transaction. Note that A.L. Aviation Properties is a privately-owned company the issued capital of which is shared, in equal portions, by Leviim Properties and Miella Venture Partners, a company fully owned by a foreign trust of which the beneficiaries today are the Effi Arzi family. After the purchase, A.L. Aviation Properties Ltd. holds 1.48% of the Company's issued and paid capital.

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

In September 2009 the IATA published a new projection according to which global airlines were expected to lose a sum of \$11 billion in 2009. This loss is \$2 billion higher than the previous IATA projection published June 2009, according to which the losses of the airlines will amount to \$9 billion.

The reasons behind the worsening projection are the continuing increase in fuel costs and the sharp decrease in yield per seat deriving mainly as a result of the global financial crisis.

According to IATA estimates, aviation industry revenues amounted to \$455 billion this year, \$80 billion less (-15%) than 2008.

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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 A (Description of Corporate Business) in the Group's 2008 annual report.

The main factors influencing the loss expected for 2009:

- **Demand** – according to updated IATA projections, global passenger traffic is expected to drop 4% in 2009 and cargo traffic by 14% (this compared to decreases of 8% and 17%, as projected in June this year).
- **Yield** – according to the updated IATA projections, the average yield per passenger shall drop 12% in 2009 and the average yield per ton of cargo shall drop 15% (this compared to decreases of 7% and 12% respectively, as predicted by IATA projections from June this year). The drop in average yield per passenger derives from a 20% drop in premium traffic.
- **Fuel** – fuel prices rose sharply as a result of expectations for improvements in economic conditions. IATA projects that the average 2009 price per barrel will equal \$61 (compared to \$56 per barrel published in June this year).

In addition, IATA estimates that airlines will continue to list losses in 2010 as well. As of now, IATA predicts a net loss of 3.8 billion, this based on a 3.2% increase in passenger traffic and 5% in cargo traffic, a 1.1% increase in average yield per passenger and 0.9% per ton of cargo, and an average price of \$72 for a barrel of oil.

In addition, IATA once more updated its estimates regarding airline losses in 2008. The updated estimation indicates that the loss will amount to \$16.8 billion, compared to the previous estimation of \$10.4 billion, this as a result of revaluation of fuel hedging costs

#### **Regional Cross-Section: January-September 2009 Compared to January-September 2008:**

Region	Passengers			Cargo	
	RPK <sup>6</sup>	ASK <sup>5</sup>	PLF <sup>4</sup>	FTK <sup>3</sup>	<sup>2</sup> AFTK
	Jan-sep Change	Jan-sep Change		Jan-sep Change	Jan-sep Change
Africa	-8.9%	-4.5%	69.6%	-19.1%	-4.6%
Asia	-8.8%	-7.3%	72.9%	-17.0%	-14.5%
Europe	-5.9%	-4.4%	76.3%	-19.3%	-9.6%
South America	-2.3%	1.5%	72.0%	-12.7%	-2.8%
Middle East	9.4%	13.2%	72.9%	-2.6%	5.0%
North America	-6.7%	-5.1%	79.2%	-17.9%	-10.4%
<b>Total</b>	<b>-5.3%</b>	<b>-3.4%</b>	<b>75.0%</b>	<b>-16.4%</b>	<b>-9.8%</b>

2 ATK - Available Ton Kilometer – available capacity for the transport of passengers (translated to tons) and cargo multiplied by the distance flown.

3 FTK - Freight Ton Kilometer – weight in tons of cargo (including mail) multiplied by distance flown.

4 PLF - Passenger Load Factor – flight occupancy rate.

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

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

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

According to data provided by the Central Bureau of Statistics, the third quarter of 2009 saw 1.3 million departures of Israelis via air, a 3% increase over the same quarter last year.

January-February 2009 saw an 18% decrease in departing Israeli traffic, deriving primarily from Operation Cast Lead. A comparison between March-June 2009 and 2008 shows a more moderate decrease (-9%), primarily as a result of the financial crisis.

In addition, the third quarter saw 575,000 tourist entrances via air (BGN and Eilat), a 3% decrease compared to the same period last year. This, after January-February 2009 listed a 16% decrease in tourist traffic to Israel via air and March-June 2009 saw a 13% decrease compared to the same months last year.

Q3 2009 saw a recovery in passenger traffic at BGN, with a slight increase of 1% listed after 14% and 12% drops listed in the first and second quarters, respectively. Seat capacity at BGN increased 2% and the load factor was 85.5% compared to 86.3% in the third quarter of 2008.

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

The quarter ending September 30 2009 saw a 37% decrease in jet fuel market prices compared to the same quarter last year. The effective average jet fuel price paid by the Company dropped, after hedging activity, by 39.4% compared to the same quarter last year. In the reported period, fuel costs constituted 27.4% of turnover (in the third quarter of 2008 fuel costs constituted 35.4% of turnover). The following data refers to jet fuel prices in the Med region, as quoted by Platts<sup>7</sup>. For further details, see Items 7.1, 7.2 and 7.3 of the Board of Directors' Report.

As of September 30 2009 the Company held an inventory of jet fuel purchased from suppliers in Israel and abroad worth \$4.9 million.

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

As of September 30 2009, the exchange rate of the NIS vs. the U.S. Dollar was devaluated by 9.9% relative to September 30 2008, and revaluated by 1.2% relative to December 31 2008.

As of September 30 2009, the exchange rate of the U.S. dollar vs. the euro was devaluated by 0.3%, relative to September 30 2008, and devaluated by 4.9% relative to December 31 2008. For further details, see Sections 7.1, 7.2 and 7.5 of the Board of Directors Report.

**To item 6.5 – Interest Rate Fluctuations**

The average 3-month Libor rate dropped by 85.9% in the quarter ending September 30 2009 compared to same quarter last year. For further details see Items 7.1, 7.2 and 7.4 of the Board of Directors Report.

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<sup>7</sup> To the best of the Company's knowledge, Platts is a member of the McGraw-Hill Group which has provided information on the energy industry for over 75 years. The company provides information and up-to-date analyses, among other things, on international prices and events pertaining to the petroleum, petrochemical, natural gas and electric and nuclear power markets.

## **1. Passenger Aircraft Activity**

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

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

Following the aviation agreement signed between Russia and Israel in November 2008, which allows airlines from the two countries to operate direct flights between Eilat and Moscow and following the approval granted by the Israeli Ministry of Transportation in January 2009 to Arkia and Israil, authorizing them to operate direct flights between Eilat and Moscow, in November 2009 Israil began operating weekly flights on the Moscow-Eilat route. Note that Sun D'Or has been conducting weekly flights between Eilat and Moscow since August 2009.

In addition, at the beginning of November 2009, the Israeli ministry of Transportation authorized Arkia to begin regular flights between Eilat and St. Petersburg.

Arkia began operating regular flights to Kiev (Ukraine) starting November 2009.

Following the new aviation agreement signed between Israel and Germany in January 2009, German airline Air Berlin has begun operating two weekly flights on the Tel Aviv-Berlin route, starting July 2009.

Starting November 2009, EasyJet began operating weekly flights on the London-Tel Aviv route.

On November 25 2009, BMI Airlines announced that following a recovery plan, which includes a restructuring of its destination map, the airline's HQ along with its owners, Lufthansa Airlines, decided to discontinue activities in several routes containing "particularly difficult market conditions", including the routes to Tel Aviv, Kiev, Amsterdam and Brussels. Therefore, BMI is expected to discontinue its activities on the Tel Aviv route starting January 10 2010.

Delta Airlines operates 4 weekly flights to Atlanta instead of 7 during winter 2009/2010, and limited to one daily flight to New York. At the same time, Delta announced its intention to increase its seat capacity on the Tel Aviv-New York route starting June 2010, this by replacing a 767-300 airplane with a 747-400, a daily addition of 187 seats on the New York route.

French airline Corsair, part of the TUI tourism corporation and which operates direct flights on the Paris-Tel Aviv route, is expected to discontinue its activities on the route until April 2010, this as a result of the expected drop in demand during winter months. In winter 2008/9 as well, Corsair paused its flights on the route, renewing them this May, when it announced that it would be operating 2-3 weekly flights on the Paris-Tel Aviv route throughout the year.

Due to financial difficulties and bankruptcy, in September 2009 the Slovakian airline Sky-Europe, which operated a weekly flight on the Bratislava-Tel Aviv route, and the Russian airline KD-AVIA, which operated flights on the

Kaliningrad-Tel Aviv route, both discontinued their activities.

Ethiopian Airlines added, starting October 2009, a weekly flight, its fifth in number, on the Addis Ababa-Tel Aviv route. The decision to increase capacity on the route to Israel came as a result of increased demand for flights to African destinations and the launching of new destinations in Africa by the Ethiopian company.

**Following that said in Section 7.2 of the Company's 2008 periodic report – Services in the Area of Activity**, the following is information regarding the development of passenger traffic based on central destination groups:

Over the course of the third quarter of 2009, a slight 1% increase was listed in all traffic at BGN, with scheduled traffic through BGN increasing 7%, while charter traffic (both Israeli and foreign) decreasing by 14% compared to the third quarter of 2008.

Passenger traffic was divided between the various airlines as follows: El Al and Sun D'Or – 34.7%; other scheduled airlines – 46.0%; charter airlines – 19.3%.

#### Western European Routes

Western European routes saw a 2% increase in passenger traffic in the third quarter of 2009. Among scheduled foreign airlines, passenger traffic increased by 7%, while seat capacity increased by 8%. The decrease in Israeli and foreign charter traffic continued in this quarter.

The third quarter of 2009 saw a 31% decrease in charter activity in this route network.

This quarter, the Group increased its seat capacity by 10% and its passenger traffic increased 7%. The Group's average load factor was 88.9% and its share of total passenger traffic in this route network was 38.1%.

#### Routes to Central and Eastern Europe

In the third quarter of 2009, Central and Eastern European routes listed a 2% increase in total passenger traffic.

Foreign airlines operating on this route network made no material changes to their seat capacity (-1%) and listed a 2% decrease in passenger traffic; decreases in passenger traffic were also listed in foreign and Israeli charter airlines, with the exception of Sun D'Or, which significantly increased its activity in this route network, mainly on routes to Bulgaria and Poland. The Group increased its seat capacity in this route network by some 32% and listed a 21% increase in passenger traffic on these routes. The Group's market share in this route network amounted to 30% and the load factor reached 81.2% compared to 88.6% in the third quarter of 2008.

#### Routes to the CIS

In the third quarter of 2009 foreign scheduled airlines operating on routes to CIS countries limited their seat capacity by 4%, while at the same time listing a 3% increase in passenger traffic. Foreign charter airlines operating on these routes discontinued their activities while Israeli airlines Sun D'Or, Arkia and Israir increased their activity on these routes. During this period, the Group increased its seat capacity on this network by 8% and the Group's passengers increased by 10% compared to the same period last year. In this quarter passenger traffic in this route network increased by 8% and no significant change occurred in total seat capacity (+1%). The Group's share of passenger traffic on these routes amounts to 32.5%.

#### Transatlantic Routes

A significant drop in passenger traffic (-16%) was listed on the route to Canada, as a result of a significant reduction in the activity of Air Canada, which reduced its seat capacity on this route by 30%, and accordingly, listed a similar drop in passenger traffic.

Routes to the U.S. listed a 2.7% increase in passenger traffic, this as a result of the entry of U.S. Airways to the Philadelphia-Tel Aviv route and a 4% increase in Delta Airlines traffic.

The Company reduced its seat capacity by 3%, among other reasons as a result of the discontinuation of its activity on the Miami route starting September 2008, and the number of Company passengers dropped accordingly (-3%).

#### East Asian Routes

A 19% increase occurred in seat capacity and passenger traffic on these routes in July-September 2009, this as a result of the activity of Korean Air on the Tel Aviv-Seoul route starting September 2008.

The Company made a slight (-2%) reduction in its load factor on its East Asian routes and listed a 4% increase in passenger traffic.

#### Regional Network

The drop in passenger traffic to Turkey continued to drop (-22%) in the third quarter of 2009, albeit at a slower rate than the drops listed in the first quarter (-52%) and the second quarter (-48%) of the year. At the same time, this quarter saw a significant increase (+65%) in passenger traffic to Greece and the Greek Islands, with charter airlines (Israeli and foreign) listing a 119% increase in activity. In all, an 8% decrease in passenger traffic in this route network was listed in the third quarter of the year.

The Group's share of this route network is only 10.9%.

For details regarding the Company's request to be appointed Designated Carrier for the Eilat route please see reference to Item 9.11.10 below.

#### **To Item 7.1.5 Technological Changes that May have a Material Impact on the Field of Activities and 7.4 – New Products**

A number of new products and services have been put into service in the Company's systems and on its website, which allow the expansion of the "self service" capability of Company customers as well as the improvement of the service provided at the Company's service center to direct customers and travel agents, the development of a new system for online check-in and the development of new means of command and control.

in addition, activity has begun in the implementation of an information system for managing and tracking air pollution (CO<sub>2</sub>) from Company aircraft with the aim of implementing EU directives on the subject. The system shall collect data from various sources of information (both from the ground and from the Company's aircraft), collect them into a single database, and include a tool for analyzing this data.

#### **To Item 7.4 – New Services**

Over the course of August 2009 the Company began a new pilot program testing the operation of the Economy Basic Class on a number of flights. Ticket prices in this class are lower than in other classes, and passengers are asked to pay extra for services provided, including food and drinks,

entertainment, luggage, arranged seating and so on. The Company has decided to expand the program and as of now, the service is offered on flights departing Israel to most Company destinations in Europe as well as Bangkok and Mumbai.

In October 2009 the Company began collaboration with Sakal Duty Free, in which the Company offers its passengers the option of purchasing a variety of electronics, fashion and toy products. Ordering may take place on flights only and shipping is at no extra cost to the customer's home. The products are not tax-free.

In April 2009 the Company signed a code sharing agreement with Czech Airlines. This was a "block" type agreement (purchasing a fixed number of weekly seats from one airline by the other). In September 2009 the Restriction of Trade Commissioner approved the agreement. As a result, the agreement came into effect as regards flights on the Tel Aviv-Prague route starting October 25 2009.

#### **To Item 7.10 – Manufacturing Ability**

The Company increased its ASK by 7.4% in the third quarter of 2009 and the Company's RPK increased at a similar rate of 6.8%. As a result, a slight decrease was listed in its weighted load factor to 85.0%, compared to 85.5% in the same quarter last year.

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

Following the agreement to carry out heavy maintenance and logistic assistance to Nepal Airlines airplanes, signed by the Company in January 2009, the agreement was expanded in such a manner that four separate inspections will be conducted and the Company will provide troubleshooting, logistic assistance and instruction services. The Company's expected revenue as a result of signing this agreement is \$6 million over the course of 3 years (2009-2011).

## **2. Cargo Aircraft Activity**

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

Pursuant to Item 8.1.1 of the Periodic Report, according to the Company's estimates, the Group's share of cargo transport in January-September 2009 of all cargo shipped to and from Israel by air (including cargo carried in the belly of passenger aircraft, including mail activity but not including Sixth Freedom) amounted to 32.8%, this in comparison with 33.2% in the same period last year.

#### **To Item 8.1.2 – Legislative Restrictions, Standards and Special Constraints Applying to the Field of Activity**

Following the Company's request from the Government Companies Authority for the consent of the holder of the Special State Share, as required by the Company's articles, to remove two 747-200 cargo aircraft from Company service, said consent has not yet been granted and the public commission established by the Minister of Transportation and Road Safety for studying the Israeli shipping market and studying the state of Israeli airlines dealing in cargo transport has yet to publish its recommendations. The Company is working to lease a 747-400 cargo aircraft.

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

According to IATA reports, in January-September 2009, international transportation of cargo in cargo aircraft dropped 16.4% compared to the same period last year, meaning a decrease in activity at a higher rate than the projected yearly rate according to IATA estimates (-5.0%). It is impossible to estimate whether this information changes expectations regarding total annual growth in 2009.

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

Airport Authority data indicates that in January-September 2009, cargo traffic through BGN dropped 22.9% relative to the same period last year.

**3. Information on Both Fields of Activity**

**To Item 9.4.2 – Employees**

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

	<b>September 30 2009</b>	<b>September 30 2008</b>
Permanent employees	3,780	3,772
Temporary employees	2,029	2,158
<b>Total employees</b>	<b>5,809</b>	<b>5,930</b>

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

On September 6 2009, the Company announced that it and its CEO, Mr. Haim Romano (hereinafter: "the CEO") had reached an agreement that the CEO's tenure would be ended following 18 months notice by the Company, this in accordance with the terms of their personal work agreement. Under these circumstances, the notice period according to the employment agreement is 18 months, during which employer-employee relations between the parties will continue (without detracting from the Company's right, based on the employment agreement, to shorten this period at any time, while repaying its balance). Over the course of this period the CEO will train his successor and pass on his position in an organized manner.

The Company's Audit Committee and Board of Directors decided that the restraint period, which according to the terms of the agreement is 6 months from the completion of work, shall be extended by an additional 12 months, in return for a one-time payment of 750,000 NIS.

In accordance with the terms of the agreement, the CEO is entitled to a retirement bonus equal to one months pay for each year of work at the Company (some 5 years), in addition to releasing retirement and executive insurance sums at his disposal, as well as the payment of a result-dependent bonus, as established in the employment contract, for the 6 month period from the notice period. In addition, the Audit Committee and the Board of Directors decided that the CEO shall be entitled to flight ticket rights, as is general Company practice for a departing executive of the CEO's rank.

On October 21 2009, the Company's Board of Directors decided to appoint Mr. Elyezer Shkedi as the Company's new CEO. Mr. Shkedi will begin serving in his new position on January 1 2010, at the end of a 2-month preparation and training period with the Company's CEO, Mr. Haim Romano. The terms of Mr. Shkedi's employment as a CEO have yet to be established.

**To Item 9.8.3 – Credit Frameworks**

Non-guaranteed credit frameworks amounted to \$35 million as of September 30 2009, a sum similar to the frameworks at the Company's disposal on December 31 2008. These frameworks may be used for any purpose.

**To Item 9.8.4 Guarantees Against Collateral**

With the drop in jet fuel prices to below the price levels defined in hedging agreements, the Company was required to provide collateral to guarantee its upholding hedging refunds to which it was obligated in accordance with its agreements with hedging institutions. As of September 30 2009, the total collateral requirement amounted to \$73 million given through deposits and letters of credit, and in addition, the hedging institutions provided non-guaranteed frameworks to the amount of \$27 million. The Company placed liens on assets (aircraft and deposits) to the required extent for banks in Israel and abroad.

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

As of September 30 2009, the balance of loans from banking corporations, including short term borrowings, amounted to \$851.5 million.

**To Item 9.10.3 – the Environment – Airport Noise Ordinances**

Following the EU decision regarding the implementation of the ETS (Emission Trading Scheme), in which the airlines will be required to supervise and report on fuel burned and CO<sub>2</sub> created, the Company is continuing its preparations for the plan's implementation.

**To Item 9.11.2.(i) – Restrictions and Supervision of the Corporation's Business – the Restriction of Business Law, 1998**

On September 21 2009 the Anti Trust Commissioner reached decisions (hereinafter: "the Commissioner" and "the Decisions", respectively) regarding the Company's request dated March 31 2009 for receipt of an exemption from the requirement for the receipt of court approval for binding arrangements (hereinafter: "the Exemption Request") pertaining to various aviation agreements between the Company and foreign air carriers (hereinafter: "the Arrangements"). According to the Commissioner's decisions, the exemption requests were approved as regards code sharing agreements between the Company and the following carriers: American Airlines, Swiss, Iberia, Czech, and Thai.

In addition, according to the Commissioner's decisions, the exemption requests for arrangements between the Company and the following foreign carriers were not approved: Air India, Lot, Austrian, Tandem, Bulgaria Air and Aerosvit. The Commissioner's explanations for the requests he failed to approve were provided on November 3 2009.

Note that the Commissioner has yet to submit a decision as regards the code share with Air China and that after submitting the exemption requests, the Company announced that it would be canceling its arrangements with SAA, Belavia and Brussels Airlines.

**To Item 9.11.10 – Legislation**

Pursuant to the study the Civil Aviation Authority has been making regarding compliance of subsidiary Sun D'Or with the Aviation Law and related regulations, Sun D'Or has acted to comply with the CAA requirements, including by appointing a number of executives as Sun D'Or employees and changes in manuals and training programs. According to the agreement

between the CAA and Sun D'Or, until the completion of the actions agreed upon between the parties, Sun D'Or is operating via wet lease of El Al aircraft.

Following the Company's reports regarding the receipt of authorization from the Ministry of Transportation and Road Safety to operate flights to Eilat in September 2009, airlines Israir and Arkia have petitioned to the High Court of Justice against the Minister of Transportation, the CAA, the Anti Trust Commissioner and the Company, in which the Court was asked to issue an injunction instructing the respondents to explain why the Court should not rule that (a) the decision on behalf of the Minister of Transportation allowing the Company to operate scheduled flights from BGN to Eilat be made null and void for reasons of lack of authority and improbability; (b) the recommendation given by the CAA to allow the Company operate scheduled flights from BGN to Eilat was made without upholding its consultation requirements and is thus invalid; (c) the decision on the Company's request to operate scheduled flights on the Eilat route should be made by another Minister. On October 4 2009 the Court rejected Israir's and Arkia's requests for injunctions and ruled that the petitions were to be ruled on by a panel of judges (the session was set for January 2010).

On October 13 2009 the CAA announced that the Ministry of Transportation intended to continue with the administrative process, in which the Company's commercial operating license would be amended, allowing it to operate scheduled flights to Eilat under the following conditions:

- a. The Company would be required to operate at least one frequency a day in each direction, in five out of seven days a week. The Company shall offer at least 100 seats for each of these frequencies.
- b. The Company may not operate more than two frequencies a day in each direction. In addition, the Company may not offer more than 430 seats a day in either direction.
- c. When selling tickets for the BGN-Eilat-BGN route, the Company may not accept frequent flier points accumulated by its clients as a result of purchasing tickets on international routes operated by the Company as payment.
- d. A uniform maximum price shall be set for each company for the BGN-Eilat-BGN and Sdeh Dov-Eilat-Sdeh Dov routes, in accordance with the sums noted.
- e. Israir shall be freed of its obligations in the matter of flight schedules and seat offerings, which it undertook to uphold in its Ministry of Transportation tender dated 1995, and it shall be allowed to set its flight schedule for the BGN-Eilat-BGN and Sdeh Dov-Eilat-Sdeh Dov routes as it sees fit.

On November 15 2009 the Company submitted its position on the aforementioned recommendation, repeating its request to permit it extended activity on the Eilat route. The CAA's position on the matter has yet to be received.

#### **To Item 9.14 – Legal Proceedings**

Following the Company's reports regarding the motion to dismiss submitted by the prosecutor pursuant to the motion filed against the Company in April 2009 to recognize the suit as a class action on the grounds that the Company had not complied with the requirements of Amendment 40 to the Communications Law (Telecommunications and Broadcasts) 2008 ("the Spam Law"), note that in September 2009 the Court approved this motion to dismiss.

Following the Company's report pursuant to Item 9.14.1 (Legal Proceedings) of the Company's 2008 periodic report on the matter of the appeal of the decision to approve a suit against the Company as being a class action on the basis of the Consumer Protection Law in the matter of over billing based on exchange rates by travel agents, the Supreme Court accepted the appeal filed by the Company and rejected the request to recognize the suit as a class action.

Following the Company's report pursuant to Item 9.14.7 (Legal Proceedings) of the Company's 2008 periodic report, regarding the motion to recognize as a class action a suit filed against the Company on the matter of the collection of a security surcharge by the Company on code sharing flights, on August 19 2009, the Court rejected the motion in question and ruled the petitioners liable for expenses to the Company. An appeal was filed before the Supreme Court on October 22 2009.

