# GAZIT-GLOBE LTD.

## INTERIM CONSOLIDATED FINANCIAL STATEMENTS

## AS OF JUNE 30, 2005

## UNAUDITED

## INDEX



- - - - - - - -

Ernst & Young

■ **Kost Forer Gabbay & Kasierer**
3 Aminadav St.
Tel-Aviv 67067, Israel

■ Phone: 972-3-6232525
Fax: 972-3-5622555

The Board of Directors
Gazit-Globe Ltd.

Re: Review of unaudited interim consolidated financial statements for the six and three months ended June 30, 2005

At your request, we have reviewed the accompanying interim consolidated balance sheet of Gazit-Globe Ltd. as of June 30, 2005, and the related interim consolidated statements of income, changes in shareholders' equity and cash flows for the six and three months then ended. Our review was made in accordance with procedures established by the Institute of Certified Public Accountants in Israel. These procedures included reading the above mentioned financial statements, reading minutes of meetings of the shareholders and of the board of directors and its committees, and making inquiries of persons responsible for financial and accounting matters.

We have been furnished with reports of other accountants in respect of the review of the interim financial statements of certain subsidiaries, whose assets constitute approximately 42.5% of total consolidated assets as of June 30, 2005, and whose revenues constitute approximately 44.3% and 44.3% of total consolidated revenues for the six and three months then ended, respectively.

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

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

Tel-Aviv, Israel
August 18, 2005

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

## CONSOLIDATED BALANCE SHEETS

| | June 30, | | December 31, |
|---|---|---|---|
| | **2005** | **2004** | **2004** |
| | **Unaudited** | | **Audited** |
| | **Reported NIS in thousands** | | |
| ASSETS | | | |
| CURRENT ASSETS: | | | |
| Cash and cash equivalents | 99,655 | 20,590 | 52,807 |
| Short-term investments | 148,022 | 73,695 | 56,021 |
| Tenants | 103,905 | 77,230 | 103,123 |
| Accounts receivable | 125,402 | 94,441 | 70,001 |
| Loans to partners in property under development | 48,373 | 58,356 | 55,810 |
| Rental property held for sale | 1,980,684 | 199,127 | 54,888 |
| | 2,506,041 | 523,439 | 392,650 |
| LONG-TERM INVESTMENTS, LOANS AND RECEIVABLES: | | | |
| Investments in affiliates | 484,766 | 407,051 | 533,867 |
| Long-term investments | 359,168 | 146,647 | 216,105 |
| Long-term loans and receivables | 101,038 | 58,871 | 88,687 |
| | 944,972 | 612,569 | 838,659 |
| FIXED ASSETS: | | | |
| Cost | 15,564,759 | 14,303,725 | 15,391,857 |
| Less - accumulated depreciation | 839,153 | 652,764 | 778,122 |
| | 14,725,606 | 13,650,961 | 14,613,735 |
| OTHER ASSETS AND DEFERRED CHARGES, NET | 270,370 | 280,599 | 307,451 |
| | 18,446,989 | 15,067,568 | 16,152,495 |

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

## CONSOLIDATED BALANCE SHEETS

| | June 30, 2005 | June 30, 2004 | December 31, 2004 |
|---|---|---|---|
| | Unaudited | Unaudited | Audited |
| | Reported NIS in thousands | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
| CURRENT LIABILITIES: | | | |
| Short-term credit from banks and others | 1,755,325 | 576,163 | 755,391 |
| Trade payables | 124,077 | 79,297 | 152,474 |
| Other accounts payable | 332,887 | 273,143 | 256,216 |
| | 2,212,289 | 928,603 | 1,164,081 |
| LONG-TERM LIABILITIES: | | | |
| Debentures | 3,622,034 | 2,304,845 | 2,298,157 |
| Liabilities to financial institutions and others | 6,649,413 | 6,425,430 | 7,182,308 |
| Tenants' security deposits | 282,285 | 272,187 | 267,416 |
| Accrued severance pay, net | 1,161 | 1,043 | 1,042 |
| Deferred taxes, net | 70,986 | - | - |
| | 10,625,879 | 9,003,505 | 9,748,923 |
| CONVERTIBLE DEBENTURES REDEEMABLE FOR SUBSIDIARY'S SHARES | 225,160 | 638,627 | 479,220 |
| MINORITY INTEREST | 4,010,499 | 3,284,552 | 3,458,056 |
| SHAREHOLDERS' EQUITY | 1,373,162 | 1,212,281 | 1,302,215 |
| | 18,446,989 | 15,067,568 | 16,152,495 |

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

| August 18, 2005 | | | |
|---|---|---|---|
| Date of approval of the financial statements | Chaim Katzman<br>Chairman of the Board | Dori Segal<br>President and Director | Gil Kotler<br>Chief Financial Officer |

