CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2013

ISRAEL AEROSPACE INDUSTRIES LTD.

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2013

IN U.S. DOLLARS IN MILLIONS

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BDO Ziv Haft

Head Office: Amot Bituach House Bldg. B
48 Dereh Menahem Begin Rd.
Tel Aviv 66180, Israel
www.bdo.co.il E-mail: bdo@bdo.co.il

AUDITORS' REPORT
To the Shareholders of
ISRAEL AEROSPACE INDUSTRIES LTD.

We have audited the accompanying consolidated statements of financial position of Israel Aerospace Industries Ltd. ("the Company") as of December 31, 2013 and 2012, and the related consolidated statements of profit and loss, comprehensive income, changes in equity and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's board of directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of certain subsidiaries whose assets constitute approximately 23.73% and 24.24% of total consolidated assets as of December 31, 2013 and 2012, respectively, and whose revenues constitute approximately 26.27%, 30.12% and 29.56% of total consolidated revenues for the years ended December 31, 2013, 2012 and 2011, respectively. The financial statements of those companies were audited by other auditors, whose reports have been furnished to us, and our opinion, insofar as it relates to amounts included for those companies, is based on the reports of the other auditors. Moreover, the data included in the financial statements relating to the carrying amount of the investments and the Company's share of the business results of investees accounted for at equity is based on financial statements some of which have been audited by other auditors.

We conducted our audits in accordance with generally accepted auditing standards in Israel, including those prescribed by the Auditors' Regulations (Auditor's Mode of Performance), 1973. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the board of directors and management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

As discussed in Note 2b to the financial statements, the Company has included in the financial statements the information required by circulars of the Israel Government Companies Authority based on Section 33b to the Government Companies Law.

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the Company and its subsidiaries as of December 31, 2013 and 2012, and the results of their operations, changes in their equity and cash flows for each of the three years in the period ended December 31, 2013, in conformity with International Financial Reporting Standards ("IFRS") and with the provisions of the Israeli Securities Regulations (Annual Financial Statements), 2010.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), as adopted by the Institute of Certified Public Accountants in Israel, the effectiveness of the Company's internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 26, 2014, expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Tel-Aviv, Israel
March 26, 2014

ZIV HAFT BDO
Certified Public Accountants

GOVERNMENT COMPANIES REGULATIONS (ADDITIONAL REPORT REGARDING ACTIONS TAKEN AND STATEMENTS MADE TO SECURE THE ACCURACY OF THE FINANCIAL STATEMENTS AND DIRECTORS' REPORT), 2005

I, Rafi Maor, certify that:

1. I have reviewed the periodic report, as defined in Chapter B to the Israel Securities Regulations (Periodic and Immediate Reports), 1970 of Israel Aerospace Industries Ltd. ("the Company") for 2013 ("the reports").

2. To the best of my knowledge and after reviewing the reports, they do not contain any untrue statement of a material fact or omit to state a material fact necessary not to make the statements made, in light of the circumstances under which such statements were made, misleading with respect to the period covered by the reports.

3. To the best of my knowledge and after reviewing the reports, the financial statements and other financial information included in the directors' report fairly present, in all material respects, the financial position, results of operations, changes in equity and cash flows of the Company as of and for the periods presented in the reports.

4. The Company's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures in the Company as required in the reports. Accordingly, we have designed such controls and procedures, or had such controls and procedures established under our charge, designed to ensure that material information relating to the Company, including its subsidiaries, is made known to us by others in the Company and in the subsidiaries, particularly during the period in which the reports were prepared.

5. The Company's other certifying officers and I have disclosed to the Company's auditors and the Company's board of directors, based on our most recent evaluation:

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information;

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

There is nothing in the aforesaid to derogate from my responsibility or the responsibility of anyone else, pursuant to any law.

March 26, 2014

Rafi Maor
Chairman of the Board of Directors

GOVERNMENT COMPANIES REGULATIONS (ADDITIONAL REPORT REGARDING ACTIONS TAKEN AND STATEMENTS MADE TO SECURE THE ACCURACY OF THE FINANCIAL STATEMENTS AND DIRECTORS' REPORT), 2005

I, Joseph Weiss, certify that:

1. I have reviewed the periodic report, as defined in Chapter B to the Israel Securities Regulations (Periodic and Immediate Reports), 1970 of Israel Aerospace Industries Ltd. ("the Company") for 2013 ("the reports").

2. To the best of my knowledge and after reviewing the reports, they do not contain any untrue statement of a material fact or omit to state a material fact necessary not to make the statements made, in light of the circumstances under which such statements were made, misleading with respect to the period covered by the reports.