Following the Company's report pursuant to Item 9.14.10 (Legal Proceedings) of the Company's 2008 periodic report regarding the arbitration proceedings held with Sabre, agreements were signed by the Company on October 1 2009 in which it was agreed to conclude all disputes and legal proceedings between the parties, including the request for arbitration. Accordingly, the commercial agreement on the basis of which the joint company of Sabre Israel had been established came to a conclusion, and on the date of the settlement the Company sold the entirety of its holdings in the joint company (49%) in return for the payment of the Company's share of the joint company's equity, and the joint company also repaid the owner's loan granted by the Company, the balance of which equaled a sum of \$1.2 million U.S. In addition, the Company and Sabre entered into a new agreement, updating the existing agreement for distribution using the Sabre distribution system, allowing Israeli travel agents connected to this system to work in a full content format. In addition, according to the settlement the Company cancelled charges issued to the joint company for data processing and communications expenses and paid the joint company sums offset in the past by those charges, concurrently with the cancellation of the additional arbitration process beginning in Israel in relation to these sums. As a result of the aforementioned settlement, the Company listed a reduced provision to the amount of \$1.7 million U.S. in its Q3 2009 Financial Statements.

Following the Company's report pursuant to Item 9.14.11 (Legal Proceedings) of the Company's 2008 periodic report in the matter of an antitrust investigation in Korea and according to the publications of several foreign airline indicating that the Korean antitrust authority had sent out an "inspector report" in October 2009 to several airlines pertaining to the investigation in question containing claims on the matter of alleged violations of Korean antitrust laws. The Company has not received the inspector report in question and to the best of its knowledge is not numbered among the companies to which the inspector report was addressed.

**EI Al Israel Airlines Ltd.**

**Report of the Board of Directors on the State of the Corporation's Affairs  
For the Period Ended September 30, 2009**

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We hereby present the Report of the Board of Directors on the State of the Corporation's Affairs for the period ending September 30, 2009.

The third quarter of 2009 saw, for the first time since the beginning of the global financial crisis in 2008, a moderate increase of one percent in international passenger traffic at BGN compared to the third quarter of 2008. At the same time, cargo traffic at BGN dropped 14.6% compared to the same quarter last year. The seat capacity of EI Al and of the scheduled foreign airlines at BGN grew 7% in the third quarter of 2009 compared to the same quarter last year. The Group's total market share at BGN grew to 34.7% compared to 32.8% in the same quarter last year, a 6% increase, while maintaining one of the highest load factors in the industry, 85.1%.

In the third quarter of 2009, jet fuel prices decreased in comparison to the same quarter last year, which along with the global financial crisis and intensifying competition, led to a 21% decrease in the average price per flight segment and a total drop of 16% in the Company's passenger revenues.

Gross profit in the third quarter of 2009 amounted to \$95.4 million, 19.2% of operating revenues, with gross profit amounting to \$134.5 million in the same quarter last year, 22.2% of operating revenues.

The Company finished the three months ending on September 30 2009 with a profit of \$12.3 million, compared to \$31.0 million in profits in the same period last year.

The Company's negative cash flow to operating activity in the third quarter of 2009 amounted to \$18.8 million, compared to negative cash flow to operating activity to the amount of \$11.3 million in the same quarter last year.

The Group's cash balance and short term deposits amounted to \$118.6 million as of September 30 2009, and in addition, as of September 30 2009 the Company had \$28.5 million in restricted deposits in favor of jet fuel hedging institutions.

Shareholders' equity as of September 30 2009 amounted to \$129.2 million, compared to \$118.7 million on December 31 2008.

## **1. General**

### **1.1 Changes to IFRS**

Starting from the first quarter of 2009, the Company has applied in its financial statements, retroactively, changes in accounting policy deriving from the application of new standards and interpretations of International Financial Reporting Standards (IFRS), which came into effect on the date of the financial statements, including IFRS 8 "Operating Segments", IAS 1 (Revised) - "Presentation of Financial Statements", IFRIC 13 - "Customer Loyalty Programs" and the revision to IAS 19 - "Employee Benefits", in the framework of the IFRS improvements, 2008.

For further details on the standards and the impact of their application to the Group's Financial Statements, see Notes 2.c, 7 and 8 to the Financial Statements.

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

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

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

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

In the field of passenger transport, the Company competes in its flights to and from Israel with 2 Israeli airlines (Arkia and Israir) and some 50 foreign airlines that operate scheduled flights and with over 20 foreign charter companies, operating continual flights out of BGA in the first nine months of 2009.

In the field of cargo transport, the Company competes with six airlines operating cargo planes, and with most of the scheduled airlines that operate passenger planes that carry cargo in their belly.

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

- A) **Passenger plane activity** – In this segment, the Group transports passengers, as well as freight (including mail and baggage) in the belly of passenger planes, and provides ancillary services, such as the sale of duty-free products. Revenues from this segment constituted 89.3% of the Group's total revenues in the third quarter of 2009.
- B) **Cargo plane activity** – In this segment, the Group transports cargo in cargo planes. Revenues of this segment constituted 2.4% of the Group's total revenues in the third quarter of 2009.

The Group has additional revenues that are not allocated to the major segments, accounting for 8.3% of total revenues. For further information on the Company's fields of activity, see Paragraph 3.6 of the Report of the Board of Directors and Note 7 to the Financial Statements.

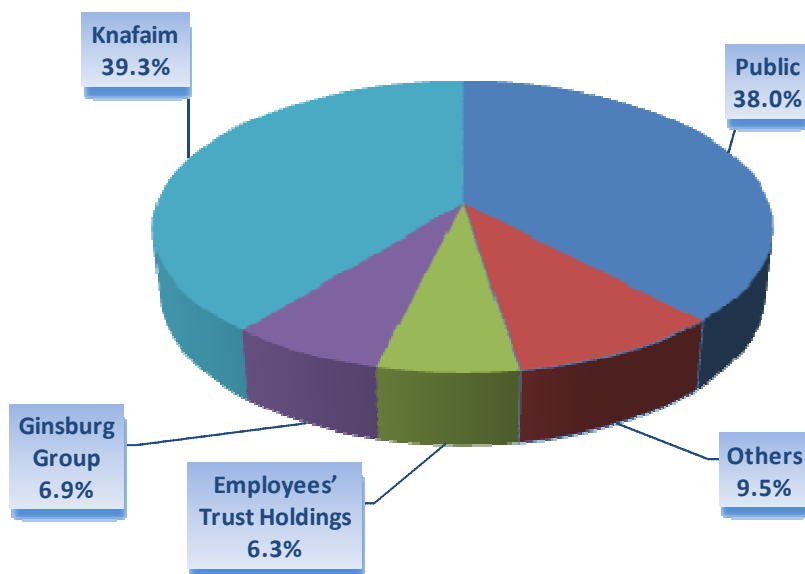
### **1.3 Holdings of Company Shareholders**

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As of September 30, 2009, holdings in the Company were:

Knafaim Holdings Ltd. ("Knafaim") – 39.3%, Ginsburg Group – 6.9%, a Company employee corporation called "Holdings in Trust of El Al Employees Ltd." ("Employees Corporation") – 6.3%, others – 9.5%, the public – 38.0%.

**Ratio of Holdings In Company Shares  
on September 30, 2009 (undiluted):**



**2. Financial Position (Consolidated Financial Statements)**

	30.09.2009 in thousands US dollars	31.12.2008 * in thousands US dollars	change in thousands US dollars	%
<b>Assets</b>				
Cash, cash equivalents and short-term deposits	118,624	58,421	60,203	103%
Restricted deposits	28,468	152,969	(124,501)	(81%)
Trade receivables	128,906	106,046	22,860	22%
Other receivables	26,969	19,693	7,276	37%
Current derivative financial instruments	7,977	174	7,803	4484%
Prepaid expenses	29,544	27,692	1,852	7%
Inventories	13,549	11,472	2,077	18%
Investment in affiliated held for sale	2,372	-	2,372	
Long-term bank deposits	1,940	2,189	(249)	(11%)
Investment in affiliated companies	445	2,736	(2,291)	(84%)
Investments in another company	1,570	1,565	5	0%
Long-term derivative financial instruments	2,667	-	2,667	
Fixed assets, net	1,348,175	1,314,182	33,993	3%
Intangible assets, net	8,992	8,618	374	4%
Assets due to employee benefits	34,343	36,777	(2,434)	(7%)
	<b>1,754,541</b>	<b>1,742,534</b>	<b>12,007</b>	<b>1%</b>
<b>Equity &amp; liabilities</b>				
Short-term borrowings and current maturities	110,109	86,271	23,838	28%
Trade payables	147,332	134,190	13,142	10%
Other payables	43,788	44,741	(953)	(2%)
Current provisions	57,919	57,049	870	2%
Current derivative financial instruments	79,519	108,072	(28,553)	(26%)
Current employee benefit obligations	93,274	87,930	5,344	6%
Current unearned revenues	211,892	197,911	13,981	7%
Long-term loans from financial institutions	730,528	678,657	51,871	8%
Long-term employee benefit obligations	65,632	76,226	(10,594)	(14%)
Long-term derivative financial instruments	27,310	86,789	(59,479)	(69%)
Long-term Provisions	9,008	11,728	(2,720)	(23%)
Deferred tax	2,949	1,872	1,077	58%
Long-term unearned revenues	46,091	52,434	(6,343)	(12%)
Shareholders' equity	129,190	118,664	10,526	9%
	<b>1,754,541</b>	<b>1,742,534</b>	<b>12,007</b>	<b>1%</b>

(\*) Retroactive implementation of changes in accounting policy - see Note 8 to the Financial Statements.

### **2.1 The main changes in asset, liability and shareholders' equity items as of September 30, 2009 compared to December 31, 2008 are:**

- An increase in the balance of cash, cash equivalents and short-term deposits, due mainly from the realization of restricted deposits, from the receipt of bank loans for the financing of 3 new 737-800 aircraft, from cash flow from operating activity and from the proceeds from the sale and lease back of 2 757 aircraft, offset in part mainly by the investment in the purchase of the three new aircraft and other fixed assets and repayment of long term loans. For further details, see 5 below.
- A decrease in total restricted deposits deposited in favor of jet fuel hedgers, according to the hedging agreements, mainly as a result of redemptions occurring in the reported period.

- The increase in trade receivables, derived mainly from the seasonal increase in passenger sales, while a decrease in cargo sales resulted from a decrease in activity.
- The increase in other receivables, derived mainly from the increase in outside charges for overhaul engine maintenance and from the increase in State's participation rate in security expenses.
- The following changes occurred to the Company's derivative financial instruments (presented in the Financial Statements under current and long term assets and current and long term liabilities):

The total fair value of jet fuel hedging, interest and foreign currency increased by \$98.5 million compared to their fair value at the end of 2008, as a result of transactions reaching redemption, from additional transactions occurring in the reported quarter and from changes in fair value of transactions still open as of the balance sheet date. The net increase in fair value of derivative financial instruments was expressed in the \$57.4 million increase (net after tax) in capital reserve in respect of cash flow hedging recognized directly in equity, in the \$20.2 million increase in deferred tax liabilities and the \$20.9 million decrease in fuel and financing expense items in the Statement of Operations. For further details, see Items 7.3 and 7.4 of the Board of Directors' Report.

- Investment in an affiliated company held for sale to the amount of \$2.4 million, as a result of the sale of the investment in Sabre Israel on October 1 2009, for further details see Note 11a to the September 30 2009 interim Financial Statements.
- Investment in affiliated companies decrease following the classification of the investment in Sabre Israel as an "investment in an affiliated company held for sale."
- Increase in fixed assets, due mainly to the purchase of 3 new 737-800 aircraft and from investments in fixed assets and engine overhaul, offset by depreciation costs and parts and accessories consumption in the reported period, and the sale and lease back of 2 757 aircraft.
- Assets due to employee benefits decreased mainly as a result of the increase in the compensation liability component in the reported period.
- An increase in short-term borrowings and current maturities, mainly due to the increase in short-term borrowings framework from Israeli banks, as well as current maturities from loans for the financing of 3 new 737-800 aircraft.
- An increase in the balance of trade payables, deriving primarily from a seasonal increase in activity.
- Employee benefit obligations increased primarily due to the increase in salary payment liabilities and deductions for the end of September 2009 in relation to the end of December 2008, as well as an increase in vacation and rest days' provision.
- Current unearned revenues increased due to the seasonal increase in passenger sales.
- The balance of long-term bank loans increased as a result of the receipt of loans from the EXIM Bank for the purchase of 3 737-800 aircraft received in the reported period, offset by the current repayment of loans.
- Long term liabilities due to employee benefits decrease primarily due to current payments and deposits to compensation funds for early retirement plans.
- Long term provisions decreased due to a payment made in the reported period to the U.S. Justice Department pertaining to a claim related to the field of cargo transport.
- Long-term unearned revenues decreased as a result of a decrease in frequent flyer club obligations, as a result of a surplus of use over accrual of frequent flyer points.
- The increase in the Company's shareholders' equity derives the increase in capital reserves in respect of cash flow hedging, as a result of the increase in the fair value of financial transactions, charged as hedging agreements, offset by the loss for the period.

As of September 30, 2009, the Company has a working capital deficit of \$387.4 million, compared with a deficit of \$339.7 million on December 31, 2008. The increase in the working capital deficit is primarily due to the decrease in restricted cash and the increase in short term borrowings, which are partially offset primarily by the increase in cash and short term deposit items and decrease in liabilities in respect of derivative financial instruments.

The working capital deficit is due to the Company's current liabilities, which contain two significant elements: unearned revenues from the sale of airline tickets and the obligation to Customer Loyalty Programs and the current maturities of long-term loans. These elements, which are characterized by a cyclical nature, are included in current liabilities, and essentially explain most of the working capital deficit.

### 3. Analysis of Operating Business Results of El Al

#### 3.1 Market Data

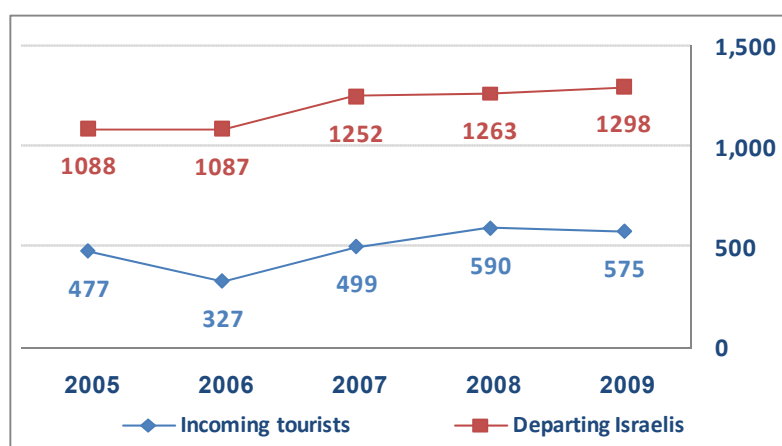
Passenger and cargo traffic at BGA	Jul - Sep 2009	Jul - Sep 2008	change	
	in thousands	in thousands	in thousands	%
Incoming tourists *	575	590	(15)	(3%)
Departing Israelis *	1,298	1,263	35	3%
Cargo import - tons **	30	35	(5)	(14%)
Cargo export - tons **	33	39	(6)	(15%)

Passenger and cargo traffic at BGA	Jan -Sep 2009	Jan -Sep 2008	change	
	in thousands	in thousands	in thousands	%
Incoming tourists *	1,491	1,656	(165)	(10%)
Departing Israelis *	2,675	2,824	(149)	(5%)
Cargo import - tons **	85	109	(24)	(22%)
Cargo export - tons **	109	142	(33)	(23%)

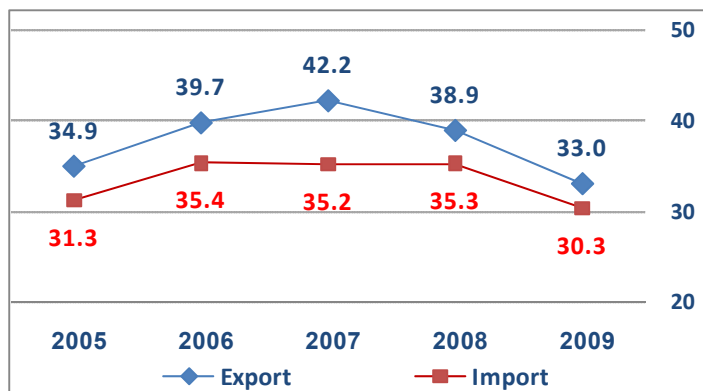
\* Source: Central Bureau of Statistics.

\*\* Does not include cargo in transit.

#### Incoming Tourist & Departing Israeli Traffic, in the third quarter of the following years: (In thousands)



**Imports & Exports of Cargo by Air, to and from Israel, in the third quarter of the following years (in thousands of tons):**



### 3.2 Company Operating Data

	Jul - Sep 2009	Jul - Sep 2008	change
Passenger leg (scheduled and chartered) - in thousands	1,214	1,138	7%
RPK (scheduled) - in millions	4,861	4,561	7%
ASK (scheduled) - in millions	5,715	5,335	7%
Load factor (scheduled)	85.1%	85.5%	(1%)
The Company's market share (scheduled and chartered)	34.7%	32.8%	6%
Flown cargo, in thousand tons	20	24	(18%)
RTK - in millions	104	127	(18%)
Weighted flying hours (including leased equipment) - in thousands (*)	43.9	42.1	4%
<u>Average man-years (EI AL only):</u>			
Permanent	3,774	3,780	(0%)
Temporary	2,278	2,406	(5%)
Total	6,052	6,186	(2%)

	Jan - Sep 2009	Jan - Sep 2008	change
Passenger leg (scheduled and chartered) - in thousands	2,912	2,981	(2%)
RPK (scheduled) - in millions	12,440	12,911	(4%)
ASK (scheduled) - in millions	15,407	15,660	(2%)
Load factor (scheduled)	80.7%	82.4%	(2%)
The Company's market share (scheduled and chartered)	37.6%	35.8%	5%
Flown cargo, in thousand tons	64	88	(28%)
RTK - in millions	315	467	(33%)
Weighted flying hours (including leased equipment) - in thousands (*)	118.9	126.3	(6%)
<u>Average man-years (EI AL only):</u>			
Permanent	3,782	3,754	1%
Temporary	2,081	2,366	(12%)
Total	5,863	6,120	(4%)
Aircraft in operation - end of period - number of units			
	38	35	3
Average age of owned fleet at the end of the period - in years			
	12.8	15.3	(2.5)

#### **Glossary:**

*Passenger leg – Flight coupon in one direction.*

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

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

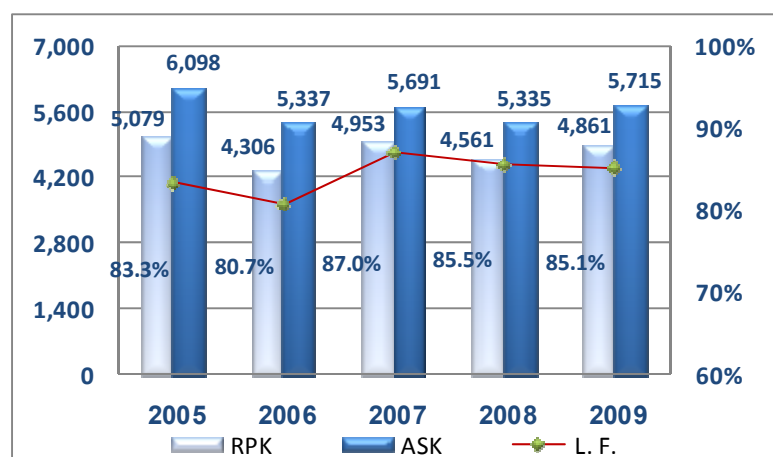
*RTK – Revenue Ton Kilometer – weight of paid flown cargo in tons multiplied by distance flown.*

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

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

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

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

**Operating data, in the third quarter for the years****(In Millions):**

### 3.3 Statement of Operations Data for the Three Month Period Ending September 30 2009 (Consolidated Financial Statements)

	Jul - Sep 2009		Jul - Sep 2008		change	
	in thousands US dollars	% of operating revenues	in thousands US dollars	% of operating revenues	in thousands US dollars	%
Operating revenues	496,059	100%	606,929	100%	(110,870)	(18%)
Operating expenses	(400,654)	(80.8%)	(472,426)	(77.8%)	71,772	(15%)
<b>Gross profit</b>	<b>95,405</b>	<b>19.2%</b>	<b>134,503</b>	<b>22.2%</b>	<b>(39,098)</b>	<b>(29%)</b>
Selling expenses	(49,343)	(9.9%)	(64,367)	(10.6%)	15,024	(23%)
General and administrative expenses	(21,137)	(4.3%)	(24,437)	(4.0%)	3,300	(14%)
Other operating revenues (expenses), net	(1,147)	(0.2%)	5,412	0.9%	(6,559)	
<b>Operating profit before financing</b>	<b>23,778</b>	<b>4.8%</b>	<b>51,111</b>	<b>8.4%</b>	<b>(27,333)</b>	<b>(53%)</b>
Financing expenses	(14,249)	(2.9%)	(12,029)	(2.0%)	(2,220)	18%
Financing income	1,167	0.2%	1,986	0.3%	(819)	(41%)
Company's share in earnings of affiliates, net	45	0.0%	480	0.1%	(435)	(91%)
<b>Profit before income taxes</b>	<b>10,741</b>	<b>2.2%</b>	<b>41,548</b>	<b>6.8%</b>	<b>(30,807)</b>	<b>(74%)</b>
Tax benefit (expenses)	1,563	0.3%	(10,581)	(1.7%)	12,144	
<b>Profit for the period</b>	<b>12,304</b>	<b>2.5%</b>	<b>30,967</b>	<b>5.1%</b>	<b>(18,663)</b>	<b>(60%)</b>

(\*) Retroactive implementation of changes in accounting policy - see Note 8 to the Financial Statements.

#### The key factors that influenced the business results in the three month period ended September 30 2009 compared with the same period last year:

- The decrease in operating revenues is due mainly to the decrease in revenue per passenger kilometer compared to the same period last year, as well as from the strengthening of the USD compared to other currencies. Cargo transport revenues also decreased compared to the same quarter last year, primarily as a result of the global slump in air cargo shipping, which led to drops both in amounts of cargo shipped as well as the average price per ton of cargo.
- The third quarter of 2009 saw a decrease in the Company's operating expenses relative to the same period last year, primarily due to a decrease in jet fuel expenses as detailed below and from the

strengthening of the USD in comparison to the euro. This decrease was offset by increased activity in the reported quarter relative to the same quarter last year.

- Salary costs in the third quarter of 2009 remained unchanged relative to the comparable period last year. The devaluation on the average NIS exchange rate relative to the USD led to a decrease in salary expenses, as well as the 2% decrease in average man-years compared to the same period last year. At the same time, salary expenses increased due to the revaluation of the NIS relative to the USD this quarter, which increased the Company's employee compensation obligations in dollar terms, as well as a one-time payment for car allowance differentials. Regarding the impact of the changes in the exchange rate of the NIS vs. the USD on the Company's liabilities due to employee benefits, see note 3.5 below.
- The Company's expenses for jet fuel dropped, primarily as a result of the drop in jet fuel prices in the reported quarter relative to the same quarter last year, from \$214.7 million in the third quarter of 2008 to \$136.0 million in the reported period, after hedging payments totaling \$21.9 million in the third quarter of 2009 (compared with hedging returns of \$13.7 million received in the comparable quarter last year). The fair value of jet fuel hedging transactions not classified as hedging agreements increased by \$3.3 million in the reported period, which reduced fuel expenses (compared to a fair value decrease of \$3.8 million in the same quarter last year).

In all, the third quarter of 2009 saw an 39.4% decrease in Company's effective jet fuel prices compared to the same quarter last year. On the other hand, the increase in flight hours in the reported period compared to the same period last year increased jet fuel expenses. As for jet fuel hedging, see 7.3 below.