## CONSOLIDATED STATEMENTS OF INCOME

| | Six months ended June 30, 2005 | Six months ended June 30, 2004 | Three months ended June 30, 2005 | Three months ended June 30, 2004 | Year ended December 31, 2004 |
|---|---|---|---|---|---|
| | Unaudited | | | | Audited |
| | Reported NIS in thousands (except per share amounts) | | | | |
| Rental income | 1,030,967 | 877,350 | 527,366 | 456,930 | 1,858,235 |
| Rental property operating expenses | 330,115 | 280,397 | 166,323 | 145,305 | 598,675 |
| Rental property depreciation | 168,628 | 129,793 | 87,939 | 67,807 | 282,176 |
| Gross profit | 532,224 | 467,160 | 273,104 | 243,818 | 977,384 |
| General and administrative expenses | 84,629 | 73,533 | 42,482 | 38,012 | 159,392 |
| Operating income | 447,595 | 393,627 | 230,622 | 205,806 | 817,992 |
| Financial expenses, net | 288,007 | 254,253 | 145,056 | 132,718 | 519,676 |
| | 159,588 | 139,374 | 85,566 | 73,088 | 298,316 |
| Other income, net | 59,392 | 27,126 | 16,050 | 1,366 | 129,202 |
| Income before taxes on income | 218,980 | 166,500 | 101,616 | 74,454 | 427,518 |
| Taxes on income | 45,496 | 24,667 | 23,123 | 13,594 | 55,029 |
| Income after taxes on income | 173,484 | 141,833 | 78,493 | 60,860 | 372,489 |
| Equity in earnings of affiliates | 26,913 | 11,676 | 15,494 | 11,680 | 36,004 |
| Minority interest in earnings of subsidiaries | (137,727) | (117,781) | (76,151) | (58,164) | (298,383) |
| Income before cumulative effect | 62,670 | 35,728 | 17,836 | 14,376 | 110,110 |
| Cumulative effect as of the beginning of the period of change in accounting principle, net (Note 2b) | (56,525) | - | - | - | - |
| Net income | 6,145 | 35,728 | 17,836 | 14,376 | 110,110 |
| Net earnings per NIS 1 par value of Ordinary shares (in reported NIS): | | | | | |
| Basic earnings: | | | | | |
| Before cumulative effect | 0.76 | 0.43 | 0.24 | 0.16 | 1.17 |
| Cumulative effect as of the beginning of the period of change in accounting principle | (0.63) | - | - | - | - |
| Net earnings | 0.13 | 0.43 | 0.24 | 0.16 | 1.17 |
| Diluted earnings | - | 0.39 | - | 0.13 | - |

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

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

| | Six months ended June 30, 2005 (unaudited) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Capital reserve | Foreign currency translation adjustments for foreign autonomous entities | Retained earnings | Dividend declared subsequent to the balance sheet date | Less - shares held by the Company | Less - loans for purchase of shares | Total |
| | Reported NIS in thousands | | | | | | | | |
| Balance at the beginning of the period (audited) | 144,014 | 922,900 | (1,024) | 124,974 | 219,573 | 17,200 | (116,004) | (9,418) | 1,302,215 |
| Exercise of stock options into shares | 2,380 | 50,179 | - | - | - | - | - | - | 52,559 |
| Foreign currency translation adjustments for foreign autonomous entities, net | - | - | - | 58,864 | - | - | - | - | 58,864 |
| Revaluation of derivatives in affiliate to market value | - | - | (9,746) | - | - | - | - | - | (9,746) |
| Net income | - | - | - | - | 6,145 | - | - | - | 6,145 |
| Repayment of loans for purchase of shares | - | - | - | - | - | - | - | 341 | 341 |
| Revaluation of loans for purchase of shares | - | - | - | - | - | - | - | (112) | (112) |
| Dividend paid | - | - | - | - | (19,904) | (17,200) | - | - | (37,104) |
| Dividend declared (1) | - | - | - | - | (21,499) | 21,499 | - | - | - |
| Balance at the end of the period | 146,394 | 973,079 | (10,770) | 183,838 | 184,315 | 21,499 | (116,004) | (9,189) | 1,373,162 |

| | Six months ended June 30, 2004 (unaudited) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Capital reserve | Foreign currency translation adjustments for foreign autonomous entities | Retained earnings | Dividend declared subsequent to the balance sheet date | Less - shares held by the Company | Less - loans for purchase of shares | Total |
| | Reported NIS in thousands | | | | | | | | |
| Balance at the beginning of the period (audited) | 137,916 | 841,647 | 1,702 | 86,175 | 175,171 | 14,583 | (106,604) | (9,378) | 1,141,212 |
| Exercise of stock options into shares | 4,193 | 51,563 | - | - | - | - | (9,400) | - | 46,356 |
| Foreign currency translation adjustments for foreign autonomous entities, net | - | - | - | 9,697 | - | - | - | - | 9,697 |
| Revaluation of derivatives in affiliate to market value | - | - | 9,521 | - | - | - | - | - | 9,521 |
| Revaluation of loans for purchase of shares | - | - | - | - | 64 | - | - | (64) | - |
| Net income | - | - | - | - | 35,728 | - | - | - | 35,728 |
| Dividend paid | - | - | - | - | (15,650) | (14,583) | - | - | (30,233) |
| Dividend declared | - | - | - | - | (16,007) | 16,007 | - | - | - |
| Balance at the end of the period | 142,109 | 893,210 | 11,223 | 95,872 | 179,306 | 16,007 | (116,004) | (9,442) | 1,212,281 |

(1) See Note 4f.