3. To the best of my knowledge and after reviewing the reports, the financial statements and other financial information included in the directors' report fairly present, in all material respects, the financial position, results of operations, changes in equity and cash flows of the Company as of and for the periods presented in the reports.

4. The Company's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures in the Company as required in the reports. Accordingly, we have designed such controls and procedures, or had such controls and procedures established under our charge, designed to ensure that material information relating to the Company, including its subsidiaries, is made known to us by others in the Company and in the subsidiaries, particularly during the period in which the reports were prepared.

5. The Company's other certifying officers and I have disclosed to the Company's auditors and the Company's board of directors, based on our most recent evaluation:

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information;

    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

There is nothing in the aforesaid to derogate from my responsibility or the responsibility of anyone else, pursuant to any law.

Joseph Weiss

March 26, 2014

Joseph Weiss
Chief Executive Officer

GOVERNMENT COMPANIES REGULATIONS (ADDITIONAL REPORT REGARDING ACTIONS TAKEN AND STATEMENTS MADE TO SECURE THE ACCURACY OF THE FINANCIAL STATEMENTS AND DIRECTORS' REPORT), 2005

I, Eyal Younian, certify that:

1. I have reviewed the periodic report, as defined in Chapter B to the Israel Securities Regulations (Periodic and Immediate Reports), 1970 of Israel Aerospace Industries Ltd. ("the Company") for 2013 ("the reports").

2. To the best of my knowledge and after reviewing the reports, they do not contain any untrue statement of a material fact or omit to state a material fact necessary not to make the statements made, in light of the circumstances under which such statements were made, misleading with respect to the period covered by the reports.

3. To the best of my knowledge and after reviewing the reports, the financial statements and other financial information included in the directors' report fairly present, in all material respects, the financial position, results of operations, changes in equity and cash flows of the Company as of and for the periods presented in the reports.

4. The Company's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures in the Company as required in the reports. Accordingly, we have designed such controls and procedures, or had such controls and procedures established under our charge, designed to ensure that material information relating to the Company, including its subsidiaries, is made known to us by others in the Company and in the subsidiaries, particularly during the period in which the reports were prepared.

5. The Company's other certifying officers and I have disclosed to the Company's auditors and the Company's board of directors, based on our most recent evaluation:

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information;

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

There is nothing in the aforesaid to derogate from my responsibility or the responsibility of anyone else, pursuant to any law.

March 26, 2014

Eyal Younian
Eyal Younian
Chief Financial Officer

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	Note	December 31, 2013	December 31, 2012 (*)
		U.S. dollars in millions	
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	**4**	**774**	505
Short-term financial assets	**5**	**1,136**	784
Available-for-sale securities	**6**	**47**	40
Trade receivables	**7**	**477**	438
Income receivable from work in progress, net	**8**	**696**	827
Other accounts receivable	**9**	**200**	301
Taxes receivable	**32**	**82**	69
Prepaid expenses in respect of service contracts		**47**	40
Inventories and inventory in process, net	**10**	**553**	505
Total current assets		**4,012**	3,509
NON-CURRENT ASSETS:			
Inventory in process	**10**	**7**	16
Long-term loans and receivables	**11**	**76**	46
Investments in associates	**12**	**22**	87
Deferred taxes	**32**	**98**	83
Property, plant and equipment, net	**13**	**672**	627
Intangible assets, net	**14**	**119**	92
Total non-current assets		**994**	951
Total assets		**5,006**	4,460

(*) Retroactively implemented, see Note 2k below.

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

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	Note	December 31, 2013	December 31, 2012 (*)
		U.S. dollars in millions	
LIABILITIES AND EQUITY			
CURRENT LIABILITIES:			
Current maturities in respect of debentures and other credit providers	15	**254**	323
Short-term financial liabilities		**5**	1
Trade payables	16	**510**	419
Other accounts payable	17	**532**	480
Provisions	18	**102**	74
Dividend payable		**-**	4
Payables for work in progress, net	19	**1,885**	1,800
Total current liabilities		**3,288**	3,101
NON-CURRENT LIABILITIES:			
Debentures	20	**346**	82
Employee benefit liabilities, net	21	**350**	338
Total non-current liabilities		**696**	420
CONTINGENT LIABILITIES AND COMMITMENTS	22		
EQUITY:	24		
Equity attributable to equity holders of the parent		**1,011**	929
Non-controlling interests		**11**	10
Total equity		**1,022**	939
Total liabilities and equity		**5,006**	4,460

(*) Retroactively implemented, see Note 2k below.