- Selling expenses decreased compared to the same quarter last year, mainly as a result of the decrease in passenger and cargo revenues as well as the increase in direct Company sales through its call center as well as a result of the drop in the rate of distribution expenses.
- General and administrative expenses decreased compared with the same quarter last year primarily due to the decrease in salary expenses, as well as reduced expenditure on consulting and other services.
- The Company listed other net expenses to the amount of \$1.1 million, net, in the reported period, primarily as a result of the influence of the revaluation of the NIS relative to the USD on early retirement plan obligations. The Company listed other net revenues to the amount of \$5.4 million in the third quarter of 2008, primarily as a result of capital gains from the sale of an airplane.
- The increase in financing costs in the third quarter of 2009 relative to the same period last year derived primarily from the increase in the Company's loan inventory and an increase in interest hedging expenses, offset by the drop in LIBOR rates and a decrease in exchange rate compared to the third quarter of 2008.
- Financing revenues decreased primarily as a result of the decrease in interest revenue from Company deposits as a result of the drop in LIBOR rates and the decrease in deposit inventory relative to the same period last year. At the same time, the Company had revenues from exchange rate hedging compared to hedging expenses in the same period last year. As for interest rate hedging and exchange rates, see 7.4 and 7.5 below.
- Tax benefit increased as a result of the profit before income taxes relative to the comparable period last year, and an additional tax benefit was listed in this quarter from the change in corporate tax rates in accordance with the financial streamlining law published July 2009.

### 3.4 Statement of Operations Data for the Nine Month Period Ending September 30 2009 (Consolidated Financial Statements)

	<u>Jan-Sep</u> 2009		<u>Jan-Sep</u> 2008		<u>change</u>	
	in thousands US dollars	% of operating revenues	in thousands US dollars	% of operating revenues	in thousands US dollars	%
Operating revenues	1,242,158	100%	1,633,639	100%	(391,481)	(24%)
Operating expenses	(1,081,695)	(87.1%)	(1,375,188)	(84.2%)	293,493	(21%)
<b>Gross profit</b>	160,463	12.9%	258,451	15.8%	(97,988)	(38%)
Selling expenses	(138,377)	(11.1%)	(180,028)	(11.0%)	41,651	(23%)
General and administrative expenses	(64,268)	(5.2%)	(75,759)	(4.6%)	11,491	(15%)
Other operating expenses, net	(986)	(0.1%)	(18,702)	(1.1%)	17,716	(95%)
<b>Operating loss before financing</b>	(43,168)	(3.5%)	(16,038)	(1.0%)	(27,130)	169%
Financing expenses	(24,868)	(2.0%)	(37,964)	(2.3%)	13,096	(34%)
Financing income	1,885	0.2%	18,313	1.1%	(16,428)	(90%)
Company's share in earnings of affiliates, net	81	0.0%	578	0.0%	(497)	(86%)
<b>Loss before income taxes</b>	(66,070)	(5.3%)	(35,111)	(2.1%)	(30,959)	88%
Tax benefit	18,790	1.5%	3,322	0.2%	15,468	466%
<b>Loss for the period</b>	<b>(47,280)</b>	<b>(3.8%)</b>	<b>(31,789)</b>	<b>(1.9%)</b>	<b>(15,491)</b>	<b>49%</b>

(\*) Retroactive implementation of changes in accounting policy – see Note 8 to the Financial Statements

**The key factors that influenced the business results in the nine month period ended September 30, 2009 compared with the same period last year:**

- The decrease in operating revenues is due mainly to the decrease in passenger revenues, which is due to the decrease in the number of passengers relative to the same period last year, from a decrease in average revenue per passenger kilometer, as well as from the strengthening of the USD compared to other currencies. Cargo transport revenues also decreased compared to the same period last year, primarily as a result of the global slump in air cargo shipping, and as a result of the discontinuation of Far East cargo activity in the third quarter of 2008.
- The first nine months of 2009 saw a decrease in the Company's operating expenses relative to the same period last year, primarily due to a decrease in jet fuel expenses and a decrease in salary expenses as detailed below as well as the decrease in activity.
- Salary costs in the first nine months of 2009 decreased relative to the comparable period last year, primarily as a result of the devaluation on the average NIS exchange rate relative to the USD of the comparable period last year and a 4% decrease in average man-years. Regarding the impact of the changes in the exchange rate of the NIS vs. the USD on the Company's liabilities due to employee benefits, see note 3.5 below.
- The Company's expenses for jet fuel dropped, primarily as a result of the drop in jet fuel prices in the reported period relative to the same period last year, from \$593.1 million in the first nine months of 2008 to \$354.8 million in the reported period, after hedging payments totaling \$91.8 million (compared with hedging returns of \$42.0 million received in the comparable period last year). The fair value of jet fuel hedging transactions not classified as hedging agreements increased by \$19.9 million in the reported period, which reduced fuel expenses (compared to a fair value decrease of \$9.7 million in the same period last year).

In all, the first nine months of 2009 saw a 35.3% decrease in Company's effective jet fuel prices compared to the same period last year. In addition, jet fuel expenses also decreased as a result of the decrease in flight hours in the reported period. As for jet fuel hedging, see 7.3 below.

- Selling expenses decreased compared to the same period last year, mainly as a result of the decrease in distribution expenses and their portion of the turnover, this as a result of the decrease

in passenger and cargo revenues as well as the increase in direct Company sales through its call center and the internet.

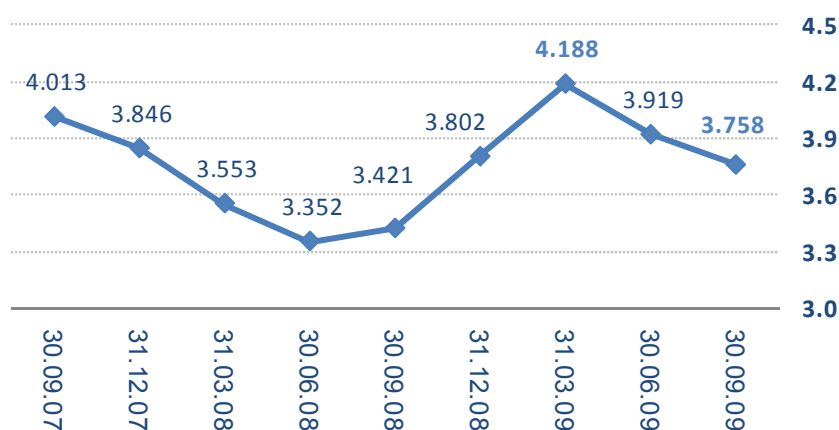
- General and administrative expenses decreased compared with the same period last year primarily due to the decrease in salary expenses.
- The Company listed other operating expenses net, to the amount of \$0.9 million, in the account period primarily in connection with early retirement plans offset by capital gains from the sale of fixed assets.
- The decrease in financing costs in the first nine months of 2009 relative to the same period last year derived primarily from the decrease in interest expenses on Company loans as a result of the drop in LIBOR rates as well as a decrease in exchange rate differences expenses.
- The Company's financing revenues decreased compared to the same period last year primarily as a result of a decrease in revenues from currency rate hedging transactions. In addition, a decrease occurred in interest revenue from Company deposits as a result of the drop in LIBOR rates and drop in deposits in the reported period relative to the same period last year. As for interest and exchange rate hedging, see 7.4 and 7.5 below.
- Tax benefit increased as a result of the pre-tax loss relative to the comparable period last year.

### **3.5 Effect of Changes in the Exchange rate on the Company's Employee Benefit Obligations**

In the three month period ending September 30 2009, the exchange rate of the NIS vs. the USD was revaluated by 4.1%, compared to a 2.1% devaluation of the NIS vs. the USD occurring in the same quarter last year.

The exchange rate of the NIS vs. the USD revaluated by 1.2% in the first nine months of 2009, compared to the 11.1% revaluation of the NIS vs. the USD occurring in the same period last year.

**US Dollar –NIS Exchange Rate:**



The Company has net obligations for employee benefits primarily for compensation, retirement plans, sick and vacation day redemption to the amount of \$79 million as of September 30 2009. As most of these obligations are in NIS while the Company's functional currency is the dollar, these obligations must be translated to dollars, which leads to differences deriving from changes in the NIS/USD exchange rate. Exchange rate differences are not one-directional, and lead to revenues or expenses to be listed accordingly in the Company's reports. These revenues or expenses have no impact on the Company's cash flow or short term operating costs. In order to allow a long term comparison of the Company's business results, these revenues or expenses must be neutralized.

A \$2.9 million expenses due to this component was listed in the quarter ending September 30 2009 relative to the same period last year, in which \$1.5 million decrease in expenses were listed due to this component.

A \$16 thousand decrease in expenses due to this component was listed in the first nine months of 2009 relative to the same period last year, in which \$9.0 million increase in expenses were listed due to this component.

The following are the business results with the influence of the exchange rate on the employee benefits obligation component neutralized, as explained above:

Three-month period ended September 30,	<u>Before</u>		<u>After</u>	
	<u>neutralizing the exchange-rate effect on the accrued severance pay</u>			
	2009	2008	2009	2008
	(in thousands US dollars)			
Operating expenses	400,654	472,426	398,910	473,167
Gross profit	95,405	134,503	97,149	133,762
<i>Gross profit rate</i>	19.2%	22.2%	19.6%	22.0%
Selling, general and administrative expenses	70,480	88,804	70,251	88,898
Other operating expenses (income), net	(1,147)	5,412	(222)	4,713
Operating profits before financing expenses	23,778	51,111	26,676	49,577
<i>Operating profits rate before financing</i>	4.8%	8.4%	5.4%	8.2%
Profits for the period	12,304	30,967	15,202	29,433
Profits for the period rate	2.5%	5.1%	3.1%	4.8%

Nine-month period ended September 30,	<u>Before</u>		<u>After</u>	
	<u>neutralizing the exchange-rate effect on the accrued severance pay</u>			
	2009	2008	2009	2008
	(in thousands US dollars)			
Operating expenses	1,081,695	1,375,188	1,081,470	1,371,283
Gross profit	160,463	258,451	160,688	262,356
<i>Gross profit rate</i>	12.9%	15.8%	12.9%	16.1%
Selling, general and administrative expenses	202,645	255,787	202,711	255,295
Other operating expenses ,net	(986)	(18,702)	(1,161)	(14,147)
Operating loss before financing expenses	(43,168)	(16,038)	(43,184)	(7,086)
<i>Operating loss rate before financing</i>	(3.5%)	(1.0%)	(3.5%)	(0.4%)
Loss for the period	(47,280)	(31,789)	(47,296)	(22,837)
<i>Loss for the period rate</i>	(3.8%)	(1.9%)	(3.8%)	(1.4%)

### **3.6 Segment Reporting**

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Presented below are operational segment data on a consolidated basis:

#### **A. General**

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

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

*On the other hand, the previous standard (IAS 14, "Segment Based Reporting") required that entities recognize two segment arrays (business and geographical), based on the risk and yield method, with the internal financial reporting system for the entity's key administrative personnel serving only as a starting point for the recognition of the above segments.*

*As a result of the adoption of the new standard, the Group has recognized reportable segments different from those presented in earlier reporting periods.*

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

*Segment A – passenger aircraft activity.*

*Segment B – cargo aircraft activity.*

*Segment C – others.*

Passenger aircraft activity includes revenues (without deducting discounts) from the transport of passengers including baggage, transporting cargo in the belly of passenger aircraft, mail transport and the contribution from the sale of duty free products. Expenses charged to this segment include variable expenses involved in operating the flights, mainly fuel costs (not including changes in fair value of jet fuel hedging agreement), passenger and cargo handling, airport taxes and fees variable maintenance costs, passage and communications fees, passenger food and supplies, aircraft leasing fees, discounts and commissions given to passengers or paid to travel agents, air crew expenses including salaries and variable security costs.

Cargo aircraft activity includes revenues from airborne cargo shipping fees. Expenses charged to this segment are the variable expenses for the operation of these flights mentioned above.

Other Company activities include revenues from charter flights via subsidiary Sun D'Or (which are written off in the "Adjustments to Consolidated" column), revenues from maintenance service provided to outside elements as well as a broad variety of services and revenues such as equipment leasing, frequent flier membership fees, loading and unloading services and more. The variable expenses involved in the creation of any sort of revenue are charged to these revenues.

Unassigned expenses include primarily depreciation expenses, salary expenses - with the exception of air crews – and other fixed costs.

Information referring to these segments is reported in B below. Sums reported for previous reporting periods were restated according to the new segment reporting base.

**B. Analysis of income and results by operating segments:**

<b>For Three-month period ending:</b>					
<b>30.09.2009</b> <b>(Unauditing)</b>	<u>passenger</u> <u>aircraft</u>	<u>cargo</u> <u>aircraft</u>	<u>others</u>	<u>Adjustment</u>	<u>Total</u> <u>consolidated</u>
<b>In Millions of US dollars</b>					
<b>operating revenues</b>					
revenue from external customers	443.2	12.0	11.5	-	466.7
inter-segment revenues	-	-	27.8	(27.8)	-
Adjustment to consolidated	-	-	-	29.4	29.4
<b>Total segment revenues</b>	<b>443.2</b>	<b>12.0</b>	<b>39.3</b>	<b>1.6</b>	<b>496.1</b>
<b>segment results</b>	<b>123.2</b>	<b>(0.8)</b>	<b>14.5</b>		<b>136.9</b>
Unassigned expenses					(113.1)
<b>Operating profits before financing</b>					<b>23.8</b>
Financing expenses					(14.2)
Financing income					1.1
Company's share in the profits of affiliates, net					0.0
<b>profits before income taxes</b>					<b>10.7</b>
Income taxes					1.6
<b>Profits for the period</b>					<b>12.3</b>

<b>For Three-month period ending:</b>					
<b>30.09.2008</b> <b>(Unauditing)</b>	<u>passenger</u> <u>aircraft</u>	<u>cargo</u> <u>aircraft</u>	<u>others</u>	<u>Adjustment</u>	<u>Total</u> <u>consolidated</u>
<b>In Millions of US dollars</b>					
<b>operating revenues</b>					
revenue from external customers	534.0	29.3	12.7	-	576.0
inter-segment revenues	-	-	29.8	(29.8)	-
Adjustment to consolidated	-	-	-	30.9	30.9
<b>Total segment revenues</b>	<b>534.0</b>	<b>29.3</b>	<b>42.5</b>	<b>1.1</b>	<b>606.9</b>
<b>segment results</b>	<b>138.0</b>	<b>2.2</b>	<b>17.6</b>		<b>157.8</b>
Unassigned expenses					(106.7)
<b>Operating profits before financing</b>					<b>51.1</b>
Financing expenses					(12.0)
Financing income					2.0
Company's share in the profits of affiliates, net					0.5
<b>Profits before income taxes</b>					<b>41.6</b>
Income taxes					(10.6)
<b>Profits for the period</b>					<b>31.0</b>

<b>For Nine-month period ending:</b>					
<b>30.09.2009</b> (Unauditing)	<u>passenger aircraft</u>	<u>cargo aircraft</u>	<u>others</u>	<u>Adjustment</u>	<u>Total consolidated</u>
In Millions of US dollars					
<b>operating revenues</b>					
revenue from external customers	1,112.2	43.2	30.1	-	1,185.5
inter-segment revenues	-	-	53.7	(53.7)	-
Adjustment to consolidated	-	-	-	56.7	56.7
<b>Total segment revenues</b>	<b>1,112.2</b>	<b>43.2</b>	<b>83.8</b>	<b>3.0</b>	<b>1,242.2</b>
<b>segment results</b>	<b>245.8</b>	<b>(2.2)</b>	<b>33.9</b>		<b>277.5</b>
Unassigned expenses					(320.7)
<b>Operating loss before financing</b>					<b>(43.2)</b>
Financing expenses					(24.9)
Financing income					1.9
Company's share in the profits of affiliates, net					0.1
<b>Loss before income taxes</b>					<b>(66.1)</b>
Income taxes					18.8
<b>Loss for the period</b>					<b>(47.3)</b>

<b>For Nine-month period ending:</b>					
<b>30.09.2008</b> (Unauditing)	<u>passenger aircraft</u>	<u>cargo aircraft</u>	<u>others</u>	<u>Adjustment</u>	<u>Total consolidated</u>
In Millions of US dollars					
<b>operating revenues</b>					
revenue from external customers	1,425.9	114.0	34.3	-	1,574.2
inter-segment revenues	-	-	62.3	(62.3)	-
Adjustment to consolidated	-	-	-	59.4	59.4
<b>Total segment revenues</b>	<b>1,425.9</b>	<b>114.0</b>	<b>96.6</b>	<b>(2.9)</b>	<b>1,633.6</b>
<b>segment results</b>	<b>307.5</b>	<b>9.2</b>	<b>40.1</b>		<b>356.8</b>
Unassigned expenses					(372.8)
<b>Operating loss before financing</b>					<b>(16.0)</b>
Financing expenses					(38.0)
Financing income					18.3
Company's share in the profits of affiliates, net					0.6
<b>Loss before income taxes</b>					<b>(35.1)</b>
Income taxes					3.3
<b>Loss for the period</b>					<b>(31.8)</b>

<b>For The year ended:</b>					
31.12.2008	<u>passenger aircraft</u>	<u>cargo aircraft</u>	<u>others</u>	<u>Adjustment</u>	<u>Total consolidated</u>
In Millions of US dollars					
<b>operating revenues</b>					
revenue from external customers	1,832.0	139.5	51.1	-	2,022.6
inter-segment revenues	-	-	76.4	(76.4)	-
Adjustment to consolidated	-	-	-	73.7	73.7
<b>Total segment revenues</b>	<b>1,832.0</b>	<b>139.5</b>	<b>127.5</b>	<b>(2.7)</b>	<b>2,096.3</b>
<b>segment results</b>	<b>436.2</b>	<b>8.7</b>	<b>57.7</b>		<b>502.6</b>
Unassigned expenses					(508.3)
<b>Operating loss before financing</b>					<b>(5.7)</b>
Financing expenses					(61.5)
Financing income					17.0
Company's share in the profits of affiliates, net					0.5
<b>Loss before income taxes</b>					<b>(49.7)</b>
Income taxes					7.8
<b>Loss for the period</b>					<b>(41.9)</b>

The first nine months and third quarter of 2009 saw a decrease in revenues in all operating segments as well as a decrease in contributions in all segments compared to the same periods last year.

Revenues from passenger aircraft decreased primarily as a result of the decrease in passenger numbers (in the nine month period), from the decrease in the average revenue per passenger kilometer, as well as the strengthening of the USD versus other currencies.

Cargo aircraft revenues also decrease compared to the comparable third quarter and the first nine months last year, this as a result of the global slump in air cargo shipping which caused a drop both in amounts of cargo flown and in the average price per ton of cargo, and as a result of the discontinuation of Far East cargo activity in the third quarter of 2008.

As for the decrease in profit rates in passenger and cargo aircraft activity, see explanation in Section 3.3 of the Bard of Directors' Report above, which analyzes the Group's operating results.

#### **4. Seasonal Factors**

The Group's activity is seasonal and focuses on peak periods. Heavy traffic of Israelis traveling abroad occurs primarily during the summer months and during holidays, while heavy incoming tourist traffic occurs during the summer months and during Jewish or Christian holidays or vacation time in their countries of origin.

**5. Liquidity and Financing Sources**

Movement in cash flows in the nine and three month periods ending September 30 2009 compared to the same periods last year:

	<b>Jul - Sep 2009 in thousands US dollars</b>	<b>Jul - Sep 2008 in thousands US dollars</b>	<b>change in thousands US dollars</b>
Cash flows used for operating activities	(18,792)	(11,348)	(7,444)
Cash flows (used for) from investing activities	(17,819)	42,685	(60,504)
Cash flows used for financing activities	(19,890)	(18,378)	(1,512)
Net increase (decrease) in cash and cash equivalents	(56,501)	12,959	(69,460)

	<b>Jan -Sep 2009 in thousands US dollars</b>	<b>Jan -Sep 2008 in thousands US dollars</b>	<b>change in thousands US dollars</b>
Cash flows from operating activities	6,126	97,849	(91,723)
Cash flows used for investing activities	(32,382)	(38,438)	6,056
Cash flows from (used for) financing activities	74,326	(43,573)	117,899
Net increase in cash and cash equivalents	48,070	15,838	32,232

In the quarter ending September 30 2009, the Company derived negative cash flows from operating activities to the amount of \$18.8 million (compared to negative cash flows from operating activity to the amount of \$11.3 million in the same quarter last year). The change in question derived mainly from a decrease in pre-tax earnings in the reported quarter and the increase in fair value earnings from derivative financial instruments not in cash.

The Company invested \$17.8 million in the third quarter of 2009 in investment activity, primarily in purchasing fixed assets to the amount of \$14.9 million and short term deposits to the amount of \$12.3 million. On the other hand, the Company realized restricted deposits to the amount of \$9.8. The Company derived cash from investment activity to the amount of \$42.7 million in the third quarter of 2008, primarily from the realization of short-term deposits to the amount of \$66.6 million and from the sale of fixed assets to the amount of \$6.5 million offset by investments in fixed assets to the amount of \$30.0 million.

The Company used \$19.9 million in financing activity in the third quarter of 2009, primarily for repaying long term loans. In the same period last year, the Company used \$18.4 million in financing primarily for repaying long term loans.

In the first nine months of 2009, the Company derived cash flows from operating activities to the amount of \$6.1 million (compared to \$97.8 in the same period last year). The decrease derived primarily from an increase in pre-tax loss, from an increase in fair value earnings from derivative financial instruments not in cash and from changes in assets and liabilities items.

The Company invested \$32.4 million in the first nine months of 2009 in investment activity, primarily in purchasing fixed assets (including 3 737-800 aircraft) to the amount of \$166.3 million and investments in short term deposits to the amount of \$12.1 million. In this period the Company realized restricted deposits to the amount of \$124.5 million and derived \$22.6 million as a yield from the realization of fixed assets. The Company used \$38.4 million in cash for investment activity in the first nine months of 2008, primarily in the purchase of fixed assets to the amount of \$93.8 million, while at the same time the Company derived \$51.5 million from the realization of short term deposits and \$7.0 million from the realization of fixed assets.

The Company received \$74.3 million from financing activity in the first nine months of 2009, primarily from loans to the amount of \$113.3 million received for the purchase of 737-800 aircraft and from the receipt of short term borrowings to the amount of \$14.7 million. At the same time, the Company repaid long term loans to the amount of \$46.5 million and paid loan raising expenses to the amount of \$7.2 million. In the

same period last year, the Company used \$43.6 million for financing activity, primarily for the repayment of \$39.9 million in long term loans and the payment of \$3.1 million in dividends.

In total, the balance of cash and cash equivalents and short term deposits as of September 30 2009 amounted to a total of \$118.6 million, compared to \$58.4 million on December 31 2008.

## **6. Critical Accounting Estimates**

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

For details on the material estimates included in the Financial Statements see Note 3 to the December 31 2008 Financial Statements. For estimates related to frequent flier club liabilities, see Notes 2.c and 8 of the September 30 2009 Financial Statements.

## **7. Qualitative Reporting on Exposure to and Management of Market Risks**

### **7.1 General – Description of Market risks to which El Al is Exposed**

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

Changes in prices of jet fuel, which constitutes a significant element of the Company's operating expenses, have a material effect on the Company's profitability. In the Company's estimation, at its current level of activity, every ¢1 increase in the price of a gallon of jet fuel during an entire year increases the Company's fuel expenses by \$2.3 million, and in addition, this change influences the extent of deposits the Company is required to provide jet fuel hedgers. The Company has taken hedging measures to reduce the exposure, as provided in Paragraph 7.3 below.

Exposure to changes in interest rates - Most of the Company's long-term loans are at variable interest. Therefore, an increase in the LIBOR rate could impact the Company's profitability.

At the present level of activity, every 1% increase in the Libor rate for a full year increases the Company's financing expenses by \$7.3 million.

The Company has adopted hedging measures to reduce the exposure, as provided in Section 7.4 below.