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

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Three months ended June 30, 2005 (unaudited)

| | Share capital | Share premium | Capital reserve | Foreign currency translation adjustments for foreign autonomous entities | Retained earnings | Dividend declared subsequent to the balance sheet date | Less - shares held by the Company | Less - loans for purchase of shares | Total |
|---|---|---|---|---|---|---|---|---|---|
| | Reported NIS in thousands | | | | | | | | |
| Balance at the beginning of the period | 145,807 | 961,187 | (355) | 130,044 | 188,078 | 19,798 | (116,004) | (9,096) | 1,319,459 |
| Exercise of stock options into shares | 587 | 11,892 | - | - | - | - | - | - | 12,479 |
| Foreign currency translation adjustments for foreign autonomous entities, net | - | - | - | 53,794 | - | - | - | - | 53,794 |
| Revaluation of derivatives in affiliate to market value | - | - | (10,415) | - | - | - | - | - | (10,415) |
| Revaluation of loans for purchase of shares | - | - | - | - | - | - | - | (93) | (93) |
| Net income | - | - | - | - | 17,836 | - | - | - | 17,836 |
| Dividend paid | - | - | - | - | (100) | (19,798) | - | - | (19,898) |
| Dividend declared (1) | - | - | - | - | (21,499) | 21,499 | - | - | - |
| Balance at the end of the period | 146,394 | 973,079 | (10,770) | 183,838 | 184,315 | 21,499 | (116,004) | (9,189) | 1,373,162 |

Three months ended June 30, 2004 (unaudited)

| | Share capital | Share premium | Capital reserve | Foreign currency translation adjustments for foreign autonomous entities | Retained earnings | Dividend declared subsequent to the balance sheet date | Less - shares held by the Company | Less - loans for purchase of shares | Total |
|---|---|---|---|---|---|---|---|---|---|
| | Reported NIS in thousands | | | | | | | | |
| Balance at the beginning of the period | 140,769 | 872,409 | 1,702 | 120,983 | 181,207 | 15,393 | (116,004) | (9,434) | 1,207,025 |
| Exercise of stock options into shares | 1,340 | 20,801 | - | - | - | - | - | - | 22,141 |
| Foreign currency translation adjustments for foreign autonomous entities, net | - | - | - | (25,111) | - | - | - | - | (25,111) |
| Revaluation of derivatives in affiliate to market value | - | - | 9,521 | - | - | - | - | - | 9,521 |
| Revaluation of loans for purchase of shares | - | - | - | - | 8 | - | - | (8) | - |
| Net income | - | - | - | - | 14,376 | - | - | - | 14,376 |
| Dividend paid | - | - | - | - | (278) | (15,393) | - | - | (15,671) |
| Dividend declared | - | - | - | - | (16,007) | 16,007 | - | - | - |
| Balance at the end of the period | 142,109 | 893,210 | 11,223 | 95,872 | 179,306 | 16,007 | (116,004) | (9,442) | 1,212,281 |

(4) See Note 4f.

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

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

| | Year ended December 31, 2004 (audited) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Capital reserve | Foreign currency translation adjustments for foreign autonomous entities | Retained earnings | Dividend declared subsequent to the balance sheet date | Less - shares held by the Company | Less - loans for purchase of shares | Total |
| | Reported NIS in thousands | | | | | | | | |
| Balance at the beginning of the year | 137,916 | 841,647 | 1,702 | 86,175 | 175,171 | 14,583 | (106,604) | (9,378) | 1,141,212 |
| Exercise of stock options into shares | 6,098 | 81,253 | - | - | - | - | (9,400) | (56) | 77,895 |
| Revaluation of loans for purchase of shares | - | - | - | - | (16) | - | - | 16 | - |
| Foreign currency translation adjustments for foreign autonomous entities, net | - | - | - | 38,799 | - | - | - | - | 38,799 |
| Revaluation of derivatives in affiliate to market value | - | - | (2,726) | - | - | - | - | - | (2,726) |
| Net income | - | - | - | - | 110,110 | - | - | - | 110,110 |
| Dividend paid | - | - | - | - | (48,492) | (14,583) | - | - | (63,075) |
| Dividend declared | - | - | - | - | (17,200) | 17,200 | - | - | - |
| Balance at the end of the year | 144,014 | 922,900 | (1,024) | 124,974 | 219,573 | 17,200 | (116,004) | (9,418) | 1,302,215 |