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

March 26, 2014			
Date of approval of the financial statements	Rafi Maor Chairman of the Board	Joseph Weiss Chief Executive Officer	Eyal Younian Chief Financial Officer

CONSOLIDATED STATEMENTS OF PROFIT AND LOSS

		Year ended December 31,		
		2013	2012 (*)	2011 (*)
	Note	U.S. dollars in millions		
Net sales	25	**3,642**	3,338	3,429
Cost of sales	26	**3,120**	2,830	2,912
Gross profit		**522**	508	517
Research and development expenses, net	27	**180**	156	153
Selling and marketing expenses	28	**89**	91	79
General and administrative expenses	29	**142**	133	132
Other expenses	30	**9**	-	1
Other income	30	**(20)**	(2)	(27)
Reorganization expenses - employee retirement	21	**38**	51	45
		438	429	383
Operating income		**84**	79	134
Finance income	31	**36**	54	43
Finance expenses	31	**(59)**	(42)	(85)
Company's share of earnings of associates, net		**(10)**	2	14
Income before taxes on income		**51**	93	106
Taxes on income (tax benefit)	32	**24**	(19)	(17)
Net income		**75**	74	89
Net income for the period attributable to:				
Equity holders of the parent		**73**	73	88
Non-controlling interests		**2**	1	1
Total		**75**	74	89
Basic and diluted net earnings per share (in U.S. dollars)		**0.03**	0.03	0.03
Number of shares used to compute net earnings per share (in thousands)		**2,559,514**	2,559,514	2,559,514

(*) Retroactively implemented, see Note 2k below.

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

		Year ended December 31,		
		2013	2012 (*)	2011 (*)
	Note	U.S. dollars in millions		
Net income for the period		**75**	**74**	**89**
Other comprehensive income net of taxes:	**33**			
Items of other comprehensive income (loss) not carried to profit or loss:				
Remeasurement of defined benefit plans, net		**15**	(5)	(5)
Total items of other comprehensive income (loss) not carried to profit or loss		**15**	**(5)**	**(5)**
Items of other comprehensive income (loss) that may be carried to profit or loss:				
Capital reserve from cash flow hedge, net		**(4)**	42	(6)
Capital reserve from available-for-sale financial assets		**-**	(1)	1
Foreign currency translation adjustments of foreign operation		**(2)**	-	-
Total items of other comprehensive income (loss) that may be carried to profit or loss		**(6)**	**41**	**(5)**
Total comprehensive income for the period		**84**	**110**	**79**
Total comprehensive income for the period attributable to:				
Equity holders of the parent		**82**	109	78
Non-controlling interests		**2**	1	1
Total comprehensive income for the period		**84**	**110**	**79**

(*) Retroactively implemented, see Note 2k below.

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Attributable to equity holders of the parent									
	Outstanding share capital	**Dividend provided**	**Capital reserve from cash flow hedge**	**Capital reserve from available-for-sale securities**	**Foreign currency translation adjustments**	**Capital reserve from re-measurement of defined benefit plans**	**Retained earnings (deficit)**	**Total**	**Non-controlling interests**	**Total equity**
	U.S. dollars in millions									
Balance as of January 1, 2011	**861**	**46**	**-**	**3**	**(*) -**	**(*) -**	**(141)**	**(*) 769**	**8**	**777**
Changes in the year ended December 31, 2011:										
Net income for the period	-	-	-	-	-	-	88	88	1	89
Other comprehensive income (loss)	-	-	(6)	1	-	(5)	-	(10)	-	(10)
Total comprehensive income for the period	-	-	(6)	1	-	(5)	88	78	1	79
Adjustment of dividend declared/provided (**)	-	(46)	-	-	-	-	46	-	-	-
Dividend approved and paid in respect of 2010 (**)	-		-	-	-	-	(23)	(23)	-	(23)
Dividend provided in respect of 2011 (**)	-	13	-	-	-	-	(13)	-	-	-
Balance as of December 31, 2011	**861**	**13**	**(6)**	**4**	**-**	**(5)**	**(43)**	**824**	**9**	**833**
Changes in the year ended December 31, 2012:										
Net income for the period	-	-	-	-	-	-	73	73	1	74
Other comprehensive income (loss)	-	-	42	(1)	-	(5)	-	36	-	36
Total comprehensive income for the period	-	-	42	(1)	-	(5)	73	109	1	110
Adjustment of dividend provided in respect of 2011 (**)	-	(13)	-	-	-	-	13	-	-	-
Adjustment of dividend approved in respect of 2011 (**)	-	-	-	-	-	-	(4)	(4)	-	(4)
Dividend provided in respect of 2012 (**)	-	17	-	-	-	-	(17)	-	-	-
Balance as of December 31, 2012	**861**	**17**	**36**	**3**	**-**	**(10)**	**22**	**929**	**10**	**939**
Changes in the year ended December 31, 2013:										
Net income for the period	-	-	-	-	-	-	73	73	2	75
Other comprehensive income (loss)	-	-	(4)	-	(2)	15	-	9	-	9
Total comprehensive income for the period	-	-	(4)	-	(2)	15	73	82	2	84
Adjustment of dividend provided in respect of 2012 (**)	-	(17)	-	-	-	-	17	-	-	-
Dividend distributed	-	-	-	-	-	-	-	-	(1)	(1)
Balance as of December 31, 2013	**861**	**-**	**32**	**3**	**(2)**	**5**	**112**	**1,011**	**11**	**1,022**