Currency exposure – Most of the Company's revenues and expenses are in foreign currency (mainly U.S. dollar), except for several shekel expenses, mainly salary expenses and suppliers paid in Israel. Accordingly, a change in the shekel/dollar exchange rate influences the Company's shekel expenses in dollar terms. In the Company's estimation, at the present level of activity, appreciation of the exchange rate of the shekel relative to the dollar of each 1% for an entire year increases the Company's annual expenses by \$3.5 million. Likewise, a surplus of receipts exists over payments in euro, but at insignificant rates.

Exposure in long-term loan frameworks – According to the provisions of the loan agreements, the Company must maintain a minimal collateral ratio between the market value of the planes and the balance of the loans that financed their purchase. Likewise, the Company is required to comply with certain covenants, for which, if not complied with, the Company could be demanded to immediately repay the loans. See Note 20.g.1 to the December 31 2008 Financial Statements for further details. The Company's exposure to market risks in this area derives from the changes that occur in the market value of planes globally, due to exceptional security events, and to the oversupply of seats on airlines in the world. For further details see Notes 4.b and 11.c to the September 30 2009 Financial Statements.

## **7.2 *El Al Market Risk Management Policies, Officials Responsible for their Management and Means of Controlling and Executing Policy***

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The Company has a Board of Directors committee for market risks management headed by the chairman of the finance, budget and Financial Statements committee, Mr. Nadav Palti, who is responsible for prescribing the policy for covering the existing exposure. The CFO is responsible for executing the policy and reporting to the Market Risks Management Committee. The Company has held regular meetings of the Market Risks Management Committee in 2009.

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

The Company's policy as regards jet fuel hedging is as follows: hedging jet fuel quantities for up to 24 months forward, so that for every period, a minimum and maximum percentage to be hedged out of total expected consumption gradually decreases. Therefore, the maximum hedge percentage at the beginning of the period is 80% and the minimum percentage at the end of the period is 20%.

The Company's policy with respect to interest hedging is to hedge about half of the Company's credit portfolio, so that half will be at variable interest and half at fixed interest, for a period of up to 5 years.

The Company's policy with respect to exchange rates is: to hedge up to half of the shekel exposure for one year forward.

The market risks committee of the Board of Directors occasionally instructs the Company's management to deviate from these rates set for jet fuel, interest and exchange rate, for specified periods of time, according to market developments.

For details regarding the policy implemented, see Sections 7.3, 7.4 and 7.5. For details of the influence of the changes in the economic environment, the implications of the crisis in capital markets and market risks after the balance sheet date see Section 11 below.

## **7.3 *Hedging Jet Fuel Prices***

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The Company executes financial transactions to hedge against changes in jet fuel prices, in accordance with its policy as described in Section 7.2 above.

As of September 30 2009, the Company entered into several agreements, in order to hedge jet fuel prices, at 51% of expected consumption in October-December 2009, 40% of expected consumption in 2010 and 18% of expected consumption in 2011. Some of these transactions are recognized as hedging agreements for accounting purposes, and some are not. The fair value of all jet fuel hedging instruments as of September 30 2009 is a net negative sum of \$78.8 million, presented in the Financial Statements in the framework of current and Long-term assets and current liabilities and long term liabilities under "Derivative Financial Instruments". The Company made payments for these hedging agreements to the amount of \$21.9 million in the reported quarter. For further details see Note 28.g to the December 31 2008 Financial Statements.

For details regarding changes occurring subsequent to the balance sheet date, see Section 11.b of the Board of Directors report.

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## ***7.4 Hedging Interest on Loans***

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The Company executes hedges of the exposure in its long-term credit portfolio, due to changes in interest rates, in accordance with its policy as laid out in Section 7.2 above.

Some of these financial instruments are recognized for accounting purposes as hedging transactions and some are not. The fair value of these instruments as of September 30, 2009 is a negative sum of \$24.9 million, which is presented in the Financial Statements in the framework of current and long term liabilities under "Derivative Financial Instruments".

After executing these hedges, as of September 30, 2009, 45% of the balance of the Company's loans is at fixed interest rates for a period of up to three and a half years. In addition, over the course of the third quarter of 2009 the Company received fixed-interest loans to the amount of \$113.3 million at fixed interest for a period of 12 years, which constitutes some 13% of the Company's loans. For further details see Note 4.a.2 of the Financial Statements.

The Company paid \$2.3 million in refunds for these hedging agreements in the reported quarter.

For additional information on these transactions, see Note 28.f to the December 31 2008 Financial Statements.

For information on changes occurring subsequent to the balance sheet date, see Section 11.c of the Board of Directors Report.

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## ***7.5 Exchange Rate Hedges***

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In August 2009 the Company entered into financial transactions intended to protect the Company from drops in the exchange rate of the USD vs. the NIS for a 15 month period. These transactions are recognized as hedging agreements.

The fair value of these instruments as of September 30 2009 is \$7.4 million, presented in the Financial Statements as part of current and non-current assets under "Derivative Financial Instruments". In the reported period the Company received refunds for these hedging agreements to the amount of \$0.9 million.

For information on changes occurring subsequent to the balance sheet date, see Section 11.d below.

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## ***7.6 Sensitivity Analysis Reporting***

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Presented below is a sensitivity analysis of the fair value of the financial instruments sensitive to possible changes in the risk factors to which they are exposed. The sensitivity analyses were performed relative to the fair value of the financial instruments as of September 30 2009.

The following are sensitivity analysis tables for instruments sensitive to changes in market factors:

**A. Sensitivity to changes in shekel/dollar exchange rate – in thousands of dollars:**

	Gain (loss) from changes		Fair value	Gain (loss) from changes	
	Increase 10%	Increase 5%		Decrease 5%	Decrease 10%
	4.134 NIS/\$	3.946 NIS/\$	3.758 NIS/\$	3.570 NIS/\$	3.382 NIS/\$
Cash and cash equivalents	(80)	(42)	881	46	98
Short-term deposits	(723)	(379)	7,954	419	884
Trade receivables	(114)	(60)	1,251	66	139
Other receivables	(575)	(301)	6,321	333	702
Current derivative financial instruments	(568)	(298)	6,249	329	694
Long-term bank deposits	(176)	(92)	1,940	102	216
Long-term derivative financial instruments	(108)	(56)	1,186	62	132
<b>Total financial Assets</b>	<b>(2,344)</b>	<b>(1,228)</b>	<b>25,782</b>	<b>1,357</b>	<b>2,865</b>
Trade payables	2,024	1,060	(22,263)	(1,172)	(2,474)
Other payables	225	118	(2,477)	(130)	(275)
Current provisions	4,585	2,402	(50,439)	(2,655)	(5,604)
<b>Total financial liabilities</b>	<b>6,834</b>	<b>3,580</b>	<b>(75,179)</b>	<b>(3,957)</b>	<b>(8,353)</b>
Exposure in linkage balance sheet due to surplus financial liabilities over financial assets*	4,491	2,352	(49,397)	(2,600)	(5,489)

\* Does not include exposure for the effect of the changes in the exchange rate on accrued severance pay, see in Section 3.4.

**B. Sensitivity to changes in euro/dollar exchange rate – in thousands of dollars:**

	Gain (loss) from changes		Fair value	Gain (loss) from changes	
	Increase 10%	Increase 5%		Decrease 5%	Decrease 10%
	0.750 Euro/\$	0.716 Euro/\$	0.682 Euro/\$	0.648 Euro/\$	0.614 Euro/\$
Cash and cash equivalents	(238)	(125)	2,616	138	291
Trade receivables	(1,232)	(645)	13,553	713	1,506
Other receivables	(106)	(55)	1,164	61	129
<b>Total financial Assets</b>	<b>(1,576)</b>	<b>(825)</b>	<b>17,333</b>	<b>912</b>	<b>1,926</b>
Short-term borrowings and current maturities	134	70	(1,471)	(77)	(163)
Trade payables	2,079	1,089	(22,866)	(1,203)	(2,541)
Other payables	314	164	(3,453)	(182)	(384)
<b>Total financial liabilities</b>	<b>2,526</b>	<b>1,323</b>	<b>(27,790)</b>	<b>(1,463)</b>	<b>(3,088)</b>
Exposure in linkage balance sheet due to surplus financial liabilities over financial assets*	951	498	(10,457)	(550)	(1,162)

\* Does not include exposure for the effect of the changes in the exchange rate on accrued severance pay, see in Section 3.4.

**C. Sensitivity to changes in jet fuel prices on inventory (dollar/gallon) – in thousands of dollars:**

Type of instrument	Gain from changes		Fair value	Loss from changes	
	Increase 10%	Increase 5%		Decrease 5%	Decrease 10%
	2.190	2.091	1.991 *	1.891	1.792
	\$/gallon	\$/gallon	\$/gallon	\$/gallon	\$/gallon
<b>Jet fuel Inventorie</b>	<b>493</b>	<b>247</b>	<b>4,930</b>	<b>(247)</b>	<b>(493)</b>

\* Jet fuel prices according to moving weighted average as of September 30 2009.

**D. Sensitivity of jet fuel hedge to changes in jet fuel prices – in thousands of dollars:**

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

Type of instrument	Gain from changes			Fair value *	Loss from changes		
	Increase 15%	Increase 10%	Increase 5%		Decrease 5%	Decrease 10%	Decrease 15%
	2.045	1.956	1.867	1.778	1.689	1.600	1.511
	\$/gallon	\$/gallon	\$/gallon	\$/gallon	\$/gallon	\$/gallon	\$/gallon
<b>Options - not designed for hedging</b>	<b>1,308</b>	<b>910</b>	<b>473</b>	<b>(2,283)</b>	<b>(500)</b>	<b>(1,019)</b>	<b>(1,551)</b>
<b>SWAP transactions - designed for hedging</b>	<b>44,760</b>	<b>29,840</b>	<b>14,920</b>	<b>(76,469)</b>	<b>(14,920)</b>	<b>(29,840)</b>	<b>(44,760)</b>
<b>Total jet fuel transections</b>	<b>46,068</b>	<b>30,750</b>	<b>15,393</b>	<b>(78,752)</b>	<b>(15,420)</b>	<b>(30,859)</b>	<b>(46,311)</b>

\* The price of Jet fuel in the Med region as of September 30 2009, according to which the fair value of the Company's hedge transactions is computed.

**E. Sensitivity of interest hedge to changes in market interest rates – in thousands of dollars:**

According to the principles of the model, the Group executed interest hedges that respond in a similar way to market factors (swap agreements with knock out not intended for hedging, IRS agreements intended for hedging, IRS agreements not intended for hedging), since no loss of significant information is sustained that is required to understand the Company's exposure to the market risk, as a result of the grouping.

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
<b>SWAP transactions with KNOCK OUT - not designed for hedging</b>	<b>348</b>	<b>174</b>	<b>(2,986)</b>	<b>(277)</b>	<b>(468)</b>
<b>IRS transactions - designed for hedging</b>	<b>771</b>	<b>386</b>	<b>(3,822)</b>	<b>(385)</b>	<b>(772)</b>
<b>IRS transactions - not designed for hedging</b>	<b>2,387</b>	<b>1,193</b>	<b>(11,778)</b>	<b>(1,193)</b>	<b>(2,388)</b>
<b>Cylinder transactions - not designed for hedging</b>	<b>805</b>	<b>394</b>	<b>(6,282)</b>	<b>(411)</b>	<b>(805)</b>
<b>Total</b>	<b>4,311</b>	<b>2,147</b>	<b>(24,868)</b>	<b>(2,266)</b>	<b>(4,433)</b>

- \* Fair value was calculated according to the market Libor rate as of the balance sheet date, at the following rates: 3-month Libor: 0.29%, 6-month Libor: 0.63%, and 12-month Libor: 1.26%, all as applicable and according to the relevant transaction.

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

Type of instrument	Loss from changes		Fair value NIS/\$	Gain from changes	
	Increase 10% in exchange rate	Increase 5% in exchange rate		Decrease 5% in exchange rate	Decrease 10% in exchange rate
	4.134	3.946	3.758	3.570	3.382
<b>FORWARD transactions - designed for hedging</b>	<b>(19,534)</b>	<b>(9,767)</b>	<b>7,435</b>	<b>9,767</b>	<b>19,534</b>

## 8. **Linkage Basis Report**

The following is the consolidated linkage basis report for September 30 2009:

	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	87,742	881	2,616	7,431		98,670
Short-term deposits	12,000	7,954				19,954
Restricted deposits	28,468					28,468
Trade receivables	103,098	1,251	13,553	11,004		128,906
Other receivables	18,695	6,321	1,164	789		26,969
Current derivative financial instruments	1,728	6,249				7,977
Prepaid expenses					29,544	29,544
Inventories					13,549	13,549
Investment in affiliated held for sale	1,229				1,143	2,372
Long-term bank deposits		1,940				1,940
Investments in affiliated companies					445	445
Investments in another company	1,570					1,570
Long-term derivative financial instruments	1,481	1,186				2,667
Fixed assets, net					1,348,175	1,348,175
Intangible assets, net					8,992	8,992
Assets due to employee benefits	148	34,195				34,343
	<b>256,159</b>	<b>59,977</b>	<b>17,333</b>	<b>19,224</b>	<b>1,401,848</b>	<b>1,754,541</b>
<b>Liabilities &amp; Equity</b>						
Short-term borrowings and current maturities	(108,631)		(1,471)	(7)		(110,109)
Trade payables	(88,821)	(22,263)	(22,866)	(13,382)		(147,332)
Other payables	(34,442)	(2,477)	(3,453)	(3,416)		(43,788)
Current provisions	(7,480)	(50,439)				(57,919)
Current derivative financial instruments	(79,519)					(79,519)
Current employee benefit obligations	(2,456)	(90,025)	(501)	(292)		(93,274)
Current unearned revenues					(211,892)	(211,892)
Long-term loans from financial institutions	(730,528)					(730,528)
Long-term employee benefit obligations	(7,604)	(51,766)	(960)	(5,302)		(65,632)
Long-term derivative financial instruments	(27,310)					(27,310)
Long-term provisions	(9,008)					(9,008)
Deferred tax					(2,949)	(2,949)
Long-term unearned revenues					(46,091)	(46,091)
Shareholders' equity					(129,190)	(129,190)
	<b>(1,095,799)</b>	<b>(216,970)</b>	<b>(29,251)</b>	<b>(22,399)</b>	<b>(390,122)</b>	<b>(1,754,541)</b>
<b>Monetary assets, net of monetary liabilities (monetary liabilities, net of monetary assets)</b>	<b>(839,640)</b>	<b>(156,993)</b>	<b>(11,918)</b>	<b>(3,175)</b>	<b>1,011,726</b>	<b>-</b>

The following is the consolidated linkage basis report for September 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	86,680	1,963	4,402	9,463		102,508
Short-term deposits	120,500	8,613				129,113
Trade receivables	120,570	439	14,316	16,456		151,781
Other receivables	22,480	7,984	1,055	2,553		34,072
Current derivative financial instruments	25,558	4,381				29,939
Prepaid expenses					34,759	34,759
Inventories					17,446	17,446
Long-term bank deposits		2,444				2,444
Investments in affiliated companies	1,229				1,618	2,847
Investments in another company	1,581					1,581
Long-term derivative financial instruments	11					11
Fixed assets, net					1,282,454	1,282,454
Intangible assets, net					7,111	7,111
Assets due to employee benefits	150	40,147				40,297
	<b>378,759</b>	<b>65,971</b>	<b>19,773</b>	<b>28,472</b>	<b>1,343,388</b>	<b>1,836,363</b>
<b>Liabilities &amp; Equity</b>						
Short-term borrowings and current maturities	(72,193)	(128)	(174)	(5)		(72,500)
Trade payables	(105,086)	(29,506)	(30,952)	(13,752)		(179,296)
Other payables	(34,822)	(6,049)	(3,342)	(2,249)		(46,462)
Current provisions	(25,706)	(51,179)				(76,885)
Current derivative financial instruments	(21,239)					(21,239)
Current employee benefit obligations	(2,467)	(92,318)	(563)	(391)		(95,739)
Current unearned revenues					(248,092)	(248,092)
Long-term loans from financial institutions	(668,339)					(668,339)
Long-term employee benefit obligations	(7,277)	(62,548)	(891)	(6,654)		(77,370)
Lease fees payable	(188)					(188)
Long-term derivative financial instruments	(19,987)					(19,987)
Long-term provisions	(16,684)					(16,684)
Deferred tax					(39,783)	(39,783)
Long-term unearned revenues					(49,183)	(49,183)
Shareholders' equity					(224,616)	(224,616)
	<b>(973,988)</b>	<b>(241,728)</b>	<b>(35,922)</b>	<b>(23,051)</b>	<b>(561,674)</b>	<b>(1,836,363)</b>
<b>Monetary assets, net of monetary liabilities (monetary liabilities, net of monetary assets)</b>	<b>(595,229)</b>	<b>(175,757)</b>	<b>(16,149)</b>	<b>5,421</b>	<b>781,714</b>	<b>-</b>

The following is the consolidated linkage basis report for December 31 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	24,496	19,530	4,187	2,387		50,600
Short-term deposits		7,821				7,821
Restricted deposits	152,969					152,969
Trade receivables	83,530	306	11,019	11,191		106,046
Other receivables	10,467	7,225	490	1,511		19,693
Current derivative financial instruments	174					174
Prepaid expenses					27,692	27,692
Inventories					11,472	11,472
Long-term bank deposits		2,189				2,189
Investments in affiliated companies	1,229				1,507	2,736
Investments in another company	1,565					1,565
Fixed assets, net					1,314,182	1,314,182
Intangible assets, net					8,618	8,618
Assets due to employee benefits	129	36,648				36,777
	<b>274,559</b>	<b>73,719</b>	<b>15,696</b>	<b>15,089</b>	<b>1,363,471</b>	<b>1,742,534</b>
<b>Liabilities &amp; Equity</b>						
Short-term borrowings and current maturities	(84,746)	(55)	(742)	(728)		(86,271)
Trade payables	(77,984)	(22,214)	(23,320)	(10,672)		(134,190)
Other payables	(36,703)	(3,742)	(2,451)	(1,845)		(44,741)
Current provisions	(10,410)	(46,639)				(57,049)
Current derivative financial instruments	(108,072)					(108,072)
Current employee benefit obligations	(2,319)	(84,055)	(927)	(629)		(87,930)
Current unearned revenues					(197,911)	(197,911)
Long-term loans from financial institutions	(678,657)					(678,657)
Long-term employee benefit obligations	(7,672)	(62,866)	(856)	(4,832)		(76,226)
Long-term derivative financial instruments	(86,789)					(86,789)
Long-term provisions	(11,728)					(11,728)
Deferred tax					(1,872)	(1,872)
Long-term unearned revenues					(52,434)	(52,434)
Shareholders' equity					(118,664)	(118,664)
	<b>(1,105,080)</b>	<b>(219,571)</b>	<b>(28,296)</b>	<b>(18,706)</b>	<b>(370,881)</b>	<b>(1,742,534)</b>
<b>Monetary assets, net of monetary liabilities (monetary liabilities, net of monetary assets)</b>	<b>(830,521)</b>	<b>(145,852)</b>	<b>(12,600)</b>	<b>(3,617)</b>	<b>992,590</b>	<b>-</b>

## 9. Disclosure in the Report of the Board of Directors Regarding the Financial Statements Approval Process

The body charged with ultimate control in the Company is its Board of Directors.

Within the framework of the Board of Directors, the Company operates several committees, including the Audit Committee, the Market Risks Management Committee, the Human Resources and Appointments Committee, the Cargo Committee, the Government Affairs and Regulations Committee and the Finance, Budget and Financial Statements Committee, consisting of four members, including an outside director. As of this report, three out of the four members of the committee have accounting and financial expertise, as defined in the Companies Law, 1999, and the regulations promulgated as a result.

An advance draft of the Financial Statements is sent to the members of the Board of Directors.

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

The committee examines the significant financial reporting issues, including material transactions that are not in the ordinary course of business – if any, the significant assessments and critical estimates that were applied in the Financial Statements, the reasonableness of the data, the accounting policy applied and the changes that

occurred in them, if any, the application of the principle of fair disclosure in the Financial Statements and various aspects of control and management of risks.

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

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

The committee adopts a resolution to recommend to the Company's Board of Directors to approve the Financial Statements, subject to making corrections, changes and supplements – if so requested by the members of the committee.

The Financial Statements are presented to the members of the board in a separate meeting, in which the CEO, the CFO and other officers of the Company participate, also attended by the independent auditor.

A discussion is also held in this forum regarding the Financial Statements, including questions addressed to the independent auditor and members of the Company's management and special issues in the reporting period are presented. At the end of the discussion, the Board of Directors adopts a resolution on the approval of the Financial Statements.

#### **10. Explanation of the Matter to which the Company's Independent Auditors Draw Attention in their Report on the Financial Statements**

The Company's independent auditors draw attention, in their opinion on the Financial Statements, to Note 5 to the Interim Financial Statements - regarding the legal proceedings against the Company.

Although the matter to which the independent auditors drew attention does not constitute a change in the uniform wording of the auditor's report, attention must be drawn to it because of its possible material effect on the Company.

#### **11. Disclosure regarding Changes in the Economic Environment, the Implications of the Capital Market Crisis and Market Risks**

- a. The international aviation industry is affected by the global security situation and political and unusual events, such as the outbreak of epidemics and natural disasters in the world, in general, and in specific areas, in particular, as well as by the economic situation in Israel and around the world.

In September 2009 the IATA published a new projection according to which airlines around the world are expected to lose a total of \$11 billion in 2009. This estimate is \$2 billion higher than previous IATA projections published in June 2009. The reasons behind this worsening projection are the continuing rise in fuel prices and the sharp drop in yield per seat, deriving mainly from the global financial crisis.

Since the end of the third quarter of 2009 jet fuel prices have remained extremely volatile. A decrease has occurred in USD interest rates along with fluctuation in exchange rate of the NIS versus the USD. The impact of these changes on the Company shall be detailed below.

- b. As of the Balance Sheet date (September 30 2009) the price of jet fuel in the Med region was 177.8 cents per gallon, while as of immediately prior to the approval of the third 2009 quarterly report this price has reached 201.1 cents per gallon, a 13% increase.

The effective price the Company is expected to pay for jet fuel consumption (after hedging) in October and November 2009 is similar to effective price it paid in January-September 2009. At the same time, the fair value of jet hedging instruments shall be set in accordance with price changes which occurred since the end of the third quarter and the completion of accounting for some of the transactions.

With the drop in jet fuel prices beginning in the second half of 2008, the Company provided, as collateral to guarantee its meeting, hedging payments owed in accordance with its agreements with the hedging institutions to the amount of \$73 million, consisting mainly of letters of credit issued by Israeli banks in return for the restriction of assets and cash, and in part from interest-bearing deposits deposited directly at the hedging banks.

Subsequent to the balance sheet date, the deposit updating mechanism continued on a regular basis in accordance with daily fluctuations in jet fuel market prices. Note that the amount of the collateral changes from day to day according to jet fuel market prices and the Company make daily calculations regarding the changes required in the collateral and their extent. As of a date near the approval of the Q3 2009 Financial Statements this collateral amounted to a sum of \$48 million.

Over the course of the third quarter of 2009 the Company completed hedging transactions for a portion of the jet fuel consumption expected by the third quarter of 2011, in accordance with Company policy, as detailed in 7.2

c. Subsequent to the balance sheet date and until a date immediately prior to the approval of the third 2009 quarterly report, a further decrease occurred in three-month Libor interest rates, at a rate of 6%.

The impact of the drop in Libor rates in the payment of interest on loans shall be evident in the next repayment date for each loan. The interest payments on Company loans for the fourth quarter of 2009 shall be made according to interest rates in previous quarters. The Company possesses hedging agreements for Libor rates (see Section 7.4 above), the fair value of which is expected to drop as a result of the decrease in Libor interest rates.

d. Subsequent to the balance sheet date, fluctuation continued in the exchange rate of the NIS vs. the USD. Immediately prior to the approval of this report, no material change occurred in the USD/NIS exchange rate. A 1% revaluation in the NIS/USD exchange rate for an entire year increases the Company's yearly expenses by \$3.5 million.