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Six months ended June 30, 2005 | Six months ended June 30, 2004 | Three months ended June 30, 2005 | Three months ended June 30, 2004 | Year ended December 31, 2004 |
|---|---|---|---|---|---|
| | Unaudited | | | | Audited |
| | Reported NIS in thousands | | | | |
| Cash flows from operating activities: | | | | | |
| Net income | 6,145 | 35,728 | 17,836 | 14,376 | 110,110 |
| Adjustments to reconcile net income to net cash provided by operating activities (a) | 319,652 | 217,561 | 168,024 | 144,299 | 451,850 |
| Net cash provided by operating activities | 325,797 | 253,289 | 185,860 | 158,675 | 561,960 |
| Cash flows from investing activities: | | | | | |
| Investment in newly consolidated companies (b) | (246) | (8,861) | (246) | - | (8,861) |
| Investment in subsidiary and in jointly controlled entity | - | (10,824) | - | - | (29,220) |
| Investments in fixed assets | (1,422,476) | (1,705,005) | (968,507) | (829,600) | (2,937,886) |
| Repayment (grant) of loans to partners in property under development, net | 9,083 | (1,945) | 5,586 | 1,783 | 4,928 |
| Proceeds from sale of fixed assets | 119,843 | 70,583 | 56,828 | 31,245 | 410,105 |
| Long-term loans granted | - | (20,755) | - | - | (53,529) |
| Repayment of long-term loans granted | 100 | 23,231 | 43 | 20,631 | 27,097 |
| Short-term investments, net | (21,192) | 3,609 | (23,050) | 463 | 37,313 |
| Purchase of marketable securities and long-term investments | (203,901) | (120,377) | (60,990) | (91,731) | (238,791) |
| Investment in affiliate | - | (374,748) | - | (68,295) | (467,143) |
| Proceeds from realization of long-term investments | 47,340 | 10,409 | 33,372 | - | 60,406 |
| Net cash used in investing activities | (1,471,449) | (2,134,683) | (956,964) | (935,504) | (3,195,581) |
| Cash flows from financing activities: | | | | | |
| Repayment of loans for the purchase of Company and subsidiary's shares | 341 | 13,476 | - | - | 15,681 |
| Exercise of stock options into shares | 52,559 | 46,356 | 12,479 | 22,141 | 77,895 |
| Issuance of shares to minorities in subsidiaries, net | 174,784 | 321,273 | 5,064 | 93,037 | 506,976 |
| Deferred charges in respect of raising loans and debentures | (22,314) | (14,995) | (17,835) | (510) | (28,102) |
| Dividend paid | (37,104) | (30,233) | (19,898) | (30,233) | (63,075) |
| Dividend paid to minorities in subsidiary | (185,685) | (138,456) | (105,158) | (53,912) | (291,193) |
| Receipt of long-term loans | 867,773 | 1,179,271 | 516,366 | 633,931 | 1,545,586 |
| Repayment of long-term loans | (983,306) | *) (443,893) | (691,988) | *) (221,746) | (379,451) |
| Withdrawal (repayment) of long-term credit lines from banks, net | 186,524 | *) (367,339) | 316,666 | *) 128,594 | 54,509 |
| Redemption and early redemption of debentures and convertible debentures | (14,789) | (19,586) | (924) | (18,741) | (170,618) |
| Sale of Company's debentures by subsidiaries | 11,036 | 2,772 | - | - | 107,937 |
| Short-term bank credit, net | (38,774) | 83,933 | (27,221) | 57,166 | 42,320 |
| Issuance of debentures | 1,170,134 | 1,206,974 | 856,634 | 107,630 | 1,211,311 |
| Increase (decrease) in tenants' security deposits, net | (785) | 12,336 | (795) | 4,696 | 9,358 |
| Net cash provided by financing activities | 1,180,394 | 1,851,889 | 843,390 | 722,053 | 2,639,134 |
| Effect of exchange rate differences from cash balances of foreign autonomous entities | 12,106 | (3,556) | 7,881 | (3,823) | (6,357) |
| Increase (decrease) in cash and cash equivalents | 46,848 | (33,061) | 80,167 | (58,599) | (844) |
| Cash and cash equivalents at beginning of period | 52,807 | 53,651 | 19,488 | 79,189 | 53,651 |
| Cash and cash equivalents at end of period | 99,655 | 20,590 | 99,655 | 20,590 | 52,807 |

*) Reclassified.