(*) Retroactively implemented, see Note 2k below.

(**) See Note 24b below.

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,		
	2013	**2012 (*)**	**2011 (*)**
	U.S. dollars in millions		
Cash flows from operating activities:			
Net income for the period	**75**	74	89
Adjustments for:			
Depreciation and amortization	**115**	111	106
Finance expense	**(7)**	(24)	(22)
Taxes on income in profit or loss	**(24)**	19	17
Company's share of losses (earnings) of associates, net	**10**	(2)	(14)
Decrease (increase) in value of loan to associate	**(2)**	(6)	(6)
Impairment (gain from disposal) of investment in associate	**2**	-	(24)
Loss from sale of property, plant and equipment and intangible assets	**2**	4	2
Expense (income) in respect of employee benefits, net	**26**	24	(7)
Decrease (increase) in value of securities measured at fair value through profit or loss, net	**(20)**	(31)	(17)
Change in fair value of financial derivatives, net	**6**	(64)	76
Decrease (increase) in value of long-term loans and receivables	**(7)**	(4)	(6)
Erosion (revaluation) of debentures	**22**	15	(8)
Gain from remeasurement to fair value of investment in associate in a business combination	**(17)**	-	-
	107	42	97
Changes in asset and liability items:			
Decrease (increase) in trade receivables	**(34)**	6	(27)
Decrease (increase) in other accounts receivable	**103**	(96)	19
Decrease (increase) in income receivable for work in progress, net	**131**	(29)	(139)
Decrease (increase) in inventories and inventory in process, net	**(42)**	(5)	41
Decrease (increase) in prepaid expenses in respect of service contracts	**(7)**	(12)	3
Decrease (increase) in long-term loans and receivables	**(23)**	9	4
Increase (decrease) in trade payable	**87**	(63)	92
Increase (decrease) in provisions	**28**	25	(9)
Increase (decrease) in payables from work in progress	**82**	(208)	(2)
Increase (decrease) in other accounts payable	**46**	10	(40)
	371	(363)	(58)
Cash from operating activities:			
Interest paid	**(10)**	(4)	(3)
Interest received	**17**	25	27
Taxes on income paid	**(9)**	(48)	(50)
	(2)	(27)	(26)
Net cash provided by (used in) operating activities	**551**	(274)	102

(*) Retroactively implemented, see Note 2k below.

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,		
	2013	**2012 (*)**	**2011 (*)**
	U.S. dollars in millions		
Net cash provided by (used in) operating activities (brought forward)	**551**	(274)	102
Cash flows from investing activities:			
Purchase of property, plant and equipment	**(108)**	(104)	(105)
Investment in intangible assets	**(27)**	(4)	(1)
Proceeds from (investment in) marketable securities, net	**(116)**	(89)	29
Proceeds from sale of (investment in) short-term deposits, net	**(208)**	(75)	25
Proceeds from sale of investees	**-**	-	55
Proceeds from sale of (investment in) available-for-sale securities, net	**(5)**	57	1
Investments and loans in investees, net	**2**	15	(44)
First-time consolidation of subsidiary (a)	**4**	-	-
Net cash used in investing activities	**(458)**	(200)	(40)
Cash flows from financing activities:			
Dividend paid	**(4)**	-	(23)
Issuance of debentures	**318**	-	-
Repayment of debentures	**(138)**	-	-
Short-term credit, net	**2**	-	5
Repayment of long-term loans	**(2)**	(5)	(7)
Net cash provided by (used in) financing activities	**176**	(5)	(25)
Increase (decrease) in cash and cash equivalents	**268**	(479)	37
Cash and cash equivalents at the beginning of the year	**505**	981	946
Translation differences from balances of cash and cash equivalents	**1**	3	(2)
Cash and cash equivalents at the end of the year	**774**	505	981

(*) Retroactively implemented, see Note 2k below.