In addition to the above, the revaluation of the NIS relative to the dollar increases the Company's shekel liabilities in dollar terms (see Section 3.5 of the Board of Directors Report), thus increasing the Company's salary and financing expenses.

Note that the impact of exchange rates on next quarter's operating results shall be determined based on exchange rates in effect throughout the quarter and at its conclusion (December 31 2009).

In August 2009 the Company conducted new hedging agreements for the USD rate of exchange for each of the months between September 2009 and November 2010, to protect a portion of its NIS payroll expenses.

## **12. Negligible Transaction**

On November 26 2009, the Company Board of Directors decided to adopt rules and guidelines for the classification of a transaction made by the company or one of its affiliates with an interested party (hereinafter: "an Interested Party Transaction") as a negligible transaction as defined in Regulation 64(3)(d)(1) of the Securities Regulations (Preparation of Yearly Financial Statements), 1993.

These rules and guidelines are also used to determine the extant of disclosure in the periodic report and in the prospectus (including in shelf proposal reports) as regards transactions with controlling shareholders or in which controlling shareholders have personal interest as defined in Regulation 22 of the Securities Regulations (Periodic and Immediate Reports), 1970 (hereinafter: "the Reporting Regulations"), as well as to determine the need to submit an immediate report for such a transaction, as set in Regulation 37(a)(6) of the Reporting Regulations.

The Company's Board of Directors has determined that in the absence of special qualitative considerations deriving from the circumstances of the issue, an Interested Party Transaction shall be considered a "negligible transaction" if:

(a) The transaction takes place over the Company's normal course of business and (b) the transaction is under market conditions and its terms are acceptable to the relevant market; and – (c) the relevant criteria for the transaction, one or more, whether it is a single commitment or a series of commitments on the same issue over the course of the same year, is at an extant of no greater than 200,000 NIS in any interested party transaction the classification of which has been considered as a "negligible transaction" on the basis of the Company's latest audited consolidated yearly financial statements. Relevant criteria for the determination of a transaction are, for instance: (1) total sales the subject of the Interested Party Transaction; or – (2) the total cost of the sales the subject of the Interested Party Transaction; or – (3) the extant of assets the subject of the Interested Party Transaction; or – (4) the extant of liabilities the subject of the Interested Party Transaction; or – (5) the extant of the expense or yield the subject of the Interested Party Transaction.

In this regard – in the event the Company does not have full rights to a certain transaction, the transaction shall be determined based on the Company's relative portion of the transaction.

In cases in which, according to the Company's judgment, all of the aforementioned criteria are irrelevant for the determination of the negligibility of the Interested Party Transaction, the transaction shall be considered negligible, in accordance with a different relevant criterion, determined by the Company, so long as the relevant criterion used for this transaction shall be no greater than 200,000 NIS.

At the same time, examination of the quantitative considerations of an interested party transaction may lead to the contradiction of the aforementioned presumption of the transaction's negligibility. Thus, for instance, and merely as an example, an Interested Party Transaction shall not generally be considered negligible if it is considered a significant event by Company Management and if it serves as basis for administrative decisions, or if interested parties are expected to receive benefits that need to be reported to the public as part of the transaction.

The transaction's negligibility shall be determined on a yearly basis for the purpose of reporting within the framework of the periodic report, the financial statements and the prospectus (including a shelf proposal report), while adding together all of the Company's transactions of the sort with the interested party in question or with corporations under the control of the interested party. To be clear – separate transactions carried out on a regular and repeating basis during a certain period with no mutual dependence or for which no additional obligations exist which are not relevant to entering into the transaction as regards the same interested party, shall be examined on a yearly basis for the purpose of reporting pursuant to the periodic report, the financial statements and the prospectus (including a shelf proposal report), and on the basis of the specific transaction for the purpose of immediate reporting.

### **13. Subsequent Events**

*Regarding events subsequent to the balance sheet date, see Note 11 of the September 30 2009 Financial Statements.*

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

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

**November 26, 2009**

***Appendix to the Report of the Board of Directors on the State of the Corporation's Affairs for the Quarter Ended September 30, 2009***

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**Minimal Disclosure Required for Value Estimates in their Regard, and Rules Pertaining to their Addition to Reports according to Securities Authority Guidelines in Accordance with Section 36a to the Securities Act, 1968.**

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

**a. Introduction**

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

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

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

This document was prepared in accordance with guidelines from the Securities Authority as per Section 36a of the Securities Law, 1968, regarding minimal required disclosure for value assessments and rules regarding their addition to reports in accordance with the Securities Law, 1968.

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

The asset group for which the test was conducted includes the 777-200 fleet which consists of 6 aircraft owned by the Company and the 747-400 fleet which consists of 5 aircraft owned by the Company.

**c. Review Date**

November 2009. The value estimate was based on financial data for the third quarter of 2009 and on financial projections for the remainder of 2009 and coming years.

**d. Value Assessor**

The value assessment was performed by El Al management.

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

The book value of the aircraft fleet is higher than its market value as appearing in price lists published by AVAC (the Aircraft Value Analysis Company). Note that use of the market value of the aircraft on the basis of AVAC price lists is common practice among airlines around the world as well as among financing banks and has been used by El Al in its various agreements with banks,

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

The net selling price is the sum that may be received from the sale of the asset in a good faith agreement between a willing buyer and a willing seller. The value in use of an asset is the current value of estimated future cash flow expected to derive from continuous use of the asset and its sale at the end of the period of use. The Company considers the market value of the assets as published by AVAC as representing the net sales price of its assets. As of this value assessment, the Company has examined the value in use of the aircraft it its possession and in its service, the accumulated costs of which in the Company's September 30 2009 Financial Statements is greater than their selling price.

As of this value assessment, the selling price of the 777-200 fleet, as specified in paragraph b. above, amounts to a total of \$513 million, compared to the accumulated costs in the books of those aircraft as of September 30 2009, which amounts to a total of \$547 million.

The selling price of the 747-400 fleet, as specified in paragraph b. above, amounts to a total of \$193 million, compared to the accumulated costs in the books of those aircraft as of September 30 2009, which totals \$268 million.

**f. Assessment Method**

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

- Useful life: for the 777-200 fleet – 14 years of activity (and sale of the aircraft at net selling price at the end of the 14 year period), for the 747-400 fleet - 7 years of activity (and sale of the aircraft at net selling price at the end of the 7 year period).
- Cash flow expected from activity: management calculated that the cash flow from the operation of the 777-200 aircraft fleet will amount to \$70 million in 2009, and the cash flow from the operation of the 747-400 aircraft fleet will amount to \$66 million. This cash flow was calculated based on revenues from the aircraft fleet less commissions and variable expenses that may be assigned to the fleet in question and less fixed cash flow expenses such as security and maintenance expenses that may be allocated relative to the cost of these aircrafts' operation.
- Residual value at the end of useful life (meaning after 14 years for the 777-200 fleet and 7 years for the 747-400 fleet): calculated based on AVAC company projections and totaling \$217 million for the 777-200 fleet and \$92 million for the 747-400 fleet (non-capitalized values).

- Growth rate: for the sake of prudence, no real future growth in the Company's activities from the aircraft fleet in question was taken into account, and it is based on data for the third quarter 2009 and the projection for the remainder of 2009.
- Discount rate: an 8% discount rate was assumed. According to Company Management's estimates, this discount rate adequately reflects the capital price component.
- The load factor for coming years was assumed to equal the same rate as in the 2009 projection.
- The current tax rate expected for the Company for the coming 7-14 year period is zero.
- The Company assumes that the aircraft in question shall be used as passenger aircraft for the next 7-14 years.
- The Company did not assume the need to make any unexpected investments in these aircraft in order to allow their continued use.

**g. Value Set using the Discounted Cash Flow Method for the 777-200 Fleet in millions dollars**

*	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	Total
<b>Total discounted cash flow</b>	67	62	58	53	49	46	42	39	36	34	31	29	27	24	597
<b>Total residual value (after 14 years)</b>														74	74

**Total value of the above assets based on the discounted cash flow method: \$671 million.**

\* Referring to the periods from October 1 to September 30 of the following year

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

Discount Rate	6.0%	6.5%	7.0%	7.5%	8.0%	8.5%	9.0%	9.5%
Yearly Contribution								
<b>In Thousands of Dollars</b>								
55,000	622,538	601,687	581,901	563,116	545,272	528,310	512,180	496,831
60,000	670,387	648,198	627,133	607,125	588,110	570,028	552,825	536,448
65,000	718,236	694,709	672,365	651,134	630,948	611,746	593,470	576,065
69,705	763,261	738,475	714,928	692,546	<b>671,259</b>	651,003	631,717	613,344
75,000	813,933	787,730	762,829	739,151	716,625	695,182	674,760	655,298
80,000	861,782	834,241	808,061	783,160	759,463	736,900	715,404	694,915
85,000	909,631	880,752	853,293	827,169	802,302	778,618	756,049	734,532

**Fuel price sensitivity analysis, use of the asset across 14 years:**

Fuel Price (Cent per Gallon)	Yearly Contribution	NPV	Reduced Value	Margin of NPV Vs. Reduced Value
<b>Millions of Dollars</b>				
198	73	699	547	152
209	71	685	547	138
220	70	<b>671</b>	547	124
231	68	657	547	110
242	66	643	547	96

**h. Value Set using the Discounted Cash Flow Method for the 747-400 Fleet in millions dollars**

*	2009	2010	2011	2012	2013	2014	2015	Total
Total discounted cash flow	64	59	55	51	47	43	40	359
Total residual value (after 7 years)							54	54

**Total value of the above assets based on the discounted cash flow method: \$413 million.**

\* Referring to the periods from October 1 to September 30 of the following year

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

Discount Rate	6.0%	6.5%	7.0%	7.5%	8.0%	8.5%	9.0%	9.5%
Yearly Contribution								
<b>Thousands of Dollars</b>								
50,000	348,862	342,497	336,316	330,312	324,480	318,814	313,307	307,953
55,000	377,599	370,796	364,189	357,771	351,534	345,472	339,579	333,850
60,000	406,336	399,096	392,063	385,229	378,587	372,130	365,852	359,747
66,389	443,056	435,258	427,680	420,315	<b>413,155</b>	406,194	399,424	392,838
70,000	463,810	455,696	447,810	440,145	432,693	425,446	418,398	411,541
75,000	492,547	483,996	475,684	467,603	459,746	452,104	444,671	437,438
80,000	521,284	512,295	503,557	495,061	486,799	478,762	470,943	463,335

**Fuel price sensitivity analysis, use of the asset across 7 years:**

Fuel Price (Cent per Gallon)	Yearly Contribution	NPV	Reduced Value	Margin of NPV Vs. Reduced Value
<b>Millions of Dollars</b>				
197	69	429	268	161
208	68	420	268	152
219	66	<b>413</b>	268	145
230	65	405	268	137
241	64	398	268	130

**i. Summary**

The following table presents the summarized value assessment as of September 30 2009 for the 777-200 fleet:

**Recoverable sum calculation**

Net Selling Price	Value in Use for EI AI	Recoverable Sum – Whichever is Higher for EI AI
<b>Millions of Dollars</b>		
<b>513</b>	<b>671</b>	<b>671</b>

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

<b>The Aircrafts' Depreciated Retained Cost on September 30 2009</b>	<b>The Recoverable Amount of the Same Aircraft to EI AI, on September 30 2009</b>	<b>Should Depreciation be Listed in the Books?</b>
<b>Millions of Dollars</b>		
<b>547</b>	<b>671</b>	<b>No</b>

The following table presents the summarized value assessment as of September 2009 for the 747-400 fleet:

**Recoverable sum calculation**

<b>Net Selling Price</b>	<b>Value in Use for EI AI</b>	<b>Recoverable Sum – Whichever is Higher for EI AI</b>
<b>Millions of Dollars</b>		
<b>193</b>	<b>413</b>	<b>413</b>

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

<b>The Aircrafts' Depreciated Retained Cost on September 30 2009</b>	<b>The Recoverable Amount of the Same Aircraft to EI AI, on September 30 2009</b>	<b>Should Depreciation be Listed in the Books?</b>
<b>Millions of Dollars</b>		
<b>268</b>	<b>413</b>	<b>No</b>

This value assessment is accurate on the date of its preparation and is based upon monetary details for the third quarter of 2009 and on projected income and expenses for the next 7-14 years. Changes in the projected assessments detailed above may alter the value assessment and the Company may subsequently be required to perform devaluation as a result of depreciation.

**EL AL Israel Airlines Ltd.**

**Concise Interim Consolidated Financial Statements**  
**As of September 30, 2009**

**(Unaudited)**

**EL AL ISRAEL AIRLINES LTD**

**Concise Interim Consolidated Financial Statements (Unaudited)**  
**As of September 30, 2009**

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**INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF  
EL AL ISRAEL AIRLINES LTD.**

**Introduction**

We have reviewed the attached financial information on **El Al Israel Airlines Ltd.** and its subsidiaries ("the Group"), which includes the concise consolidated report on its financial status as of September 30 2009 and its consolidated concise Statement of Operations and reports on General Earnings, Changes in Equity and Cash Flows for the nine and three month periods ending that date. The Company's Board of Directors and management are responsible for the preparation and presentation of financial information for this interim period in accordance with International Accounting Standard 34 "Interim Financial Reporting", as well as for the preparation of financial information for this interim period in accordance with Chapter D of the Securities Regulations (Periodic and Immediate Reports), 1970. Our responsibility is to express our opinion on these financial statements based on our reviews.

We did not review the concise interim financial information of subsidiaries, whose assets included in consolidation constitute 1.1% of total consolidated assets as of September 30, 2009, and whose revenues constitute 1.2% of total consolidated revenues for the nine and three month periods ending that date. The financial statements of those subsidiaries were reviewed by other auditors whose reports have been provided to us, and our opinion, insofar as it relates to the amounts included in respect thereof, is based on the reports of those other auditors.

**Scope of the Review**

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

**Conclusion**

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

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

Without qualifying the above opinion, we direct your attention to Note 5 of these Financial Statements regarding legal proceedings pending against the Company.

Brightman Almagor Zohar & Co.  
Certified Public Accountants

Tel Aviv, November 26, 2009

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

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

	<b>As of September 30</b>		<b>As of December 31</b>
	<b>2 0 0 9</b>	<b>(*) 2 0 0 8</b>	<b>(*) 2 0 0 8</b>
	<b>Thousands of Dollars</b>		<b>Thousands of Dollars</b>
	<b>(Unaudited)</b>		
<b><u>Assets</u></b>			
<b><u>Current assets</u></b>			
Cash and cash equivalents	98,670	102,508	50,600
Short-term deposits	19,954	129,113	7,821
Restricted deposits	28,468	-	152,969
Trade receivables	128,906	151,781	106,046
Other receivables	26,969	34,072	19,693
Derivative financial instruments	7,977	29,939	174
Prepaid expenses	29,544	34,759	27,692
Inventories	13,549	17,446	11,472
Investment in affiliated held for sale	2,372	-	-
<b>Total current assets</b>	<b>356,409</b>	<b>499,618</b>	<b>376,467</b>
<b><u>Non-current assets</u></b>			
Long-term bank deposits	1,940	2,444	2,189
Investment in affiliated companies	445	2,847	2,736
Investment in another company	1,570	1,581	1,565
Derivative financial instruments	2,667	11	-
Fixed assets, net	1,348,175	1,282,454	1,314,182
Intangible assets, net	8,992	7,111	8,618
Assets due to employee benefits	34,343	40,297	36,777
<b>Total non-current assets</b>	<b>1,398,132</b>	<b>1,336,745</b>	<b>1,366,067</b>
<b>Total Assets</b>	<b>1,754,541</b>	<b>1,836,363</b>	<b>1,742,534</b>

(\*) Retroactive implementation of changes in accounting policy - see Note 8.

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

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

	<b>As of September 30</b>		<b>As of December 31</b>
	<b>2 0 0 9</b>	<b>(*) 2 0 0 8</b>	<b>(*) 2 0 0 8</b>
	<b>Thousands of Dollars</b>		<b>Thousands of Dollars</b>
	<b>(Unaudited)</b>		
<b><u>Liabilities and shareholders' equity</u></b>			
<b><u>Current liabilities</u></b>			
Short-term borrowings and current maturities	110,109	72,500	86,271
Trade payables	147,332	179,296	134,190
Other payables	43,788	46,462	44,741
Provisions	57,919	76,885	57,049
Derivative financial instruments	79,519	21,239	108,072
Employee benefit obligations	93,274	95,739	87,930
Unearned revenues	211,892	248,092	197,911
<b>Total current liabilities</b>	743,833	740,213	716,164
<b><u>Non-current liabilities</u></b>			
Long-term loans from financial institutions	730,528	668,339	678,657
Employee benefit obligations	65,632	77,370	76,226
Lease fees payable	-	188	-
Derivative financial instruments	27,310	19,987	86,789
Long-term provisions	9,008	16,684	11,728
Deferred tax	2,949	39,783	1,872
Long term unearned revenues	46,091	49,183	52,434
<b>Total non-current liabilities</b>	881,518	871,534	907,706
<b>Total liabilities</b>	1,625,351	1,611,747	1,623,870
<b><u>Shareholders' equity</u></b>			
Share capital	155,012	155,012	155,012
Share premium	28,007	28,007	28,007
Capital reserve from transactions with a former controlling shareholder	237,122	237,122	237,122
Capital reserve in respect of share-based payment	6,147	5,472	5,780
Capital reserve in respect of cash flow hedging	(54,166)	(15,464)	(111,605)
Accumulated loss	(242,932)	(185,533)	(195,652)
<b>Total shareholders' equity</b>	129,190	224,616	118,664
<b>Total liabilities and equity</b>	1,754,541	1,836,363	1,742,534

(\*) Retroactive implementation of changes in accounting policy – see Note 8.

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

\_\_\_\_\_  
**Haim Romano**  
CEO

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

Certification date of interim financial statements: Ben-Gurion Airport, November 26, 2009

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

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

	<b>For the Nine Month Period Ending September 30</b>		<b>For the Three Month Period Ending September 30</b>		<b>For the Year Ending December 31</b>
	<b>2 0 0 9</b>	<b>(*) 2 0 0 8</b>	<b>2 0 0 9</b>	<b>(*) 2 0 0 8</b>	<b>(*) 2 0 0 8</b>
	<b>Thousands of Dollars</b>				
	<b>(Unaudited)</b>		<b>(Unaudited)</b>		
Operating revenues	1,242,158	1,633,639	496,059	606,929	2,096,326
Operating expenses	(1,081,695)	(1,375,188)	(400,654)	(472,426)	(1,776,329)
<b>Gross profit</b>	160,463	258,451	95,405	134,503	319,997
Selling expenses	(138,377)	(180,028)	(49,343)	(64,367)	(227,573)
General and administrative expenses	(64,268)	(75,759)	(21,137)	(24,437)	(97,103)
Other operating (expenses) revenues, net	(986)	(18,702)	(1,147)	5,412	(975)
	(203,631)	(274,489)	(71,627)	(83,392)	(325,651)
<b>Operating profits (loss) before financing</b>	(43,168)	(16,038)	23,778	51,111	(5,654)
Financing expenses	(24,868)	(37,964)	(14,249)	(12,029)	(61,566)
Financing income	1,885	18,313	1,167	1,986	16,969
<b>Financing expenses, net</b>	(22,983)	(19,651)	(13,082)	(10,043)	(44,597)
Company's equity in earnings of affiliates, net	81	578	45	480	543
<b>Profit (Loss) before income taxes</b>	(66,070)	(35,111)	10,741	41,548	(49,708)
Tax benefit (taxes on income)	18,790	3,322	1,563	(10,581)	7,801
<b>Profit (loss) for the period</b>	(47,280)	(31,789)	12,304	30,967	(41,907)
<b>Basic profit (loss) per NIS 1 par value share (in USD)</b>	(0.09)	(0.06)	0.02	0.06	(0.08)
Basic profit (loss) per share	(0.09)	(0.06)	0.02	0.06	(0.08)
Diluted profit (loss) per share					
<b>Weighted average numbers of shares issued for calculation of profit (loss) per share (in thousands)</b>					
Basic	495,719	495,719	495,719	495,719	495,719
Diluted	495,719	495,719	495,719	495,719	495,719

(\*) Retroactive implementation of changes in accounting policy – see Note 8.

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

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

	<b>For the Nine Month Period Ending September 30</b>		<b>For the Three Month Period Ending September 30</b>		<b>For the Year Ending December 31</b>
	<b>2 0 0 9</b>	<b>(*) 2 0 0 8</b>	<b>2 0 0 9</b>	<b>(*) 2 0 0 8</b>	<b>(*) 2 0 0 8</b>
	<b>Thousands of Dollars</b>				
	<b>(Unaudited)</b>		<b>(Unaudited)</b>		
<b>Profit (loss) for the period</b>	(47,280)	(31,789)	12,304	30,967	(41,907)
<b>Other Comprehensive Income (Loss)</b>					
Earning (Loss) in respect of cash flow hedging, net of tax	57,439	(23,805)	8,511	(98,165)	(119,946)
<b>Other Comprehensive Income (Loss) for the period, net of tax</b>	57,439	(23,805)	8,511	(98,165)	(119,946)
<b>Comprehensive Income (Loss) for the period</b>	10,159	(55,594)	20,815	(67,198)	(161,853)

(\*) Retroactive implementation of changes in accounting policy - see Note 8.