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Six months ended June 30, 2005 | Six months ended June 30, 2004 | Three months ended June 30, 2005 | Three months ended June 30, 2004 | Year ended December 31, 2004 |
|---|---|---|---|---|---|
| | Unaudited | Unaudited | Unaudited | Unaudited | Audited |
| | Reported NIS in thousands | | | | |
| (a) Adjustments to reconcile net income to net cash provided by operating activities: | | | | | |
| Income and expenses not involving cash flows: | | | | | |
| Gain from realization and revaluation of marketable securities, net | (24,523) | (4,736) | (20,548) | (421) | (11,015) |
| Minority interest in earnings of subsidiaries | 137,727 | 117,781 | 76,151 | 58,164 | 298,383 |
| Equity in losses (earnings) of affiliates, net of dividend received | 7,953 | (11,676) | 19,372 | (11,680) | (36,004) |
| Depreciation | 164,842 | 129,903 | 84,319 | 70,285 | 284,824 |
| Deferred taxes, net | 79,047 | 10,897 | 14,676 | 7,323 | 28,295 |
| Loss from early redemption of debentures and convertible debentures | - | 30 | - | 7 | 15 |
| Adjustment differences on monetary assets and long-term monetary liabilities, net | 14,904 | (24,977) | 18,524 | (19,802) | 14,209 |
| Amortization of other assets and deferred charges | 8,950 | 9,669 | 3,736 | 2,524 | 22,775 |
| Loss (gain) from sale of real estate | (22,109) | (6,322) | (15,146) | 2,030 | (81,396) |
| Increase in accrued severance pay, net | 119 | 26 | 45 | 10 | 25 |
| Gain from issuance of shares to minorities in investees | (35,728) | (15,524) | - | (212) | (32,583) |
| Changes in asset and liability items: | | | | | |
| Increase in tenants and accounts receivable | (59,318) | (22,198) | (47,436) | (17,440) | (107,719) |
| Increase in trade payables and other accounts payable | 43,108 | 30,117 | 31,561 | 52,101 | 57,322 |
| Increase in tenants' security deposits, net | 4,680 | 4,571 | 2,770 | 1,410 | 14,719 |
| | 319,652 | 217,561 | 168,024 | 144,299 | 451,850 |

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Six months ended June 30, 2005 | Six months ended June 30, 2004 | Three months ended June 30, 2005 | Three months ended June 30, 2004 | Year ended December 31, 2004 |
|---|---|---|---|---|---|
| | Unaudited | | | | Audited |
| | Reported NIS in thousands | | | | |
| (b) Investment in newly consolidated companies *): | | | | | |
| Subsidiaries' assets and liabilities at date of acquisition: | | | | | |
| Working capital (excluding cash and cash equivalents): | | | | | |
| Current assets | (179) | (1,381) | (179) | - | (1,381) |
| Current liabilities | 31,499 | 5,932 | 31,499 | - | 5,932 |
| | 31,320 | 4,551 | 31,320 | - | 4,551 |
| Fixed assets, long-term investments and loans (mainly real estate) | (47,486) | (123,804) | (47,486) | - | (123,804) |
| Other assets | - | (3,653) | - | - | (3,653) |
| Long-term liabilities | 16,339 | 115,512 | 16,339 | - | 115,512 |
| Minority interest | (419) | (1,467) | (419) | - | (1,467) |
| | (31,566) | (13,412) | (31,566) | - | (13,412) |
| | (246) | (8,861) | (246) | - | (8,861) |
| (c) Significant non-cash operations: | | | | | |
| Conversion of convertible debentures into subsidiary's shares | 260,600 | - | - | - | 69,687 |
| Purchase of fixed assets in consideration for subsidiary's shares | - | - | - | - | 13,000 |

*) A company consolidated for the first time by Mishkenot Clal since the second quarter of 2005. Mishkenot Clal was sold subsequent to the balance sheet date, see Note 4a.

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

## NOTE 1:- GENERAL

These financial statements have been prepared in a condensed format as of June 30, 2005, and for the six and three months then ended ("interim financial statements"). These financial statements should be read in conjunction with the Company's audited annual financial statements and accompanying notes as of December 31, 2004 and for the year then ended.

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

a. The interim financial statements have been prepared in accordance with generally accepted accounting principles for the preparation of financial statements for interim periods, as prescribed in Accounting Standard No. 14 of the Israel Accounting Standards Board and in accordance with the Chapter D of the Securities Regulations (Periodic and Immediate Reports), 1970.

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

b. Initial adoption of Accounting Standard No. 19 with respect to taxes on income:

   On January 1, 2005, the Company adopted Accounting Standard No. 19, "Taxes on Income" ("the Standard") of the Israel Accounting Standards Board. The Standard prescribes the principles for recognition, measurement, presentation and disclosure of taxes on income and deferred taxes in the financial statements. Pursuant to the Standard, the effect of the initial adoption of the Standard was recognized by recording the cumulative effect as of the beginning of the period in which the Standard is adopted.

   The major changes promulgated by the Standard in relation to the accounting principles which were previously in effect are: recognition of deferred taxes for temporary differences resulting from using a currency for financial reporting purposes that is different than the currency used for tax purposes and recognition of deferred taxes for temporary differences relating to land.

   As a result of the initial adoption of the provisions of the Standard, the Company recorded a deferred tax liability in the amount of approximately NIS 56.5 million which was reported as an expense and presented as a separate line item in the statement of income, "Cumulative effect as of the beginning of the period of change in accounting principle, net."

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

c. Effect of a new Accounting Standard in the period prior to its initial adoption:

In July 2005, the Israel Accounting Standards Board issued Accounting Standard No. 22, "Financial Instruments: Disclosure and Presentation".

This Standard prescribes principles regarding the presentation of financial instruments and details the proper disclosure required in their respect in the financial statements. The presentation principles apply to the classification of financial instruments or their component parts, on initial recognition as a financial liability, financial asset or equity instrument; the classification of related interest, dividends, losses and gains; and the circumstances in which a financial asset and a financial liability should be offset. This Standard shall apply to financial statements for periods commencing on or after January 1, 2006.