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(a) First-time consolidation of subsidiary:

	Year ended December 31,		
	2013	2012	2011
	U.S. dollars in millions		
Current assets (excluding cash and cash equivalents)	**(32)**	-	-
Non-current assets	**(50)**	-	-
Current liabilities	**13**	-	-
Non-current liabilities	**1**	-	-
Non-controlling interests	**-**	-	-
Reversal of fair value of investment presented at equity	**73**	-	-
Total aggregate cash flows provided by the business combination	**4**	-	-

(b) Non-cash activities:

	Year ended December 31,		
	2013	2012 (*)	2011 (*)
	U.S. dollars in millions		
Dividend payable	**-**	4	-

(*) Retroactively implemented, see Note 2k below.

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

NOTE 1:- GENERAL

a. Israel Aerospace Industries Ltd. ("the Company") was founded in 1966 and is a "wholly-owned Government company", as this term is defined in the Israeli Government Companies Law, 1975 ("the Government Companies Law").

The Company's debentures were issued and listed for trade on the Tel-Aviv Stock Exchange ("the TASE") effective from May 2007 whereas the Company's shares are not listed for trade on the TASE. Accordingly, the Company is a private company that is subject to the provisions of the Israel Securities Law, 1968 and is a reporting entity.

The Company operates in five main operating segments: missiles and space systems, military aircraft, military electronics (through Elta Systems Ltd., a wholly-owned subsidiary), civilian aircraft and aircraft maintenance services (Bedek Aviation). See also Note 34 below regarding operating segments.

The Company's registered domicile is Ben-Gurion Airport, Lod 70100.

b. The consolidated financial statements of the Company as of December 31, 2013 comprise the financial statements of the Company and its subsidiaries (collectively - "the Group") and the Group's rights in associates and jointly controlled entities.

c. As a Government company, the Company is subject to the Israeli Government Companies Authority's profit allocation policy. The Government Companies Law states that the Board's decisions regarding the Company's profit allocation requires the approval of the Government Companies Authority. If the Government Companies Authority disagrees with the Board's decision, the Company (as long as it is not a company under privatization process) will act in accordance with the Government Companies Authority's resolution, as approved by the Israeli Government. According to the Government Companies Authority's current policy (which is liable to change from time to time), 50% of the annual current net income, before any bonuses are paid to employees, are distributed as a dividend. Recording a dividend provision is performed in accordance with the guidelines of the Government Companies Authority. See also information in Note 24 below.

In the context of the Company's engagement with several banks and financial institutions and its engagement in a deed of trust in respect of debentures (series C), the Company has undertaken to meet certain financial covenants which are liable to affect its ability to distribute a dividend. See details in Note 22a(3) below.

NOTE 1:- GENERAL (Cont.)

d. **Privatization:**

In September 2003, the Government Companies Authority requested the position of the Company's Board regarding a proposed resolution for the Company's privatization which the Government Companies Authority aimed to bring to the approval of the Ministers Committee on Privatization. According to the proposed resolution, up to 33% of the Company's share capital (on a fully diluted basis) will be sold by means of a private placement of share units in Israel and/or abroad and/or through one or more public offerings based on a prospectus in Israel and/or abroad that will include the State's sale offer or a sale offer combined with capital raising for the Company.

In October 2003, the Company's Board's response was delivered to the Director of the Government Companies Authority in which the Board supports a process in the context of which the Company will issue shares to the public, mainly given the Company's need to invest in R&D and in infrastructures in the coming years and the aim to enhance and establish the Company's capital structure. The Company's Board considers the participation of the employees' representatives in all stages of the issuance process as crucial.

In October 2005, the Company's Board decided to readopt its decision of October 2003. As of the date of approval of the financial statements, there has been no change in the Board's decision of October 2005.

According to the economic plan for 2013-2014 - restructuring, budget aggregates and budget composition - issued by the Ministry of Finance in May 2013 ("the economic plan for 2013-2014"), the following decisions were made: (a) setting up a team headed by the Director of the Government Companies Authority ("the team") whose members will include the Director General of the Ministry of Defense, the Commissioner of Budgets and the Accountant General at the Ministry of Finance or their representatives; (b) instructing the team to act to issue 20% or more of the Company's shares by removing all issuance barriers, including the barriers regarding mandatory security arrangements and enforcing the State's vital interests and subject to making an appropriate decision on privatization pursuant to the Government Companies Law. In the context of the team's work, all the aspects regarding the issuance process will be explored, including the expected economic benefits and the possible implications on the Company's operations; (c) the team will submit its recommendations to the Ministers Committee on Privatization within 90 days from the date of making such a decision. To the best of the Company's knowledge, as of the date of the financial statements, there is no certainty that a decision to privatize the Company will indeed be accepted, if and insofar as the matter is discussed by the Ministers Committee on Privatization, whether in the format described above or in a different format, and there is no certainty regarding the date of privatization, if a decision is passed.