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

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

**For the Nine Month Period Ended September 30 2009**

	Share capital	Share premium	Capital reserve from transactions with a former controlling shareholder	Capital reserve in respect of share- based payment	Capital reserve in respect of cash flow hedging	Accumulated loss	Total
Thousands of Dollars							
(Unaudited)							
<b>Balance as of January 1 2009</b>	155,012	28,007	237,122	5,780	(111,605)	(152,969)	161,347
Influence of changes in accounting policy	-	-	-	-	-	(42,683)	(42,683)
<b>Balance as of January 1 2009 after retroactive adjustments</b>	155,012	28,007	237,122	5,780	(111,605)	(195,652)	118,664
<b>Total Profit (loss) for the period</b>	-	-	-	-	57,439	(47,280)	10,159
Share based payment	-	-	-	367	-	-	367
Total transactions with parent company shareholders pursuant to their position as shareholders	-	-	-	367	-	-	367
<b>Total shareholders' equity as of September 30 2009</b>	155,012	28,007	237,122	6,147	(54,166)	(242,932)	129,190

**For the Three Month Period Ended September 30 2009**

	Share capital	Share premium	Capital reserve from transactions with a former controlling shareholder	Capital reserve in respect of share- based payment	Capital reserve in respect of cash flow hedging	Accumulated loss	Total
Thousands of Dollars							
(Unaudited)							
<b>Balance as of July 1 2009</b>	155,012	28,007	237,122	5,999	(62,677)	(255,236)	108,227
<b>Total profit (loss) for the period</b>	-	-	-	-	8,511	12,304	20,815
Share based payment	-	-	-	148	-	-	148
Total transactions with parent company shareholders pursuant to their position as shareholders	-	-	-	148	-	-	148
<b>Total shareholders' equity as of September 30 2009</b>	155,012	28,007	237,122	6,147	(54,166)	(242,932)	129,190

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

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

**For the Nine Month Period Ended September 30 2008**

	<u>Share capital</u>	<u>Share premium</u>	<u>Capital reserve from transactions with a former controlling shareholder</u>	<u>Capital reserve in respect of share-based payment</u>	<u>Capital reserve in respect of cash flow hedging</u>	<u>Accumulated loss</u>	<u>Total</u>
<b>Thousands of Dollars</b>							
<b>(Unaudited)</b>							
<b>Balance as of January 1 2008</b>	155,012	28,007	237,122	4,464	8,341	(114,102)	318,844
Influence of changes in accounting policy	-	-	-	-	-	(39,597)	(39,597)
<b>Balance as of January 1 2008 after retroactive adjustments</b>	<u>155,012</u>	<u>28,007</u>	<u>237,122</u>	<u>4,464</u>	<u>8,341</u>	<u>(153,699)</u>	<u>279,247</u>
<b>Total profit (loss) for the period</b>	-	-	-	-	(23,805)	(31,789)	(55,594)
Adjustments due to dividends distributed	-	-	-	-	-	(45)	(45)
Share based payment	-	-	-	1,008	-	-	1,008
Total transactions with parent company shareholders pursuant to their position as shareholders	-	-	-	1,008	-	(45)	963
<b>Total shareholders' equity as September 30 2008</b>	<u>155,012</u>	<u>28,007</u>	<u>237,122</u>	<u>5,472</u>	<u>(15,464)</u>	<u>(185,533)</u>	<u>224,616</u>

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

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

**For the Three Month Period Ended September 30 2008**

	<u>Share capital</u>	<u>Share premium</u>	<u>Capital reserve from transactions with a former controlling shareholder</u>	<u>Capital reserve in respect of share-based payment</u>	<u>Capital reserve in respect of cash flow hedging</u>	<u>Accumulated loss</u>	<u>Total</u>
<b>Thousands of Dollars</b>							
<b>(Unaudited)</b>							
<b>Balance as of July 1 2008</b>	155,012	28,007	237,122	5,060	82,701	(173,986)	333,916
Influence of changes in accounting policy	-	-	-	-	-	(42,514)	(42,514)
<b>Balance as of July 1 2008 after retroactive adjustments</b>	155,012	28,007	237,122	5,060	82,701	(216,500)	291,402
<b>Total profit (loss) loss for the period</b>	-	-	-	-	(98,165)	30,967	(67,198)
Share based payment	-	-	-	412	-	-	412
Total transactions with parent company shareholders pursuant to their position as shareholders	-	-	-	412	-	-	412
<b>Total shareholders' equity as of September 30 2008</b>	<u>155,012</u>	<u>28,007</u>	<u>237,122</u>	<u>5,472</u>	<u>(15,464)</u>	<u>(185,533)</u>	<u>224,616</u>

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

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

**For the Year Ended December 31 2008**

	Share capital	Share premium	Capital reserve from transactions with a former controlling shareholder	Capital reserve in respect of share- based payment	Capital reserve in respect of cash flow hedging	Accumulated loss	Total
Thousands of Dollars							
<b>Balance as of January 1 2008</b>	155,012	28,007	237,122	4,464	8,341	(114,102)	318,844
Influence of changes in accounting policy	-	-	-	-	-	(39,597)	(39,597)
<b>Balance as of January 1 2008 after retroactive adjustments</b>	155,012	28,007	237,122	4,464	8,341	(153,699)	279,247
<b>Total loss for the period</b>	-	-	-	-	(119,946)	(41,907)	(161,853)
Adjustments due to dividends distributed	-	-	-	-	-	(45)	(45)
Share based payment	-	-	-	1,316	-	-	1,316
Total transactions with parent company shareholders pursuant to their position as shareholders	-	-	-	1,316	-	(45)	1,271
<b>Total shareholders' equity as of December 31 2008</b>	155,012	28,007	237,122	5,780	(111,605)	(195,652)	118,664

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

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

	<u>For the Nine Month Period Ending September 30</u>		<u>For the Three Month Period Ending September 30</u>		<u>For the Year Ending December 31</u>
	<u>2 0 0 9</u>	<u>(*) 2 0 0 8</u>	<u>2 0 0 9</u>	<u>(*) 2 0 0 8</u>	<u>(*) 2 0 0 8</u>
	<b>Thousands of Dollars</b>				
	<u>(Unaudited)</u>		<u>(Unaudited)</u>		
<b><u>Cash Flows from Operating Activities</u></b>					
Net profit (loss) for the period	(47,280)	(31,789)	12,304	30,967	(41,907)
Appendix A - Adjustments required for presentation of cash flow from current operations	53,406	129,638	(31,096)	(42,315)	160,782
<b>Cash deriving from (used for) operating activities, net</b>	6,126	97,849	(18,792)	(11,348)	118,875
<b><u>Cash Flows for Investment Activities</u></b>					
Acquisition of fixed assets (including general engine overhauls and payment on account of aircraft)	(166,321)	(93,764)	(14,887)	(30,025)	(159,580)
Proceeds from realized fixed assets	22,624	6,960	107	6,537	9,676
Investment in intangible assets	(1,297)	(3,267)	(571)	(523)	(5,078)
Realization of (investment in) restricted deposits	124,501	-	9,823	-	(152,969)
Realization of (investment in) short-term deposits, net	(12,133)	51,520	(12,337)	66,582	172,812
Investment in deposits for service providers	(43)	(205)	(8)	(70)	(80)
Repayment of deposits for service providers	38	236	1	102	83
Realization of long-term deposits	309	82	98	82	277
Investment in long-term deposits	(60)	-	(45)	-	(238)
<b>Cash deriving from (used for) investment activities, net</b>	(32,382)	(38,438)	(17,819)	42,685	(135,097)
<b><u>Cash Flows for Financing Activities</u></b>					
Receipt of long-term loans from financial institutions	113,259	-	-	-	36,000
Repayment of long-term loans from financial institutions	(46,244)	(39,575)	(20,010)	(17,228)	(64,911)
Repayment of other long-term loans	(220)	(292)	(36)	(92)	(385)
Payment for loan raising costs	(7,159)	-	-	-	-
Increase (decrease) in short-term credit, net	14,690	(653)	156	(1,058)	12,501
Dividends paid	-	(3,053)	-	-	(3,053)
<b>Cash deriving from (used for) financing activities, net</b>	74,326	(43,573)	(19,890)	(18,378)	(19,848)
<b>Increase (decrease) in cash and cash equivalents</b>	48,070	15,838	(56,501)	12,959	(36,070)
<b>Balance of cash and cash equivalents at the beginning of the period</b>	50,600	86,670	155,171	89,549	86,670
<b>Balance of cash and cash equivalents at the end of the period</b>	98,670	102,508	98,670	102,508	50,600

(\*) Retroactive implementation of changes in accounting policy - see Note 8.

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

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

	<b>For the Nine Month Period Ending September 30</b>		<b>For the Three Month Period Ending September 30</b>		<b>For the Year Ending December 31</b>
	<b>2 0 0 9</b>	<b>(* ) 2 0 0 8</b>	<b>2 0 0 9</b>	<b>(* ) 2 0 0 8</b>	<b>(* ) 2 0 0 8</b>
	<b>Thousands of Dollars</b>				
	<b>(Unaudited)</b>		<b>(Unaudited)</b>		
<b>Appendix A</b>					
<b>Income and expenses not involving cash flows:</b>					
Depreciation and amortization (including disposal of accessories, disused components and consumables used)	110,833	96,698	35,656	32,433	131,098
Adjustment of value of long-term deposits	-	(268)	(72)	55	(21)
Share of earnings of affiliated companies, less dividends received, net	(81)	(579)	(45)	(481)	(468)
Deferred taxes, net	(19,103)	(3,066)	(1,691)	11,288	(6,989)
Increase (decrease) in liabilities in respect of employee benefits and in provisions	(8,709)	12,681	13,186	(10,061)	(17,555)
Net capital gains from realized fixed assets	(583)	(5,023)	(89)	(4,696)	(7,418)
Adjustment of value of other long-term loans	-	(14)	-	(6)	-
Adjustment of value of deposits for service providers	-	52	-	97	148
Benefit value of employee stock option program	367	1,008	148	412	1,316
Loss (gain) from adjustment of fair value of derivatives recognized in the statement of operations	(20,883)	10,821	(827)	11,081	65,087
Decrease in other long-term liabilities	-	-	-	-	(168)
<b>Changes in asset and liability items:</b>					
Decrease (Increase) in trade receivables	(22,860)	(8,164)	10,402	22,395	37,571
Increase in other accounts receivable	(7,276)	(16,444)	(197)	(12,910)	(1,269)
Decrease (Increase) in prepaid expenses	(92)	569	7,553	8,515	6,840
Decrease (Increase) in inventories	(2,077)	(1,465)	3,372	(671)	4,509
Increase (decrease) in trade payables	13,142	11,876	(3,321)	(14,387)	(33,230)
Increase (decreases) in other payables	3,090	(2,808)	(29,051)	(20,380)	(4,856)
Increase (decrease) in unearned revenues	7,638	33,764	(66,120)	(64,999)	(13,813)
	<u>53,406</u>	<u>129,638</u>	<u>(31,096)</u>	<u>(42,315)</u>	<u>160,782</u>

**Appendix B – Cash Payment (Receipt) of Interest, Taxes and Dividends**

Interest payments	<u>22,479</u>	<u>28,501</u>	<u>12,038</u>	<u>15,181</u>	<u>35,759</u>
Interest receipts	<u>(959)</u>	<u>(8,236)</u>	<u>(196)</u>	<u>(2,004)</u>	<u>(10,680)</u>
Tax payments – advances in respect of extraneous expenses	<u>52</u>	<u>97</u>	<u>19</u>	<u>20</u>	<u>235</u>
Dividend receipts	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(76)</u>

(\* ) Retroactive implementation of changes in accounting policy – see Note 8.

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

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

**Note 1** - **General**

- a. EL AL Israel Airlines Ltd is primarily engaged, through its subsidiaries (hereinafter – "the Group") in the transport of passengers and cargo, including luggage and mail, on scheduled flights and charter flights between Israel and foreign countries. Further information on the Group's operating segments is presented in Note 7 below.
- b. These concise statements must be seen in context with the Company's yearly Financial Statements dated December 31 2008 and the year ending that date, and the attached notes.

**Note 2** - **Significant Accounting Policies**

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

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

In the preparation of these Interim Financial Statements, the Group implemented accounting policy, rules of presentation and calculation methods identical to those applied in the preparation of its Financial Statements for December 31 2008 and for the year ending that date, with the exception of changes in accounting policy deriving from the implementation of standards, amendments to standards and new interpretations coming into effect on the balance sheet date as detailed in Paragraph C below as well as from the application of new standards, revisions and interpretations which are not in effect and which were adopted early by the Group as detailed in Paragraph D below.

- b. The Consolidated Concise Financial Statements have been prepared in accordance with the provisions of Chapter D of the Securities Regulations (Immediate and Periodic Reports), 1970.
- c. **New standards, revisions and interpretations in effect, applied in these Financial Statements:**

- **IFRS 8 – "Operating Segments"**

The standard, which supersedes IAS 14 "Segment Reporting", sets forth how a corporation is to report information by segment in its 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 1, 2009 with retroactive adjustment of comparison figures for prior reporting periods. The first-time implementation of the standard has no impact on the Group's reported operating results and financial status. On the matter of reporting on the Company's operating segments in accordance with IFRS 8, including retroactive adaptation of comparison numbers, see Note 7 below.

- **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 these 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. The standard will apply, through retroactive application, to reporting periods starting on January 1, 2009. According to the standard, the Group presents a report on its total earnings which specifies total other earnings components separately from the components shown in the Statement of Operations as well as a report on changes in shareholders' equity presenting balances for transactions with shareholders, pursuant to their role as shareholders. The first-time implementation of the standard has no impact on the Group's reported operating results and financial status.

- **IFRIC 13 – "Customer Loyalty Programs"**

This clarification stipulates that transaction for sale of goods and services, wherein the company awards its customers with bonus credits, shall be treated as multi-component transactions, with 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 Group is liable to provide the rewards.

The interpretation applies to yearly reporting periods starting January 1 2009.

As a result of the retroactive implementation of the interpretation, the Group recognized an increase in net unearned revenues (less prepaid commission expenses) of a \$49,258 thousand as of December 31 2008, against a \$36,944 thousand increase in accumulated loss and a \$12,314 thousand in deferred tax, and an increase in net unearned revenues (less prepaid commission expenses) of \$47,434 thousand as of September 30 2008, against a \$35,575 thousand increase in accumulated loss and a \$11,859 thousand in deferred tax. Regarding the impact of retroactive implementation on the other items of the Financial Statements, see Note 8 below.

- **IFRS 2 (Revision) – "Share-Based Payment" – Vesting Conditions and their Cancellation**

This revision determines which vesting conditions must be taken into account in measuring fair value upon granting share-based payment and the accounting treatment of instruments with no vesting conditions and their cancellation.

The revision applies, retroactively, to yearly reporting periods starting January 1 2009.

The implementation of this revision has no impact on the Group's Financial Statements.

- **IFRS 7 (Revision) "Financial Instruments: - Disclosure"**

This amendment expands the required disclosure regarding liquidity risk and the measurement of fair value, while establishing a three-tier grading for the presentation of fair value measurements.

The amendment applies to yearly periods starting January 1 2009 or subsequently. The amendment will be implemented retroactively.

The implementation of the standard has no impact on the Group's reported operating results and financial status.

- **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 became effective starting on annual reporting periods starting January 01, 2009. Most of the revisions were 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:

- (1) 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 applies to annual reporting periods starting on January 01, 2009. This revision is applied retroactively.

The implementation of the revision has no impact on the Group's Financial Statements.

- (2) Revision of IAS 19 "Employee Benefits", which stipulates that an accumulated right to compensation for absences shall be measured as a short-term employee benefit, or as other long term employee benefits based on the date the employee's right to receive the benefit was created.

As a result, the Group presents vacation benefits as short term employee benefits, measured at the height of the non-capitalized sum the Group expects to pay for the realization of this right.

As a result of the retroactive implementation of the revision, the Group recognized an increase in obligations as a result of short term employee benefits of a \$7,756 and a \$8,727 thousand as of December 31 2008 and September 30 2008, respectively, against a \$5,739 and a \$6,402 thousand increase in accumulated loss, respectively, and an increase of a \$2,017 and a \$2,325 thousand in deferred tax assets, respectively.

Regarding the impact of retroactive implementation on the remainder of financial statement items, see Note 8 below.

**d. New standards, revisions and interpretations, not in effect, applied in these Financial Statements by way of early adoption:**

- **Improvements to 2009 International Financial Reporting Standards**

- **IFRS 8 (Revision) "Operating Segments" – Disclosure Regarding Segment Assets**

This revision states that disclosure regarding reportable segment assets shall only be provided if this information is provided on a regular basis to the chief operational decision maker. Prior to the implementation of the revision, this information is required ignoring the manner of the reporting to the chief operational decision maker.

The revision shall be implemented retroactively on comparison data, regarding yearly reporting periods starting January 1, 2010 or subsequently. Early implementation is possible.

The Company has adopted this revision by way of early implementation. In light of this, segment assets were not presented in these Financial Statements.

**e. New standards, revisions and interpretations, not in effect, not applied in these Financial Statements by way of early adoption:**

- **IAS 39 (Revision) "Financial Instruments: Recognition and Measurement"**

The amendment states, inter alia, that changes in cash flow deriving from exposure to inflationary risks may be designated as hedged items. In addition, the revision states that the internal value of purchased options, unlike the time value, may be used as a hedging instrument of unilateral risks deriving from a projected transaction.

The revision shall apply to yearly reporting periods starting January 1, 2010 or later. Early implementation is possible.

At this stage, Company management cannot assess the impact of the implementation of the revision on its financial status and operating results.

- **Improvements to 2009 International Financial Reporting Standards**

**IAS 39 (Revision) "Financial Instruments: Recognition and Measurement" – Cash Flow Hedging**

This revision clarifies the reclassification date for profits or losses charged to financial assets or financial liabilities deriving from the hedging of a projected transaction. The reclassification from shareholders' equity to the Statement of Operations shall be in a period when the projected cash flows being hedged influence the Statement of Operations. Prior to this revision, the reclassification to gain/loss took place when the asset purchased or liability taken influenced the Statement of Operations.

The revision shall be applied on a "here onward" basis to all contracts in effect for yearly reporting periods starting January 1 2010 or subsequently. Early application is permitted.

At this stage, Company Management cannot assess the impact of the application of the revision on its financial status and operating results.

**f. Exchange rates and linkage basis:**

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

	<b>As of September 30</b>		<b>As of December 31</b>
	<b>2009</b>	<b>2008</b>	<b>2 0 0 8</b>
CPI (in points)	114.2	111.1	110.4
NIS/USD exchange rate	3.758	3.421	3.802
EUR/USD exchange rate	0.682	0.684	0.717
pound sterling/USD exchange rate	0.621	0.544	0.685

**Change in %:**

	<b>For the Nine Month Period Ended September 30</b>		<b>For the Year Ended December 31</b>
	<b>2009</b>	<b>2008</b>	<b>2 0 0 8</b>
CPI	3.4	4.4	3.8
USD vs. NIS	(1.2)	(11.1)	(1.1)
USD vs. EUR	(4.9)	0.6	5.6
USD vs. pound sterling	(9.3)	9.0	37.4

**For the Three Month Period Ended September 30**

	<b>2009</b>	<b>2008</b>
CPI	1.3	2.0
USD vs. NIS	(4.1)	2.1
USD vs. EUR	(3.7)	7.9
USD vs. pound sterling	3.2	8.4

**Note 3** - **Security Expenses**

Pursuant to that stated in Note 15 to the Company's annual Financial Statements, on February 1 2009 the Israeli Government passed an updated resolution regarding participation in the security expenses of Israeli airlines (following the resolutions dated January 27 2008 and August 24 2008), as follows:

- a. To increase the participation rate in security expenses in Israeli airlines to 60% from 2009 onward. Implementation of the resolution shall take place immediately after the Knesset passes its 2009 budget.
- b. To instruct the Ministers of Finance and of Transportation and Road Safety to increase the State's participation in Israeli airline security costs to 75%, immediately after the signing of a global aviation agreement with the European Union ("Open Skies") in accordance with Government Resolution 441 dated September 12 2006.
- c. To instruct the Minister of Transportation and Road Safety to report to the Government, six months subsequent to this resolution, on the progress of negotiations with the European Union regarding the global aviation agreement ("Open Skies").
- d. Prior to the approval of the 2009 budget, the Budget Director at the Ministry of Finance will act to submit a budget addition deriving from this resolution for the Government's approval, for the funding for an increase in the State's participation in civil aviation security costs.
- e. The airlines will act to conduct "exchange purchases" in Israel, as much as is possible at rates agreed upon with the Industrial Cooperation Authority."

On May 13 2009 the Company filed a revised petition, in which the Company requested that the original government decision regarding 2008 be implemented, or alternately, up until the August 2008 cancellation resolution.

After the 2009 State Budget passed in July 2009 and until the balance sheet date, the Company received a total of \$6 million from the State of Israel for participation in security expenses for the nine month period ending on the balance sheet date, a sum reflecting the Government Resolution passed February 1 2009. As stated in Paragraph a. above, according to which starting at the beginning of 2009 the Israeli airlines' participation in security costs shall be reduced from 50% to 40%. The added Government participation in these security expenses has been recognized in the Statement of Operations for the nine month period ending on the balance sheet date offset by the security expenses borne by the Company in this period. Out of the sum in question, a total of \$4.7 million was charged to the Q2 2009 Statement of Operations.

**Note 4** - **Fixed Assets**

**a. Acquisition and disposals of fixed assets:**

1. On February 23 2009 a Boeing 757-200 possessed by the Company, manufactured in 1987, was sold and leased back to the El Al Group via operational lease. The plane was purchased by a Panamanian aircraft leasing company. The Company received \$9 million in return for the aircraft. According to the agreement, the Group shall lease the aircraft under market conditions for a 22 month period, with the option to extend the lease for an additional 12 months, as well as a monthly credit for engine maintenance calculation amounting to \$1.8 million. The transaction had no material influence on the Group's Statement of Operations.
2. Following that stated in Note 14.e.2 to the annual Financial Statements, the delivery of the three Boeing 737-800 aircraft to the Company was completed in April, May and June 2009 in return for \$49 million per aircraft. To complete the transaction and finance the purchase, the Company received the approval of the Export-Import Bank of the United States (here: "the Bank") for \$37.5 million in financing for each aircraft. Pursuant to the completion of the transaction in question and as part of the financing agreement, in each of the above aircraft deliveries the Company signed an agreement with the Spanish airline to cancel the direct purchase of the aircraft in question, so that the aircraft would be sold by the Spanish airline to Boeing, with the Company purchasing the aircraft directly from Boeing.

The financing loan for the first aircraft was received in April 2009 for a 12-year period, bearing fixed interest of 3.62%. This loan will be repaid in 48 quarterly payments of principal and interest on fixed dates each year (January, April, July and October). The financing loan for the second aircraft was received in May 2009 for a 12-year period, bearing fixed interest of 3.62%. This loan will be repaid in 48 quarterly payments of principal and interest on fixed dates each year (February, May, August and November). The financing loan for the third aircraft to the amount of \$37.5 million was received in June 2009 for a 12-year period, bearing fixed interest of 4.01%. This loan will be repaid in 48 quarterly payments of principal and interest on fixed dates each year (March, June, September and December).

3. In March 2009 the Company signed an agreement with Pratt & Whitney for the maintenance of PW 4000 engines installed in Boeing 767 and 747-400 aircraft in the Company's service. Some of these engines will be in the framework of an insurance agreement, according to which payment to the repairing party shall be calculated according to engine hour performance and the engines will be maintained by the repairing party. Payment for repair of the remaining engines shall be according to work receipts invested in the repairs.

In addition, a memorandum of understanding was signed with IAI regarding the maintenance of additional engines of these aircraft models in the framework of an insurance agreement.

4. On May 18 2009, a Boeing 757-200, manufactured in 1990, in the company's possession was sold and leased back by the El Al Group via operational lease. The aircraft was purchased by a Panamanian aircraft leasing company. The Company received \$11.5 million in return for the aircraft. According to the agreement, the Group will lease the aircraft under market conditions for a 27 month period. As a result of the transaction, the Company recognized an additional \$2.6 million expense in its financial statements as of the completion of the transaction in question.
5. In April 2009 an agreement was signed with the Volvo Aero Services Corp ("VAS") for the sale of Company Boeing 767-200 (EAA) engines in return for a total of \$1.8 million.
6. Pursuant to Note 14.e.1 of the annual financial statements, as regards the agreement with Boeing for the purchase of 4 Boeing 777 aircraft, the Company is studying possible methods of financing this agreement, including a lease.

**b. Impairment of fixed assets:**

Over the course of the reported period, the Company examined the recoverable value of aircraft fleets in which signs of deterioration were evident, which include, *inter alia*, aircraft price lists published from time to time, As regards the recoverable amount of these aircraft fleets, in which signs of deterioration were detected, it was found that the recoverable amount for each aircraft fleet surpasses its depreciated cost as of that date. Accordingly, no provision for the impairment of aircraft assets was made in these Financial Statements.

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

Over the course of the reported period the Company was required to provide additional aircraft in its possession as additional bank guarantees due to loans taken to finance its aircraft fleet. As of this report, the Company is complying with the guarantee to loan ratio as required in accordance with the terms set in the framework of loan agreements with the lending banks. As for the difference created in relation to the loan balance to guarantee ratio subsequent to the balance sheet date, see Note 11 of these Financial Statements.

**d. Unrestricted Assets**

The value of the Group's total fixed assets as of September 30 2009 is \$1,348 million. The Group's key assets are aircraft and spare engines, the depreciated cost of which as of September 30 2009 is \$1,209 million. The depreciated cost of the Group's main assets that are not restricted by a third party amounts to a total of \$38 million. In addition, as of the balance sheet date, the Group possesses parts and fixed assets to the amount of \$139 million, free of any encumbrance.

**e. Cargo Aircraft Activity**

In July 2009 the Company submitted a request to the Government Companies Authority for the consent of the holder of the Special State Share, as required by the Company's articles, to remove two 747-200 cargo aircraft from Company service, this in light of the Company's intention not to operate these aircraft after the end of 2009, among other reasons due to age and maintenance restrictions.