According to the new Standard, compound financial instruments, that include both a liability and an equity component (e.g., convertible debentures), should be bifurcated between the equity and liability component and each component should be classified separately in accordance with the Standard’s guidance. That is in contrast to current accounting principles, according to which the aforementioned financial instrument is classified in its entirety as a financial liability or as a single mezzanine item (depending on the probability of conversion). Transaction costs (net of any related income tax benefit) of an equity transaction are accounted for as a deduction from equity, while transaction costs of a financial liability are deducted from the liability and are taken into account, when calculating the effective interest rate.

The new Standard also broadens the definition of a financial liability, thus causing certain financial instruments, which are considered under current accounting guidance to be equity instruments, to be considered as financial liabilities. In addition, the new Standard supersedes Standards No. 48 and 53 of the Institute of Certified Public Accountants in Israel, according to which an investor should record a provision for a probable loss resulting from a decrease in its interest in the investee, following the conversion of the investee’s convertible instruments ("loss provision").

The Standard shall be applied prospectively. Comparative data presented in financial statements for periods beginning on the Standard’s effective date will not be restated. Financial instruments that were issued prior to the Standard’s effective date will be classified and presented in accordance with the provisions of the Standard beginning on the Standard’s effective date. Compound financial instruments, which were issued in prior periods and were not yet converted or redeemed as of the Standard’s effective date, will be bifurcated to their components and presented accordingly, beginning on the Standard’s effective date. A loss provision included in the financial statements of an investor at the Standard’s effective date should be reversed at such date as a cumulative effect in the current period.

In the Company's opinion, the effect of the new Standard on its financial position, results of operations and cash flows is not expected to be material.

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

d. The following are details of exchange rates of the U.S. dollar, the Euro, the Canadian dollar and of the Israeli CPI:

| | Representative exchange rate of US$ | Representative exchange rate of € | Representative exchange rate of C$ | Israeli CPI |
|---|---|---|---|---|
| | | N I S | | Points *) |
| **As of:** | | | | |
| June 30, 2005 | 4.574 | 5.5270 | 3.7110 | 181.6 |
| June 30, 2004 | 4.497 | 5.4657 | 3.3444 | 181.1 |
| December 31, 2004 | 4.308 | 5.8768 | 3.5787 | 180.7 |
| | | % | | |
| **Change during the period:** | | | | |
| June 2005 (6 months) | 6.2 | (6.0) | 3.7 | 0.5 |
| June 2005 (3 months) | 4.9 | (2.2) | 3.2 | 1.1 |
| June 2004 (6 months) | 2.7 | (1.2) | (1.9) | 1.4 |
| June 2004 (3 months) | (0.7) | (1.3) | (3.5) | 1.5 |
| December 2004 (12 months) | (1.6) | 6.2 | 5.0 | 1.2 |

*) The index on an average basis of 1993 = 100.

**NOTE 3:- ADDITIONAL INFORMATION**

a. During the reported period, approximately 2,298 thousand stock options (series 8) and approximately 82 thousand directors' stock options were exercised into approximately 2,380 thousand shares in consideration for approximately NIS 52.6 million.

b. In January 2005, FCR issued by a private placement approximately 2.7 million shares of FCR at the price of C$ 19.25 per share, for the total consideration of approximately C$ 52 million. Gazit Canada acquired approximately 707 thousand shares in this issuance with an investment of approximately C$ 14 million.

As a result of the issuance and the exercise of stock options into shares of FCR, the Company's shareholdings in FCR were diluted from 56.8% to 54.7% and the Company recorded in the first quarter of 2005 a capital gain of approximately NIS 14.3 million.

c. During February 2005, the Company issued by private placements to institutional investors approximately NIS 227 million par value of debentures (series A) in consideration for approximately NIS 221 million. The above issuance was executed by the enlargement of the series of debentures, which was first issued to the public in May 2002.

d. In February 2005, a wholly owned American subsidiary of the Company issued NIS 100 million par value of non-marketable debentures to entities controlled by Clal Holdings Insurance Company Ltd. (collectively referred to hereinafter as "Clal Insurance"). The issued debentures are redeemable in February of the years 2010 through 2012. The debentures are linked to the Israeli CPI and bear annual interest at the rate of 5.1%, payable once a year and fully guaranteed by the Company.

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

The Company also issued to these allotees approximately 3.2 million non-marketable stock options that are exercisable into the shares of the Company.

The options are exercisable into the shares of the Company on a one-for-one basis until January 31, 2007. If the stock options are exercised by January 31, 2006, the exercise price shall be NIS 31 per share, linked to the Israeli CPI. If the stock options are exercised subsequent to that date, the exercise price shall be NIS 33 per share, linked to the Israeli CPI.