NOTE 2:- BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

a. Adoption of International Financial Reporting Standards ("IFRS"):

The financial statements have been prepared in conformity with the provisions of IFRS.

b. Principles of preparation of the financial statements:

1. The annual financial statements include the additional disclosure required by Israeli Securities Regulations (Annual Financial Statements), 2010.

2. According to the Government's resolution of August 2004, the general accounting principles applicable to Government companies are those that apply to the private sector. The accounting principles that are unique to Government companies are practiced as an expansion or elaboration of issues that are specific to Government companies, as detailed in the Government Companies Authority's circular. The financial statements comply with the guidelines of the Government Companies Authority in accordance with accounting and finance circular - financial statements 2013-5-1.

3. The Group's accounting principles have been consistently applied for all reporting periods presented in these consolidated financial statements. The accounting policies were consistently applied by all the Group companies.

4. The financial statements are presented in accordance with the presentation currency (see paragraph c below) with all the values rounded up to the nearest million, unless stated otherwise.

5. The financial statements have been prepared using the cost principle, excluding assets and liabilities which have been presented at fair value, including, among others, financial instruments at fair value through profit and loss and available-for-sale financial assets.

6. The Company has adopted the reporting format based on classification according to the nature of expenses for items of profit and loss.

NOTE 2:- BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS (Cont.)

c. The functional currency and presentation currency:

The functional currency of the financial statements is the U.S. dollar ("dollar"), which is the Company's functional currency.

The dollar is the currency that best reflects the principal economic environment in which the Company operates. The majority of the Company's revenues are received in dollars and the Company manages its budget and project pricing accordingly in dollars. Therefore, the dollar is the currency used by the Company to determine the prices of products and services supplied by it. In addition, receipts from operating activities are made in dollars and the dollar is used by the Company's management to determine its currency risk management policy.

d. Foreign currency transactions:

Transactions that are not conducted in the functional currency are accounted for as follows:

1. A transaction denominated in foreign currency is recorded upon initial recognition in the functional currency using the immediate exchange rate between the functional currency and the foreign currency on the transaction date.

2. At the end of each reporting period, monetary items denominated in foreign currency are translated at the immediate exchange rate at the end of the reporting period.

3. At the end of each reporting period, non-monetary items denominated in foreign currency and measured at historical cost are translated at the exchange rate on the transaction date.

4. Exchange rate differences arising from the settlement of monetary items or from the translation of monetary items at different exchange rates than those used in the translation upon initial recognition during the period or than those used in the translation of previous financial statements will be recognized in profit or loss in the period in which they incur, excluding exchange rate differences as discussed in paragraph 5 below.

5. Exchange rate differences in respect of a monetary item that forms part of a net investment in a foreign operation will be initially recognized in a separate item in equity and recognized in profit or loss upon disposal of the net investment.

NOTE 2:- BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS (Cont.)

e. Foreign operation:

1. The Group determines the functional currency of each Group member, including companies accounted for at equity. When an investee's functional currency differs from the Company's functional currency, that investee represents a foreign operation whose financial statements are translated into the Company's functional currency so that they can be included in the consolidated financial statements as follows.

    a) Assets and liabilities for each statement of financial position are translated at the closing rate at the end of that reporting period.

    b) Income and expenses for each statement of comprehensive income are translated at average exchange rates for a period of one month.

    c) Share capital, capital reserves and other changes in capital and retained earnings are translated based on the opening balances translated at the exchange rate at that date and other relevant transactions as described in paragraph b) above.

    d) All resulting exchange rate differences are recognized as other comprehensive income and accumulated in equity (under "foreign currency translation adjustments").

2. Disposal of foreign operation:

    Upon the disposal of a foreign operation, the cumulative amount of exchange rate differences attributable to the foreign operation which had been recognized as a separate item in equity is transferred to profit or loss in the same period as the gain or loss from the disposal of the foreign operation is recognized.

f. Linkage:

Assets and liabilities that are linked to the changes in the Israeli Consumer Price Index ("CPI") are included at the relevant index for each asset or liability.