As reported by the Company, it intends to continue transporting cargo in the cargo holds of passenger aircraft and using designated cargo planes, while studying various possibilities for further Company cargo activities. The Company has established a Board of Directors Committee to study the issue of cargo activity at the Company. The Company's representatives have appeared before the committee. In light of the Company's intention not to operate the aircraft in question past the end of 2009, the Company has accelerated depreciation expenses of cargo aircraft, parts and engines belonging to the cargo fleet. Following the aforementioned change in estimates, the Company recognized depreciation expenses in the second and third quarters to the amount of \$10.2 million, instead of \$7.4 million. In addition to the above, the Company shall recognize additional depreciation expenses in the fourth quarter of the year to the amount of \$4.9 million instead of \$3.4 million. Subsequent to the balance sheet date, on November 8 2009 the Company made the decision to adapt one of the cargo aircraft in its possession for an additional year of use while at the same time study alternatives for the formulation of a dry lease agreement for a 747-400 cargo plane.

Note that in June 2009 the Minister of Transportation and Road Safety established a public committee to study the Israeli cargo transport industry and to study the state of Israeli airlines dealing in cargo shipping.

**Note 5 - Legal Proceedings**

As of September 30 2009, claims filed against the Company amount to a total of \$140 million, for which the Company listed a \$2 million provision in its financial statements, this based on the opinions of the Company's legal counsel.

Legal claims non-quantified in monetary amounts have also been filed against the Company. The above provision in the financial statements also includes provisions for non-quantified claims, as estimated by Company management.

In the assessment of Company management, based upon the opinions of its legal counsel, the Company does not anticipate that it will be exposed to an additional loss with respect to the abovementioned claims in excess of the above provisions recorded in the financial statements. The following is a detailed summary of material legal and financial claims:

**a. Class action suits:**

- (1) Pursuant to Note 24.d.a.5 to the annual Financial Statements, in November 2007, a claim was lodged in Haifa District Court against the Company, along with a motion for recognition as a class action pursuant to the Class Action Law, in the amount of NIS 105 million (some \$28 million as of the balance sheet date). The plaintiffs claim that the prices charged by the Company for overweight baggage on its flights are excessive and are calculated without any connection to the Company's ordinary flight prices.

In February 2009 the Court approved the plaintiffs' withdrawal of his motion to recognize the claim as a class action and dismissed the claim subject to the Company's payment of legal expenses.

- (2) Pursuant to Note 24.d.a.6 of the annual Financial Statements, a claim was filed with the Tel Aviv District Court by a passenger, who claimed that her flight from Madrid to Tel Aviv was delayed due to a strike at Ben Gurion Airport, which she alleges the Company had failed to address, thereby causing 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. Based on the

plaintiff's claims, the sum of the suit amounts to a total of NIS 12 million (some \$3.2 million on the balance sheet date).

In March 2009 the Court approved the dismissal of the claim without the imposition of any expenses payments.

- (3) On April 23 2009 a motion was filed against the Company to recognize the suit as a class action, claiming that the Company failed to meet the requirements of Revision 40 to the Communications Law (Telecommunications and Broadcasts) 2008, known as the Spam Law, which forbids the transmission of advertising over email, fax, text message or telephone without the recipient's approval. The personal claim is for NIS 150, with the requested class action, as estimated by the plaintiff, amounting to a sum of NIS 22.5 million (\$6 million as of the Balance Sheet Date). The plaintiff estimates the group at 150,000 people. The group is defined by the plaintiff as members of the Company's frequent flier club to which the Company allegedly sent text messages unlawfully. In August 2009 the plaintiff withdrew his charges and filed a request to withdraw his personal claim against the Company. The Court approved the motion in question in September 2009.
- (4) Pursuant to Note 24.d.a.(1) to the yearly Financial Statements, in the matter of the appeal of the decision to approve a suit against the Company as being a class action on the basis of the Consumer Protection Law in the matter of over billing based on exchange rates by travel agents, on August 26 2009 the Supreme Court accepted the appeal filed by the Company and rejected the request to recognize the suit as a class action.
- (5) Pursuant to Note 24.d.a.(3) to the yearly Financial Statements, in the matter of the motion to recognize as a class action a suit filed against the Company on the matter of the collection of a security surcharge by the Company on code sharing flights, on August 19 2009, the Court rejected the motion in question and ruled the petitioners liable for expenses to the Company. An appeal was filed before the Supreme Court, subsequent to the balance sheet date, on October 22 2009.

**c. Legal proceedings in the field of restriction of business overseas:**

- (1) Pursuant to Note 24.d.b.1 to the annual Financial Statements, on January 21 2009 the Company's Board of Directors approved a plea bargain made with the U.S. Justice Department to end the process. Within the framework of the plea bargain, the Company was required to admit that it had violated U.S. antitrust law and was involved in the fixing of one or more price components in the field of air cargo transport to and from the U.S. in the period between January 2003 and February 2006, and was required to pay a fine of \$15.7 million (a capitalized sum of \$15.4 million to be paid in several interest-bearing installments across four year period). In addition, the Company undertook to continue its full cooperation with the U.S. Justice Department in its investigation. As part of the agreement, the U.S. Justice Department agreed not to file additional charges against the Company or charges against Company employees and executives, past or future (with a few exceptions) regarding violations of U.S. antitrust laws made in the field of airborne cargo transport prior to entry into the plea bargain.

A U.S. Federal Court approved the decision on February 4 2009. In light of the above, the provision made by the Company was reduced by some \$5 million on December 31 2008.

- (2) Pursuant to Note 24.d.b.4 of the Yearly Financial Statements, in February 2009 the Company received a request for complementary information from the Korean Fair Trade Commission. The Company has provided its responses to the requests in question. To the best of the Company's knowledge, the Korean Commission is investigating a series of airlines. Subsequent to the balance sheet date, the Korean antitrust authority had sent out an "inspection report" in October 2009 to several airlines pertaining to the investigation in question containing claims on the matter of alleged violations of Korean antitrust laws. The Company has not received the inspection report in question and to the best of its knowledge is not numbered among the companies to which the inspection report was addressed. The Company cannot at this stage estimate the results of the Korean Commission's investigation or assess the investigation's

possible financial impact on the Company, and as a result no provision has been made for this claim in the Financial Statements.

- (3) The above legal proceedings pertaining to the investigations of restriction of trade authorities may have a material impact on the Company, due to the fines these bodies may impose, which may be substantial.
- (4) On May 7 2009, the Company received a copy from a motion to approve the filing of a derivative claim and a draft of the claim itself, which were filed before the Tel Aviv-Yaffo District Court. The filing party, who claims to hold 4,500 Company shares (which constitute 0.001% of the Company's equity) asks that the Court approve the claim as a derivative claim against a number of executives serving at the Company in 2003 and who no longer serve at the Company ("the Claim"), based on the allegation that these executives allegedly violated their due diligence obligations towards the Company by causing the Company to be involved in fixing one price component, or more, in the field of cargo transport to and from the U.S. in the period in question and thus, they claim, they caused damage to the Company of at least \$15.7 million U.S., this pursuant to the settlement between the Company and the U.S. Justice Department the Company reported on January 22 2009. The claim was preceded by a motion to file a derivative claim which was rejected by the Company after the Company's Board of Directors decided that it would not be in the Company's best interests to file such a claim against Former Company executives. The Company has filed its response to the motion to submit a derivative claim, stating that this motion must be dismissed.

**c. Other legal proceedings:**

- (1) In June 2006, a suit was filed against the Company and the State of Israel-Ministry of Finance by 94 claimants who were employed by the Company and took early retirement between 2001 and 2003. The claimants in their suit have appealed for declaratory relief/order of performance to amend their retirement agreements in a manner in which the retiree will receive the early pension stipend, including fringe benefits, until the legal retirement age, instead of until the age of 65; alternately, the claimants appealed to revoke the retirement agreements. The court instructed the claimants to quantify their claim and to pay an appropriate fee. The claimants quantified their claim at NIS 18.2 million (some \$4.8 million as of the balance sheet date). In January 2009 the Court ordered that this claim be combined with two other claims. On January 6 2009 it ruled that the claimants submit their position regarding the limitation of the causes of the claim. The Company allowed a provision for this claim in its Financial Statements, based on the opinion of its legal counsel.
- (2) On March 8 2009 the Company filed a petition to the High Court of Justice against the Minister of Transportation, the Civil Aviation Authority (hereinafter: "the Respondents") and against British Midlands Airways ("BMI"). The Company's position is that the Respondents may not increase the frequency of BMI flights from London to Tel Aviv without first arranging landing and takeoff approvals for Heathrow Airport for the Company, as required by the Israel-U.K. aviation agreement. In the petition, the Supreme Court is asked to issue a conditional order requiring the Respondents to explain: (1) why they would not deny approval to BMI to operate additional regular flights until the realization of the aviation agreement between Israel and the U.K and the Company's receipt of landing and takeoff approval at Heathrow Airport on an equal basis (and if such approval has been granted, why it would not be frozen or revoked); (2) why the Supreme Court would not declare that they are required to arrange the Company's landing and takeoff approvals at Heathrow Airport prior to granting BMI any additional rights; and (3) why they would not carry out the test agreed upon in the 2007 agreement between Israel and the U.K regarding the implications and results of the agreement. In addition, the Supreme Court was asked to issue an injunction instructing the Respondents to deny BMI approval for additional regular flights to Israel (and if such approval had been granted – to postpone it) until the petition is decided. The Supreme Court issued its ruling on March 16 2009, stating that no injunction would be issued and that the petition would be brought before a panel of judges by the middle of May 2009.

In a court hearing held on May 13 2009, the State (the Ministry of Transportation and the Civil Aviation Authority) announced that it was aware of the slot problem (takeoff and landing approvals), and that it had tried to provide solutions in the past and will attempt to help in the

future, subject to existing constraints and taking into consideration the array of interests for which the State is responsible. The State will raise this matter on every opportunity in order to provide assistance, particular regarding aviation talks to take place summer 2009, and in addition shall encourage the parties (the Company and BMI) to negotiate among themselves. In light of the State's announcement and as recommended by the Court, the Company has decided to withdraw its claim.

- (3) Pursuant to that stated in Note 24.d.(c).(1) to the Yearly Financial Statements, on April 28 2009 the Company filed opening motions to the Tel Aviv District Court in the matter of the dispute between the parties concerning the management of joint subsidiary Sabre Israel, *inter alia*, in the matter of communications and data processing costs the Company charged the Subsidiary and an offset performed by the Company, as a result, against its payments to the Subsidiary. As stated, as a result of this offset the subsidiary initiated arbitration proceedings in accordance with Israeli law, supposedly by virtue of the marketing fee agreement, which was signed between the parties in the framework of the agreement signed between the Company and Sabre in 2001. An arbitrator has been appointed, but the Company disputes his right to rule on the issue. On May 13 2009, Sabre Israel filed a \$1.4 million suit via arbitration, claiming that the Company had not paid commissions in accordance with the marketing fee agreement.

In addition, on April 2 2009 the Company informed Sabre of the existence of an exit event, as defined in the agreement, and requested that it act towards voluntary liquidation, as stated in the agreement. Sabre disputes the existence of the exit event.

Regarding the settlement signed with Sabre subsequent to the balance sheet date, see Note 11a to these Financial Statements.

**Note 6 - Agreements with Related Parties**

- a. On January 22 2009 the Company's CEO, Mr. Haim Romano, acting on his own initiative, informed the Company's Board of Directors that he would be waiving 15% of the total yearly salary he is entitled to receive from the Company for 2009 (with the exception of provisions and social benefits). Said waiver was made as a result of the global economic crisis and market conditions.
- b. In a special General Meeting of the Company's shareholders held on March 4 2009, the following was decided:

To increase the financial remuneration to sitting directors and/or directors serving from time to time at the Company, with the exception of external directors, all for the purpose of the execution of their duties as Company directors and all actions deriving from this position, as follows:

- (1) Remuneration for participation in meetings of the Company's Board of Directors and/or any of its committee at the fixed sum appearing in the third addendum to the Companies Regulations (Rules Regarding Remuneration and Expenses for external Directors) 2000 (hereinafter: "the Remuneration Regulations"), in accordance with the Company's grade in accordance with the first addendum to the Remuneration Regulations, as determined from time to time. The remuneration for participation in meetings via telecommunications shall be 60% of the remuneration for participation in the meeting and the remuneration for a decision passed without actually convening shall be 50% of the remuneration for participating in the meeting.

Yearly remuneration is at the fixed sum appearing in the second addendum to the Remuneration Regulations, in accordance with the Company's grade according to the first addendum to the Remuneration Regulations, as shall be determined from time to time.

- (2) To approve remuneration for Ms. Sophia Kimmerling, considered a controlling party at the Company, for her service as a director at Sun D'Or International Airlines Ltd., a fully owned Company subsidiary, as follows:

For participation in meetings of the Sun D'Or Board of Directors and/or of any of its committees at the fixed sum as appears in the third addendum to the Remuneration Regulations, in accordance

with Sun D'Or's grade according to the first addendum to the Remuneration Regulations, as determined from time to time. Remuneration for participation in meetings via telecommunications shall be 60% of the remuneration for participation in the meeting and the remuneration for a decision passed without actually convening shall be 50% of the remuneration for participating in the meeting.

Yearly remuneration is at the fixed sum appearing in the second addendum to the Remuneration Regulations, in accordance with Sun D'Or's grade according to the first addendum to the Remuneration Regulations, as determined from time to time.

Ms. Kimmerling and her spouse shall be entitled to flight tickets on Sun D'Or flights – one ticket per year free of charge and three tickets per year at 10% of the price of a ticket sold on the internet.

- (3) To ratify the employment of Nimrod Borovich, CPA, son of Mr. David Borovich (husband of Mrs. Tamar Mozes Borovich) and nephew of Prof. Israel (Izzy) Borovich, a controlling party at the Company, as manager of a strategic partnership project at the Company in return for a gross monthly salary of NIS 25,000 and associated benefits, as specified in the employment report attached to the Company's January 22, 2009 immediate report.
- (4) To approve the appointment of Ms. Yodfat Harel-Gross to the Company's Board of Directors for a term of service to conclude at the Company's next annual General Meeting. In light of the approval of the monetary remuneration to Company directors detailed above, Ms. Har'el-Gross is entitled to the remuneration in question upon her appointment as director.

**c. Service Agreement and Option Issue to the Chairman of the Company's Board of Directors**

**(1) Service Agreement**

On April 30 2009 the Audit Committee and the Company's Board of Directors decided to approve the Company's entry into an agreement with the Chairman of the Board – Mr. Amikam Cohen (hereinafter – "the Chairman of the Board") for the provision of Chairman services retroactively starting February 1 2009 (hereinafter – "the Service Agreement"). The Chairman of the Board shall provide the Company with active Chairman services as expected in publicly-owned companies in the field of activity of the Company and of its subsidiaries (hereinafter – "the Services"). In return for the services, the Chairman shall be entitled to the following:

- a. A monthly salary of NIS 90,000 plus VAT linked to the CPI (hereinafter – "the Remuneration");
- b. 4,650,000 non-tradable options exercisable as 4,650,000 regular NIS 1 par value shares (see Share Based Payment below) ;
- c. Benefits pertaining to the receipt of flight tickets from the Company;
- d. Reasonable expense refunds for travel, hosting and mobile telephone expenses made by the Chairman in the context of the services subject to the law and in accordance with Company procedure.

The remuneration and the remaining benefits and payments detailed above constitute full remuneration to the Chairman for the provision of services, including for his services as Company director, and with the exception of these he shall be entitled to no additional benefit and/or wage and/or remuneration from the Company of any form, including directors' salary (participation remuneration and yearly remuneration) for the services of the Chairman of the Board as a Company director.

## **(2) Share Based Payment**

On April 30 2009, the Company Audit Committee and the Board of Directors decided to approve the issue of non-tradable options to the Chairman of the Company's Board of Directors (hereinafter – "the Option Plan"). The options shall be granted in the framework of the agreement to provide services as Chairman of the Company's Board of Directors

The Company shall grant the Chairman of the Board 4,650,000 non-tradable options exercisable as 4,650,000 regular NIS 1 par value Company shares (hereinafter – "the Exercise Shares"). The options shall be allocated free of charge. Assuming the exercise of all the options, the Exercise Shares shall constitute 0.95% of the Company's paid-up capital (including fully diluted). The Company has the option of stating that exercise of the options shall take place in return for Company shares of an amount reflecting the sum of the financial benefit embodied in the options alone (cashless exercise) and in the event that the Company chooses this option, the amount of shares actually issued shall be smaller than the rate denoted above.

The exercise price of each option shall be NIS 0.885, the closing price of a Company share on February 1 2009, which is when the Chairman of the Board began his tenure, subject to adjustments established in the Option Plan.

The right to exercise the option shall vest in three portions which shall vest throughout the Chairman of the Board's service at the Company, as follows:

- a. 12 months from the beginning of the Chairman's service, that being February 1 2009 (hereinafter – "the Allocation Date"), the Chairman of the Board shall acquire vesting for the exercise of 1/3 of the options. In this regard it is hereby made clear that if the end of the Chairman's tenure falls before one year from the allocation date, the Chairman shall not be entitled to any options.
- b. 2 years from the allocation date, the Chairman shall accumulate vesting for an additional 1/3 of the options.
- c. 3 years from the allocation date, the Chairman shall accumulate vesting for an additional 1/3 of the options.
- d. Starting from the end of the first year from the allocation date, in the event of the discontinuation of the Chairman's service prior to the passing of two or three years, the Chairman of the Board shall be entitled to a relative portion of the options as stated in paragraphs B and C above, in such a manner that every three months after the end of the first year since the allocation date, the Chairman of the Board shall be entitled to exercise an additional 387,500 options.

The Chairman of the Board shall be entitled to exercise any option portion vesting as Company shares, starting from the vesting date of each portion until 26 months from the vesting date of each portion (hereinafter as regards vested options – "the Exercise Period"), except if the options or any portion thereof expired prior to the exercise period, all in accordance with the Options Plan. All options granted to the Chairman of the Board and not exercised by him into Company shares by the end of the exercise period shall expire and may not be exercised.

## **(3) Assessing Fair Value of Options**

The fair value of the above options is assessed using the application of the Black & Scholes model and the Binomial options pricing model. In this framework, the Company did not take into account the influence of the vesting conditions, with the exception of market conditions, on the fair value of the capital instruments granted.

On June 24 2009 the General Meeting ratified the Service Agreement and option issue to the Chairman of the Company's Board of Directors. The value of the options, based on the following parameters, for the date on which the option plan was approved by the Company's General Meeting was NIS 1.3 million (some \$332,000 on that date).

**Parameters used in the application of the model, as of June 24 2009:**

Share price (in NIS)	0.879
Exercise price (in NIS)	0.885
Expected fluctuation (*)	42% - 45%
Option lifespan (in years) (*)	2.4 - 3.7
Risk-free interest rate	2.3% - 3.3%
Expected dividend rate	0%

(\*) The expected fluctuation is determined based on historic fluctuations in the price of the Company's share. The lifespan of the options is determined in accordance with the assumption that their exercise is expected to take place in the average period between the vesting period and the end of the options' lifespan.

**d.** In a special General Meeting of the Company's shareholders held on June 24 2009, the following was decided:

- (1) To ratify the appointment of Mr. Pinchas Ginsburg as Director on the Company's Board of Directors for tenure to conclude with the Company's next annual General Meeting.
- (2) To ratify Amendment 110 to the Company's Articles, regarding the increase of the maximum number of directors in the Company's Board of Directors.
- (3) To ratify the appointment of Mr. Shlomo Hannael as Director on the Company's Board of Directors for tenure to conclude with the Company's next annual General Meeting.

**e. Payment for the agreement to extend the CEO's non-compete period:**

On September 6 2009, the Company announced that the Company's CEO would be concluding his tenure, this based on advance notice delivered by the Company in accordance with the personal employment agreement between the Company and the CEO (hereinafter: "the Employment Agreement").

Under these circumstances, the notice period according to the employment agreement is 18 months, during which employer-employee relations between the parties will remain in effect (without detracting from the Company's right, based on the employment agreement, to shorten this period at any time, while repaying its balance). Over the course of this period the CEO will train his successor and pass on his duties in an organized manner.

The Company's Audit Committee and Board of Directors decided that the non-compete period, which according to the terms of the agreement is 6 months from the completion of work, shall be extended by an additional 12 months, in return for a one-time payment of 750,000 NIS.

Note that in accordance with the terms of the agreement, the CEO is entitled to a retirement bonus equal to one months pay for each year of work at the Company (some five years), in addition to releasing retirement and executive insurance sums at his disposal, as well as the payment of a result-dependent bonus, as established in the employment contract, for the 6 month period from the notice period. In addition, the Audit Committee and the Board of Directors decided that the CEO shall be entitled to flight ticket rights, as is general Company practice for a departing executive of the CEO's rank.

**f. Quality control services agreement:**

On September 18 the Company entered into an agreement with R&M (hereinafter "the Service Provider") to provide clandestine inspections and quality control of the Company's website in return for a monthly sum of 2,700 NIS. Each party may bring the agreement to a conclusion by providing notice to the other,

The commitment in question was approved by the Company's Board of Directors as a non-exceptional agreement in which a Company's controlling shareholder has personal interest, as the service provider is a company owned by the son-in-law of Mr. David Borowitz, a Company controlling shareholder and spouse of Mrs. Tamar Moses-Borowitz, Deputy Chairperson of the Board of Directors and a Company controlling shareholder.

The commitment was approved, among other reasons, as the service provider has a great deal of experience in the field of clandestine inspection and is familiar with the Company, its business and its

work model in light of existing commitments; the agreement was made over the Company's regular course of business and under market conditions and was preferred over other proposals studied by the Company, both as regards the level of services offered and price.

**Note 7 - Segment-Based Reporting**

**a. General:**

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

On the other hand, the previous standard (IAS 14, "Segment Based Reporting") required that entities recognize two segment arrays (business and geographical), based on the risk and yield method, with the internal financial reporting system for the entity's key administrative personnel serving only as an starting point for the recognition of the above segments. As a result of the adoption of the new standard, the Group has recognized reportable segments different from those presented in earlier reporting periods.

Prior to the adoption of the new standard, segment-based information reported externally was analyzed based on flight routes, aviation rights and global representation. Accordingly, the Company reported geographical segments in a primary reporting format, which included the following geographical areas: North America, Europe, Far East and Central Asia and the rest of the world. At the same time, the reports are conveyed to the Group's chief operational decision maker, for the purpose of allocating resources and assessing the performance of the operational segments based on the difference between revenues from passenger aircraft, cargo aircraft, aircraft leasing (mainly to subsidiary Sun D'Or) and other revenues.

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

**Segment A** – passenger aircraft activity.

**Segment B** – cargo aircraft activity.

**Segment C** – others.

Passenger aircraft activity includes revenues (without deducting discounts) from the transport of passengers including baggage, transporting freight in the belly of passenger aircraft, mail transport and the contribution from the sale of duty free products.

Cargo aircraft activity includes revenues from airborne cargo shipping fees.

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

Information referring to these segments is reported below. Sums reported for previous reporting periods were restated according to the new segment reporting base.

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

Segment-based earnings represent the contribution made by each segment. Each segment's contribution is determined as follows: revenues created from operating segments less variable expenses involved in the operation of passenger airplane and cargo airplane flights, which include, *inter alia*, fuel expenses (not including fair value changes of jet fuel hedging agreements); airport fees and taxes, variable maintenance costs, air navigation and communication, passenger food and supplies, aircraft leasing fees, discounts and commissions granted passengers or paid to travel agents, air crew expenses including salaries and variable security costs.

Unassigned costs primarily include depreciation costs, salary costs – with the exception of air crew costs – and other fixed costs.