As of the issuance date and assuming full exercise and if it does not sell shares which it holds, Clal Insurance will become an interested party in the Company with holdings of about 7.9% of the share capital (eliminating dormant shares and other issuances that the Company may effect from time to time).

e. On March 31, 2005, FCR redeemed all of the convertible debentures (series D) in an aggregate of approximately C$ 161.7 million and the accrued interest into approximately 8.6 million shares of FCR, according to its right to enforce conversion on holders of convertible debentures. The Company held approximately 87.9 million par value (54%) of convertible debentures (series D), through its wholly owned subsidiaries, and received approximately 4.6 million of FCR shares. As a result of this conversion, the Company's shareholdings in FCR were diluted and the Company recorded in the first quarter of 2005 a capital gain of approximately NIS 16.6 million, net of taxes.

f. In April 2005, the Company issued, at par value, NIS 425 million debentures (series C) by a private placement to institutional entities . The Company listed these debentures for trade on May 10, 2005 pursuant to a prospectus. The aforesaid debentures are linked to the increase in the Israeli CPI, bear fixed annual interest at the rate of 4.95%, payable twice a year. The principal of the debentures is payable in 8 annual payments from 2011 through 2018 (each of the first seven payments will be 10% of the amount and the final eighth payment will be 30% of the amount). Similarly, pursuant to the Company's said prospectus, it offered to the public an additional NIS 75 million par value of debentures (series C) at same terms, along with debenture options that are exercisable into an additional 450 million debentures (series C). Said debentures were rated (AA) by Maalot - The Israel Securities rating Company Ltd and Aa3 by Midroog Ltd.. .

During the reported period and subsequent to the balance sheet date, a wholly owned subsidiary of the Company acquired approximately 4.3 million debenture options (series C) which it converted into approximately NIS 431 million par value of debentures (series C). Subsequent to the balance sheet date, the wholly owned subsidiary of the Company sold approximately NIS 121 million par value of debentures (series C) in consideration for a total of approximately NIS 126 million. Also, approximately 0.2 million debenture options (series C) were exercised by others into approximately NIS 17 million par value of debentures (series C) in consideration for approximately NIS 19.2 million.

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

g. In May 2005, the Company's Board approved an employment contract with the deputy chairman of the Board. According to the above agreement, the deputy chairman of the Board (whose employment will be at 50% of a full time position) will be entitled to an annual salary of approximately NIS 780 thousand, with the addition of related expenses.

Further, according to the employment contract, on August 21, 2005, the Company expects to issue to the deputy chairman of the Company's Board 400,000 stock options exercisable into the shares of the Company with an exercise price of NIS 29.65 per share, subject to adjustments.

According to the Black-Scholes model, as of the date of the approval of the Board, as stated above, the fair value of the stock options is approximately NIS 3.1 million.

The above engagement was approved by the Company's meeting of shareholders in June 2005.

h. In May 2005, the Company's Board approved that the Company expand its activities into the field of shopping center operations in Israel, based on the experience and capabilities that the Group has gained through its activity in the field of shopping centers in North America. In this context, the Board approved an agreement with a local entity to establish a joint company that shall operate in said segment in Israel ("subsidiary"). The Company's share in the subsidiary is 85% and the partner's share - 15% (the partner was granted an option to increase its stake up to 25%). Said partner also acts as the general manager of the subsidiary. The subsidiary (Gazit Globe Israel (Development) Ltd.) began to examine several commercial properties. In June 2005, the subsidiary invested approximately NIS 185 million in a company that owns (100%) a shopping center in Rishon Le'zion .

i. During June 2005, FCR issued a series of debentures with a total par value of C$ 100 million. The debentures are unsecured, redeemable in one payment in June 2012 and bear fixed interest at the rate of 5.08%. Said debentures were rated at investment rating of (-BBB) by the Canadian Rating Agency ("DBRS").

j. At June 30, 2005, the balance of long-term investments includes an investment of NIS 4.5 million in the shares of Winn Dixie Stores Inc. ("WD"), which is in Court bankruptcy under Chapter 11 . The above amount is presented net of an impairment loss of approximately NIS 11.2 million, which was recorded in the second quarter of 2005.

k. In June 2005, the Company was issued VAT assessments for the years 2003 and 2004 and part of the years 2002 and 2005, according to which the VAT authorities limited the deduction of input taxes for the relevant period to approximately NIS 4 million. The Company filed an objection to this assessment and rejected all the VAT authorities' claims.

The Company believes that the assessment, its way of computation and rationale are not consistent with the nature of the Company's activity and, therefore, limiting the Company as to deduction of input taxes is groundless. At this stage the chances of the objection being accepted cannot be assessed and, accordingly, no provision has been made in the financial statements.

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

l. In June 2005, EQY announced that it has entered into an agreement with an American investment bank to examine strategic alternatives as to its property portfolio in Texas and Louisiana, among which the possibility of selling the portfolio or a joint venture with third parties in connection with the portfolio. EQY owns 32 properties with an area of about 280 thousand sq.m. in Texas and 15 properties with an area of about 150 thousand sq.m. in Louisiana. The basic rental income from these properties totals approximately $ 41 million a year. EQY has also placed a further 15 properties on the market; these properties, lovated in various states, have an area of about 120 thousand sq.m.. All properties, as stated above, the depreciated cost of which at June 30, 2005 totaled approximately NIS 2 billion, were classified as rental property held for sale and presented among current assets.