NOTE 2:- BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS (Cont.)

g. Details of foreign currencies and the CPI:

Below are data of the exchange rates of the U.S. dollar, the Euro and the Israeli CPI and the changes therein in the reporting periods:

	Representative exchange rate of U.S.$	Representative exchange rate of Euro	CPI for December
December 31, 2013	3.4710	4.7819	102.3
December 31, 2012	3.7330	4.9206	100.5
Change in the year ended:		%	
December 31, 2013	(7.02)	(2.82)	1.79
December 31, 2012	(2.30)	(0.35)	1.63
December 31, 2011	7.66	4.23	2.17

h. Key assumptions used in making material estimates:

The preparation of the financial statements requires management to make evaluations, estimates and assumptions that have an effect on the application of the accounting policies and on the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from those estimates.

When establishing the accounting estimates used in the preparation of the Company's financial statements, management is required to make assumptions regarding circumstances and events that involve significant uncertainties. In exercising judgment when making those assumptions, management relies on past experience, various facts, external factors and reasonable assumptions based on the relevant circumstances of each estimate.

The estimates and underlying assumptions are reviewed on an ongoing basis. Changes in accounting estimates are recognized in the period in which the estimates are adjusted and in every future affected period.

The following is information regarding the principal accounting estimates used in adopting the significant accounting policies:

1. Contingent liabilities - in assessing the chances of legal claims filed against the Company and its investees, the Company and the investees relied on the opinions of their internal and external legal counsel. These estimates are based on the legal counsel's best professional judgment, taking into account the stage of proceedings and legal precedents in respect of the different issues. Since the outcome of the claims will be determined in courts, the results could differ from these estimates.

NOTE 2:- BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS (Cont.)

h. Key assumptions used in making material estimates (Cont.):

2. Actuarial valuation for the Company's retired and existing employees - in order to evaluate the Company's employer-employee liabilities, the Company relies on actuarial calculations by an outside actuary and on various assumptions, as described in Note 21 below. These assumptions may be affected both by macroeconomic factors and by factors that are specific to the Company and therefore any changes in these parameters are likely to cause a significant change in the value of the assets and liabilities and actuarial gains and losses recognized by the Company.

3. Work according to construction contracts - the Company's operations are based on a large number of projects whose accounting treatment requires use of work performance estimates and evaluations and risk assessment. Among others, in the context of preparing for the work, the Company makes provisions for unexpected expenses based on past experience as well as evaluations of contracts in which a provision for an expected loss is needed. These estimates are likely to change and affect the results of projects.

4. Inventories - the net realizable value of inventories is reviewed at the end of each reporting period. Factors that might affect selling prices consist, among others, of existing market demands for the Company's inventories, competition and technological effects.

5. Useful life of property, plant and equipment and intangible assets with a definite useful life - the useful life is based on management's evaluations for the period in which the assets are expected to yield revenues which are tested every period for examining their adequacy. Changes in management's evaluations may lead to material changes in the carrying amount of these assets and in the depreciation expenses carried to profit or loss.

6. Fair value of financial instruments - the fair value of financial instruments that are not quoted in an active market is determined using model-based valuation techniques. These techniques are significantly affected by the assumptions that underlie the calculation such as discount rates and estimated future cash flows, see also Note 23 below.

7. Taxes on income - the Group is subject to different tax laws in several countries. Extensive discretion is required when determining the current and deferred taxes of each Group member. The Group recognizes liabilities in respect of tax results of transactions based on management's estimates, which rely on professional counsel, regarding the timing and amount of the tax liability arising from the transactions. The tax results of these transactions could differ from management's estimates.

NOTE 2:- BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS (Cont.)

i. Fair value:

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Fair value measurement is based on the assumption that the transaction will take place in the asset's or the liability's principal market, or in the absence of a principal market, in the most advantageous market.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

Fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities measured at fair value or for which fair value is disclosed are categorized into levels within the fair value hierarchy based on the lowest level input that is significant to the entire fair value measurement:

Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - inputs other than quoted prices included within Level 1 that are observable either directly or indirectly.

Level 3 - inputs that are not based on observable market data (valuation techniques which use inputs that are not based on observable market data).

NOTE 2:- BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS (Cont.)

j. First-time adoption of new IFRSs, Amendments to IFRSs and new Interpretations:

1. Commencing from the financial statements for the annual period beginning on January 1, 2013, the Company retrospectively applies IFRS 10, "Consolidated Financial Statements", IFRS 11, "Joint Arrangements" and IFRS 12, "Disclosure of Interests in Other Entities" based on the transition provisions of these Standards.

   a) As a result of the adoption of IFRS 10, the investment in Elbatech is currently accounted for in the financial statements as a subsidiary. For details of the quantitative effect, see Note 2k below.

   b) As a result of the adoption of IFRS 11, the Company's investments in the following joint ventures which had been previously recognized using the proportionate consolidation method are accounted for in these financial statements at equity:

      (1) PSF-Conversion LLP
      (2) M&B Conversion Ltd.
      (3) G-Nius Unmanned Ground Systems Ltd.
      (4) Gal-El (MMIC) Registered Partnership

      Accordingly, the total carrying amount of the assets and liabilities previously consolidated using the proportionate consolidation method represented the deemed cost of the investment as of January 1, 2012 for the purpose of application of the equity method of accounting. For details of the quantitative effect, see Note 2k below.