<b>For the Nine Month Period Ended Sept 30 2009</b>					
<b>Passenger Aircraft</b>	<b>Cargo Aircraft</b>	<b>Others</b>	<b>Adjustments</b>	<b>Total</b>	
<b>Millions of Dollars</b>					
<b>(Unaudited)</b>					
<b>Revenues</b>					
Revenues from external customers	1,112.2	43.2	30.1	-	1,185.5
Inter-segment revenues	-	-	53.7	(53.7)	-
Adjustments to consolidated	-	-	-	56.7	56.7
<b>Total segment revenues</b>	<b>1,112.2</b>	<b>43.2</b>	<b>83.8</b>	<b>3.0</b>	<b>1,242.2</b>
<b>Segment results</b>	<b>245.8</b>	<b>(2.2)</b>	<b>33.9</b>	<b>-</b>	<b>277.5</b>
Unassigned expenses					(320.7)
<b>Operational loss</b>					<b>(43.2)</b>
Financing expenses					(24.9)
Financing income					1.9
Company's equity in earnings of affiliates, net					0.1
<b>Loss before income taxes</b>					<b>(66.1)</b>
Tax benefit					18.8
<b>Loss for the period</b>					<b>(47.3)</b>

<b>For the Nine Month Period Ended Sept 30 2008</b>					
<b>Passenger Aircraft</b>	<b>Cargo Aircraft</b>	<b>Others</b>	<b>Adjustments</b>	<b>Total</b>	
<b>Millions of Dollars</b>					
<b>(Unaudited)</b>					
<b>Revenues</b>					
Revenues from external customers	1,425.9	114.0	34.3	-	1,574.2
Inter-segment revenues	-	-	62.3	(62.3)	-
Adjustments to consolidated	-	-	-	59.4	59.4
<b>Total segment revenues</b>	<b>1,425.9</b>	<b>114.0</b>	<b>96.6</b>	<b>(2.9)</b>	<b>1,633.6</b>
<b>Segment results</b>	<b>307.5</b>	<b>9.2</b>	<b>40.1</b>	<b>-</b>	<b>356.8</b>
Unassigned expenses					(372.8)
<b>Operational loss</b>					<b>(16.0)</b>
Financing expenses					(38.0)
Financing income					18.3
Company's equity in earnings of affiliates, net					0.6
<b>Loss before income taxes</b>					<b>(35.1)</b>
Tax benefit					3.3
<b>Loss for the period</b>					<b>(31.8)</b>

<b>For the Three Month Period Ended September 30 2009</b>					
<b>Passenger Aircraft</b>	<b>Cargo Aircraft</b>	<b>Others</b>	<b>Adjustments</b>	<b>Total</b>	
<b>Millions of Dollars</b>					
<b>(Unaudited)</b>					
<b>Revenues</b>					
Revenues from external customers	443.2	12.0	11.5	-	466.7
Inter-segment revenues	-	-	27.8	(27.8)	-
Adjustments to consolidated	-	-	-	29.4	29.4
<b>Total segment revenues</b>	<b>443.2</b>	<b>12.0</b>	<b>39.3</b>	<b>1.6</b>	<b>496.1</b>
<b>Segment results</b>	<b>123.2</b>	<b>(0.8)</b>	<b>14.5</b>	<b>-</b>	<b>136.9</b>
Unassigned expenses					(113.1)
<b>Operational profit</b>					23.8
Financing expenses					(14.2)
Financing income					1.1
Company's equity in earnings of affiliates, net					-
<b>Profit before income taxes</b>					10.7
Tax benefit					1.6
<b>Profit for the period</b>					<b>12.3</b>

<b>For the Three Month Period Ended September 30 2008</b>					
<b>Passenger Aircraft</b>	<b>Cargo Aircraft</b>	<b>Others</b>	<b>Adjustments</b>	<b>Total</b>	
<b>Millions of Dollars</b>					
<b>(Unaudited)</b>					
<b>Revenues</b>					
Revenues from external customers	534.0	29.3	12.7	-	576.0
Inter-segment revenues	-	-	29.8	(29.8)	-
Adjustments to consolidated	-	-	-	30.9	30.9
<b>Total segment revenues</b>	<b>534.0</b>	<b>29.3</b>	<b>42.5</b>	<b>1.1</b>	<b>606.9</b>
<b>Segment results</b>	<b>138.0</b>	<b>2.2</b>	<b>17.6</b>	<b>-</b>	<b>157.8</b>
Unassigned expenses					(106.7)
<b>Operational profit</b>					51.1
Financing expenses					(12.0)
Financing income					2.0
Company's equity in earnings of affiliates, net					0.5
<b>Profit before income taxes</b>					41.6
Taxes on income					(10.6)
<b>Profit for the period</b>					<b>31.0</b>

	<b>For the Year Ended December 31 2008</b>				
	<b>Passenger Aircraft</b>	<b>Cargo Aircraft</b>	<b>Others</b>	<b>Adjustments</b>	<b>Total</b>
	<b>Millions of Dollars</b>				
<b>Revenues</b>					
Revenues from external customers	1,832.0	139.5	51.1	-	2,022.6
Inter-segment revenues	-	-	76.4	(76.4)	-
Adjustments to consolidated	-	-	-	73.7	73.7
<b>Total segment revenues</b>	<b>1,832.0</b>	<b>139.5</b>	<b>127.5</b>	<b>(2.7)</b>	<b>2,096.3</b>
<b>Segment results</b>	<b>436.2</b>	<b>8.7</b>	<b>57.7</b>	<b>-</b>	<b>502.6</b>
Unassigned expenses					(508.3)
<b>Operational loss</b>					<b>(5.7)</b>
Financing expenses					(61.5)
Financing income					17.0
Company's equity in earnings of affiliates, net					0.5
<b>Loss before income taxes</b>					<b>(49.7)</b>
Tax benefit					7.8
<b>Loss for the year</b>					<b>(41.9)</b>

**Note 8 - Retroactive Adjustments Due to Retroactive Application of Changes in Accounting Policy****a. Liabilities Due to Frequent Flier Programs**

Until December 31 2008, the provision for frequent flier clubs was calculated based on an estimate of the effective costs to the Company as a result of the use of the benefits awarded by the plans in question, while using the probability estimate to take advantage of the benefits. The effective cost was based on the estimate of the expected relative weight, in Management's opinion, of the marginal expenses the Company may bear and of the loss of alternative revenues deriving from the rejection of paying customers, in the realization of the benefits in question.

Starting January 1 2009, the Group has applied IFRIC 13 regarding customer loyalty programs. This clarification states that flight ticket sales transactions in which the Company awarded its customers frequent flier points (hereinafter – "the Points"), 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, with the remnant charged to the ticket. The proceeds charged to points shall be recognized as income when the points are redeemed and the Company's obligation to provide the service is upheld. In determining the fair value of frequent flier points awarded Company customers, the Company based its calculations on the sales price (after adjustments) of frequent flier points sold to business partners.

**b. Employee Benefits due to Vacations**

Up until December 31 2008, the vacation provision was calculated while differentiating between short term and long term vacations, this based on Company management's estimates regarding the timing of the exercise of vacation days of Company employees. Under this assumption, the provision to long term vacation was calculated using actuary estimates. The Company's liability for total employee vacation days was presented in the framework of liabilities due to employee benefits in the framework of the Company's current liabilities.

Starting January 1 2009, the Company has applied the revision to IAS 19, "Employee Benefits." This revision states that accumulated entitlement to compensation due to absences shall be classified as a short term employee benefit, or as a long term employee benefit based on the date on which the employee received the right to the benefit.

As a result, the Company presents vacation benefits as short term employee benefits, equal to the non-capitalized sum the Company expects to pay for the exercise of this right, while taking into account pay raises expected within a year of the balance sheet date.

**c. The influence of the retroactive adjustment on the report items on the financial status:**

<b>As of September 30 2008</b>					
<b>As Reported in the Past</b>	<b>Impact of Retroactive Application Due to Frequent Flier Program</b>	<b>Impact of Retroactive Application Due to Employee Vacation Benefits</b>	<b>Reclassifica- tion</b>	<b>As Reported in These Financial Statements</b>	
<b>Thousands of Dollars (Unaudited)</b>					
Short term provisions	(100,265)	(52,007)	-	75,387	(76,885)
Prepaid expenses	25,958	4,573	-	4,228	34,759
Other receivables	38,300	-	-	(4,228)	34,072
Short-term employee benefit obligations	(87,012)	-	(8,727)	-	(95,739)
Short term unearned revenues	(221,888)	-	-	(26,204)	(248,092)
Deferred tax liability	(53,967)	11,859	2,325	-	(39,783)
Long term unearned revenues	-	-	-	(49,183)	(49,183)
Accumulated loss	143,556	35,575	6,402	-	185,533

<b>As of December 31 2008</b>					
<b>As Reported in the Past</b>	<b>Impact of Retroactive Application Due to Frequent Flier program</b>	<b>Impact of Retroactive Application Due to Employee Vacation Benefits</b>	<b>Reclassifica- tion</b>	<b>As Reported in These Financial Statements</b>	
<b>Thousands of Dollars</b>					
Short term provisions	(81,076)	(53,873)	-	77,900	(57,049)
Prepaid expenses	19,247	4,615	-	3,830	27,692
Other receivables	23,523	-	-	(3,830)	19,693
Short-term employee benefit obligations	(80,174)	-	(7,756)	-	(87,930)
Short term unearned revenues	(172,445)	-	-	(25,466)	(197,911)
Deferred tax liability	(16,203)	12,314	2,017	-	(1,872)
Long term unearned revenues	-	-	-	(52,434)	(52,434)
Accumulated loss	152,969	36,944	5,739	-	195,652

**d. The influence of the retroactive adjustment on the report items on gain/loss:**

	<b>For the Nine Month Period Ending September 30 2008</b>			<b>As Reported in These Financial Statements</b>
	<b>As Reported in the Past</b>	<b>Impact of Retroactive Application Due to Frequent Flier program</b>	<b>Impact of Retroactive Application Due to Employee Vacation Benefits</b>	
	<b>Thousands of Dollars</b>			
	<b>(Unaudited)</b>			
Operating revenues	1,635,761	(2,122)	-	1,633,639
Operating expenses	(1,373,844)	-	(1,344)	(1,375,188)
Selling expenses	(180,434)	462	(56)	(180,028)
General and administrative expenses	(75,647)	-	(112)	(75,759)
Loss before income taxes	(31,939)	(1,660)	(1,512)	(35,111)
Tax benefit	2,530	415	377	3,322
Loss for the period	(29,409)	(1,245)	(1,135)	(31,789)
<b>Loss per share (NIS 1 par value) in USD</b>				
Basic loss per share	(0.06)			(0.06)
Diluted loss per share	(0.06)			(0.06)

	<b>For the Three Month Period Ending September 30 2008</b>			<b>As Reported in These Financial Statements</b>
	<b>As Reported in the Past</b>	<b>Impact of Retroactive Application Due to Frequent Flier program</b>	<b>Impact of Retroactive Application Due to Employee Vacation Benefits</b>	
	<b>Thousands of Dollars</b>			
	<b>(Unaudited)</b>			
Operating revenues	607,273	(344)	-	606,929
Operating expenses	(473,865)	-	1,439	(472,426)
Selling expenses	(63,865)	(562)	60	(64,367)
General and administrative expenses	(24,560)	-	123	(24,437)
Profit before income taxes	40,832	(907)	1,623	41,548
Taxes on income	(10,402)	227	(406)	(10,581)
Net profit for the period	30,430	(680)	1,217	30,967
<b>Profit per share (NIS 1 par value) in USD</b>				
Basic profit per share	0.06			0.06
Diluted profit per share	0.06			0.06

	<b>For the Year Ending December 31 2008</b>			
	<b>As Reported in the Past</b>	<b>Impact of Retroactive Application Due to Frequent Flier program</b>	<b>Impact of Retroactive Application Due to Employee Vacation Benefits</b>	<b>As Reported in These Financial Statements</b>
	<b>Thousands of Dollars</b>			
Operating revenues	2,101,065	(4,739)	-	2,096,326
Operating expenses	(1,775,849)	-	(480)	(1,776,329)
Selling expenses	(228,808)	1,255	(20)	(227,573)
General and administrative expenses	(97,063)	-	(40)	(97,103)
Loss before income taxes	(45,684)	(3,484)	(540)	(49,708)
Tax benefit	6,862	871	68	7,801
Loss for the year	(38,822)	(2,613)	(472)	(41,907)
<b>Loss per share (NIS 1 par value) in USD</b>				
Basic loss per share	(0.08)			(0.08)
Diluted loss per share	(0.08)			(0.08)

**Note 9 - Seasonality**

Passenger traffic through Ben Gurion Airport is characterized by a high degree of seasonality. Most activity is during the summer months, peaking in July through September. The winter months (January through March) are characterized by low passenger traffic.

**Note 10 - Other Events During the Reported Period****a. Work Dispute**

On July 29 2009, the Company's offices received notice from the New Histadrut [workers' union] – the Professional Union Department ("the Histadrut"), on the basis of the Work Dispute Resolution Law, 1957, according to which the Histadrut has the right to declare a strike starting August 12 2009.

On August 4 2009 the representatives of the Company, the Histadrut and the Company's workers announced that they would be freezing the work dispute, as declared by the Histadrut, this concurrent with the Company's agreement to freeze various moves related to work relationships it took recently. In addition, it was agreed that intensive negotiations would be held between Company Management, the workers' representatives and the Histadrut administration to create a shared streamlining plan benefiting both the Company and its employees.

**b. Changes in Corporate Tax rates**

On July 23 2009 the Economic Streamlining Law 2009 (Legislative Changes to Implement the 2009 and 2010 Economic Plan) (hereinafter - "the Arrangements Law") was published. According to the Arrangements Law, corporate tax rates will gradually decrease starting 2011, for which a tax rate of 24% was set, to tax year 2016, for which a corporate tax rate of 18% was set.

The implementation of these amendments had an impact on the Company's deferred tax balances and on the increase in the Company's tax benefit for the nine and three month period ending September 30 2009 to the amount of \$4 million.

**c. The Company's Appointment as Designated Carrier to Eilat:**

On August 24 2009, the Company's request to be appointed designated carrier on the BGN-Eilat line, alongside Arkia and Israil, was approved following the recommendation of the Civil Aviation Authority. In his announcement, the Ministry of Transportation and Road Safety spokesman said the date on which flights will begin, frequencies and seats capacity the Group will be able to operate will be determined following thorough staff work carried out by the Civil Aviation Authority.

In September 2009 airlines Israil Aviation and Tourism Ltd. and Arkia Israel Airlines (hereinafter: "Israil" and "Arkia") petitioned separately to the High Court of Justice against the Minister of Transportation, the CAA, the Restriction of Trade Commissioner and the Company, in which the Court was asked to issue an injunction instructing the respondents to explain why the Court should not rule that (a) the decision on behalf of the Minister of Transportation allowing the Company to operate scheduled flights from BGN to Eilat be made null and void for reasons of lack of authority and improbability; (b) the recommendation given by the CAA to allow the Company operate scheduled flights from BGN to Eilat was made without upholding its consultation requirements and is thus invalid; (c) the decision on the Company's request to operate scheduled flights on the Eilat line should be made by a different Minister.

Subsequent to the balance sheet date, in October 2009 the Court decided to consolidate the two petitions dealing with the same issue and directed against the same factors into a single claim, to be brought before a panel of three judges at a date to be set later. The Court also rejected Israil's and Arkia's requests for injunctions at this stage. At the same time, it ruled that in the event that a final decision is reached regarding the flights and their actual beginning, Arkia and Israil shall retain the right to renew their motions for injunctions.

Note that on October 13 2009 the CAA announced that the Ministry of Transportation intended to continue with the administrative process, in which the Company's commercial operating license would be amended, allowing it to operate scheduled flights to Eilat under the following conditions:

- a. The Company would be required to operate at least one frequency a day in each direction, in five out of seven days a week. The Company shall offer at least 100 seats for each of these frequencies.
- b. The Company may not operate more than two frequencies a day in each direction. In addition, the Company may not offer more than 430 seats a day in either direction.
- c. When selling tickets for the BGN-Eilat-BGN route, the Company may not receive frequent flier points accumulated by its clients as a result of purchasing tickets on international routes operated by the Company as payment.
- d. A uniform maximum price shall be set for each company for the BGN-Eilat-BGN and Sdeh Dov-Eilat-Sdeh Dov routes, in accordance with the sums noted.
- e. Israil shall be freed of its obligations in the matter of flight schedules and seat offerings, which undertook to uphold in its Ministry of Transportation tender dated 1995, and it shall be allowed to set its flight schedule for the BGN-Eilat-BGN and Sdeh Dov-Eilat-Sdeh Dov routes as it sees fit.

The Company is expected to submit its position on the aforementioned proposal.

**d. The Decision of the Restriction of Trade Commissioner:**

On September 21 2009 the Restriction of Trade Commissioner reached decisions (hereinafter: "the Commissioner" and "the Decisions", respectively) regarding the Company's request dated March 31 2009 for receipt of an exemption from the requirement for the receipt of court approval for binding arrangements (hereinafter: "the Exemption Request") pertaining to various aviation agreements between the Company and foreign air carriers (hereinafter: "the Arrangements").

According to the Commissioner's decisions, the exemption requests were approved as regards code sharing agreements between the Company and the following carriers: American Airlines, Swiss Airways, Iberia, Czech, and Thai.

In addition, according to the Commissioner's decisions, the exemption requests for arrangements between the Company and the following foreign carriers were not approved: Air India, Lot, Austrian, Tandem, Bulgaria Air and Aerosvit.

Subsequent to the balance sheet date, in November 2009, the Restriction of Trade Commissioner published her arguments regarding the decision not to ratify the aforementioned exemption requests.

Note that the Commissioner has yet to submit a decision as regards the code share with Air China and that after submitting the exemption requests, the Company announced that it would be canceling its arrangements with SAA, Belavia and Brussels Airlines.

The Company is studying the decisions and shall consider its next steps.

**e. Maintenance Agreement**

The Company signed an agreement during the reported period to provide heavy maintenance and logistical support upon request of Nepal Airlines Boeing 757 aircraft. The Company's expected revenue as a result of signing this agreement is \$6 million over the course of 3 years (2009-2011).

**f. Collateral and Hedging Agreements**

Pursuant to that stated in Note 33 to the Financial Statements, with the drop in jet fuel prices to below the price levels defined in hedging agreements with international institutions, the Company was required to provide collateral to guarantee its upholding hedging refunds to which it was obligated in accordance with its agreements with hedging institutions. As of September 30 2009, the total collateral requirement amounted to \$73 million given through deposits and letters of credit, and in addition, the hedging institutions provided non-guaranteed frameworks to the amount of \$27 million. The Company placed liens on assets (aircraft and deposits) to the required extent for banks in Israel and abroad.

**Note 11 - Events Subsequent to the Balance Sheet Date**

**a. Settlement with Sabre:**

Following Note 24.d.c.(1) of the yearly Financial Statements, on October 1 2009 a series of agreements was signed between the Company and the plaintiffs and the joint company, upon the signing of which all disputes and legal proceedings between the parties, including the request for arbitration, would be concluded (the array of agreements in question shall be referred to, together, as the "Settlement Agreement").

According to the Settlement Agreement, on October 1 2009 the commercial agreement on the basis of which the joint company of had been established shall come to a conclusion. On that date Sabre BV shall purchase from El Al the entirety of its holdings in the joint company (49%) in return for the payment of the Company's share of the joint company's equity, as determined at the end of the third quarter of 2009 and the joint company also repaid the owner's loan granted by the Company, the balance of which equaled a sum of \$1.2 million U.S. The joint company's equity equaled a total of \$2,352 thousand U.S. as of September 30 2009.

The Company and Sabre shall enter into a new agreement, updating the existing agreement for distribution using the Sabre distribution system, allowing Israeli travel agents connected to this system to work in a full content format ("the New Arrangement"). The New Arrangement shall remain in effect for several years. In addition, according to the settlement the Company cancelled charges issued to the joint company for data processing and communications expenses and paid the joint company sums offset in the past by those charges, concurrently with the cancellation of the additional arbitration process beginning in Israel in relation to these sums.

As part of the Settlement Agreement and subject to its implementation, each of the parties shall completely free the other and the joint company of any claims or demands. In addition, all outstanding legal proceedings between the parties and between the joint company and El Al shall be dismissed

As a result of the aforementioned settlement, the Company listed a reduced provision to the amount of \$1.7 million U.S. in its Q3 2009 Financial Statements.

**b. Appointment of CEO:**

On October 21 2009, the Company's Board of Directors decided to appoint Mr. Elyezer Shkedy as the Company's new CEO. Mr. Shkedy will enter his new position on January 1 2010, at the end of a 2-month preparation and training period with the Company's CEO, Mr. Haim Romano.

The terms of Mr. Shekedi's employment as a CEO have yet to be established.

**c. Ratio of Balance of Loans to Collateral:**

Subsequent to the balance sheet date, in October 2009, and updated aircraft price list was published, according to which a differential has been created in the ratio of balance of loans to collateral required as part of the Company's loan agreements with the banks. The Company is undergoing advanced talks with the banks to reach an arrangement regarding the lack of collateral as required by the financing agreements in question.

**d. Negligible Transaction**

On November 26 2009, the Company Board of Directors decided to adopt rules and guidelines for the classification of a transaction made by the company or one of its affiliates with an interested party (hereinafter: "an Interested Party Transaction") as a negligible transaction as defined in Regulation 64(3)(d)(1) of the Securities Regulations (Preparation of Yearly Financial Statements), 1993.

These rules and guidelines are also used to determine the extent of disclosure in the periodic report and in the prospectus (including in shelf proposal reports) as regards transactions with controlling shareholders or in which controlling shareholders have personal interest as defined in Regulation 22 of the Securities Regulations (Periodic and Immediate Reports), 1970 (hereinafter: "the Reporting Regulations") and Regulation 54 of the Securities Regulations (Prospectus Details and Prospectus Draft – Structure and Form), 1969, as well as to determine the need to submit an immediate report for such a transaction, as set in Regulation 37(a)(6) of the Reporting Regulations.

The Company's Board of Directors has determined that in the absence of special qualitative considerations deriving from the circumstances of the issue, an Interested Party Transaction shall be considered a "negligible transaction" if:

(a) The transaction takes place over the Company's normal course of business and (b) the transaction is under market conditions and its terms are acceptable to the relevant market; and (c) the relevant criteria for the transaction, one or more, whether it is a single commitment or a series of commitments on the same issue over the course of the same year, is at an extent of no greater than 200,000 NIS in any interested party transaction the classification of which has been considered as a "negligible transaction" on the basis of the Company's latest audited consolidated yearly financial statements. Relevant criteria for the determination of a transaction are, for instance: (1) total sales the subject of the Interested Party Transaction; or – (2) the total cost of the sales the subject of the Interested Party Transaction; or – (3) the extent of assets the subject of the Interested Party Transaction; or – (4) the extent of liabilities the subject of the Interested Party Transaction; or – (5) the extent of the expense or yield the subject of the Interested Party Transaction.

In this regard – in the event the Company does not have full rights to a certain transaction, the transaction shall be determined based on the Company's relative portion of the transaction.

In cases in which, according to the Company's judgment, all of the aforementioned criteria are irrelevant for the determination of the negligibility of the Interested Party Transaction, the transaction shall be considered negligible, in accordance with a different relevant criterion, determined by the Company, so long as the relevant criterion used for this transaction shall be no greater than 200,000.

At the same time, examination of the quantitative considerations of an interested party transaction may lead to the contradiction of the aforementioned presumption of the transaction's negligibility. Thus, for instance, and merely as an example, an Interested Party Transaction shall not generally be considered negligible if it is considered a significant event by Company Management and if it serves as basis for administrative decisions, or if interested parties are expected to receive benefits that need to be reported to the public as part of the transaction.

The transaction's negligibility shall be determined on a yearly basis for the purpose of reporting within the framework of the periodic report, the financial statements and the prospectus (including a shelf proposal report), while adding together all of the Company's transactions of the sort with the interested party in question or with corporations under the control of the interested party. To be clear - separate transactions carried out on a regular and repeating basis during a certain period with no mutual dependence or for which no additional obligations exist which are not relevant to entering into the transaction as regards the same interested party, shall be examined on a yearly basis for the purpose of reporting pursuant to the periodic report, the financial statements and the prospectus (including a shelf proposal report), and on the basis of the specific transaction for the purpose of immediate reporting.