**NOTE 4:- EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE**

a. In July 2005, the Company entered into an agreement with Azorim Properties Ltd. and its wholly owned subsidiary ("Azorim Properties group"), whereby the Company shall sell its entire holding in Mishkenot Clal, meaning 50% of the share capital of Mishkenot Clal, to Azorim Properties group that, subsequent to the transaction, will hold the entire share capital of Mishkenot Clal. Closing is conditional upon the receipt of the approval of the Anti-Trust Commissioner.

Azorim Properties group will pay the Company NIS 59 million in consideration for the shares acquired and Azorim Properties group will assume all of the Company's liabilities with regard to Mishkenot Clal, including monetary debts in the amount of approximately NIS 31 million.

As a result of the sale, the Company expects to record a capital gain of approximately NIS 2 million.

b. In July 2005, Citycon issued 12 million shares of Citycon at a price of € 3.01 per share, for a total consideration of approximately € 36 million (approximately NIS 197 million). The Company acquired approximately 2.6 million shares in this issuance with an investment of € 7.7 million (approximately NIS 42.2 million).

As a result of this issuance, the Company's shareholdings in Citycon were diluted from 39.26% to 37.54% and the Company will record in the third quarter of 2005 a capital gain of approximately NIS 10 million.

c. In May 2005, FCR's Board approved a new dividend reinvestment plan ("DRIP") as from the second quarter of this year, in the context of which in July 2005 FCR issued, in respect of the dividend that is distributed in respect of the second quarter of this year, approximately 685 thousand shares of which approximately 520 thousand shares were issued to the Company.

d. In August 2005, the Company issued to institutional investors approximately 9.7 million par value of its debentures (series A) in consideration for approximately NIS 9.6 million. The issue was made by enlarging the existing debenture series, the par value of which, after this issue, amounts to approximately NIS 673 million.

**NOTE 4:- EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE (Cont.)**

e. In August 2005, FCR announced that on September 30, 2005 it will redeem all of the convertible debentures (series C) in an aggregate of approximately C$ 100 million and the interest accrued up to that date into the shares of FCR according to its right to enforce conversion on holders of convertible debentures. The Company holds approximately C$ 38.2 million par value (38%) of debentures (series C), through its wholly owned subsidiaries.

f. In August 2005, the Company declared a dividend of NIS 0.23 per share payable in September 2005. The record date for the entitlement to the dividend is September 11, 2005.

g. On July 25, 2005, the Knesset (Israeli Parliament) passed the Law for the Amendment of the Income Tax Ordinance (No. 147), 2005, which prescribes, among others, a gradual decrease in the corporate tax rate in Israel to the following tax rates: in 2006 - 31%, in 2007 - 29%, in 2008 - 27%, in 2009 - 26% and in 2010 and thereafter - 25%.

Management estimates that the effect of the amendment on the balances of deferred taxes as of June 30, 2005 is not expected to be material.

**NOTE 5:- INFORMATION ABOUT GEOGRAPHIC SEGMENTS**

| | Six months ended June 30, 2005 (unaudited) | | | |
|---|---|---|---|---|
| | U.S. | Canada | Israel | Total - consolidated |
| | Reported NIS in thousands | | | |
| Rental income | 576,736 | 438,913 | 15,318 | 1,030,967 |
| Segment results | 328,124 | 203,759 | 341 | 532,224 |

| | Six months ended June 30, 2004 (unaudited) | | | |
|---|---|---|---|---|
| | U.S. | Canada | Israel | Total - consolidated |
| | Reported NIS in thousands | | | |
| Rental income | 521,986 | 340,178 | 15,186 | 877,350 |
| Segment results | 303,514 | 162,822 | 824 | 467,160 |

**NOTE 5:- INFORMATION ABOUT GEOGRAPHIC SEGMENTS (Cont.)**

| | Three months ended June 30,2005 (unaudited) | | | |
|---|---|---|---|---|
| | U.S. | Canada | Israel | Total - consolidated |
| | Reported NIS in thousands | | | |
| Rental income | 294,957 | 224,723 | 7,686 | 527,366 |
| Segment results | 168,271 | 104,548 | 285 | 273,104 |

| | Three months ended June 30, 2004 (unaudited) | | | |
|---|---|---|---|---|
| | U.S. | Canada | Israel | Total - consolidated |
| | Reported NIS in thousands | | | |
| Rental income | 273,183 | 176,085 | 7,662 | 456,930 |
| Segment results | 158,903 | 84,744 | 171 | 243,818 |

| | Year ended December 31, 2004 (audited) | | | |
|---|---|---|---|---|
| | U.S. | Canada | Israel | Total - consolidated |
| | Reported NIS in thousands | | | |
| Rental income | 1,085,522 | 742,308 | 30,405 | 1,858,235 |
| Segment results | 620,285 | 355,957 | 1,142 | 977,384 |

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