2. The Company applies IAS 19R, "Employee Benefits", retrospectively starting from the financial statements for the annual period beginning on January 1, 2013 based on the transition provisions of this Standard. As a result of the application of IAS 19R, the Company has retroactively applied the following amendments:

   (a) Actuarial gains and losses are recognized in other comprehensive income when incurred and not carried to profit or loss.

   (b) The distinction between short-term employee benefits and long-term employee benefits is based on the expected settlement date and not on the date on which the employee first becomes entitled to the benefits.

   (c) Past service cost arising from changes in the plan is recognized immediately.

   For details of the quantitative effect, see Note 2k below.

NOTE 2:- BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS (Cont.)

j. **First-time adoption of new IFRSs, Amendments to IFRSs and new Interpretations (Cont.):**

3. The Company retrospectively applies IFRS 12, "Disclosure of Interests in Other Entities", based on the transition provisions of this Standard. The effects of the adoption of the Standard are reflected in the notes to the financial statements.

4. Commencing from the financial statements for the annual period beginning on January 1, 2013, the Company prospectively applies IFRS 13, "Fair Value Measurement". The effects of the adoption of the Standard are reflected in the notes to the financial statements.

5. Commencing from the financial statements for the annual period beginning on January 1, 2013, the Company retrospectively applies IAS 1R. Following the adoption of IAS 1R, the manner of presentation of the statement of comprehensive income was modified. The Amendment does not affect income, other comprehensive income or total comprehensive income for the period.

k. **Effect of retrospective adoption of new IFRSs and Amendments to IFRSs:**

In keeping with the matters discussed in Note 2j above, following is the effect of the retrospective adoption of IFRSs and Amendments to IFRSs starting from the financial statements for periods beginning on January 1, 2012.

1. The effect of retrospective adoption on items of statement of financial position:

	December 31, 2012				
		Change in respect of			
	Before retrospective adoption	IFRS 11	IFRS 10	IAS 19	After retrospective adoption
	U.S. dollars in millions				
Total current assets	3,511	(6)	4		3,509
Total non-current assets	949	1	1		951
Total assets	**4,460**	**(5)**	**5**		**4,460**
Total current liabilities	3,106	(5)	-		3,101
Total non-current liabilities	420	-	-		420
Equity attributable to equity holders of the parent	929	-	-		929
Non-controlling interests	5	-	5		10
Total equity	934	-	5		939
Total liabilities and equity	**4,460**	**(5)**	**5**		**4,460**

NOTE 2:- BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS (Cont.)

j. First-time adoption of new IFRSs, Amendments to IFRSs and new Interpretations (Cont.):

	January 1, 2012				
		Change in respect of			
	Before retrospective adoption	IFRS 11	IFRS 10	IAS 19	After retrospective adoption
	U.S. dollars in millions				
Total current assets	3,664	(7)	5		3,662
Total non-current assets	941	1	-		942
Total assets	**4,605**	**(6)**	**5**		**4,604**
Total current liabilities	3,337	(6)	-		3,331
Total non-current liabilities	440	-	-		440
Equity attributable to equity holders of the parent	824	-	-		824
Non-controlling interests	4	-	5		9
Total equity	828	-	5		833
Total liabilities and equity	**4,605**	**(6)**	**5**		**4,604**

2. The effect of retrospective adoption on items of statement of profit and loss and other comprehensive income:

	Year ended December 31, 2012				
		Change in respect of			
	Before retrospective adoption	IFRS 11	IFRS 10	IAS 19	After retrospective adoption
	U.S. dollars in millions				
Net sales	3,345	(12)	5	-	3,338
Cost of sales	2,837	(5)	3	(5)	2,830
Gross profit	508	(7)	2	5	508
Operating income	78	(5)	1	5	79
Income before taxes on income	88	-	-	5	93
Net income	69	-	-	5	74
Items that may not be subsequently reclassified to profit or loss	-	-	-	(5)	(5)
Total items that may be subsequently reclassified to profit or loss	41	-	-	-	41
Total comprehensive income for the period	110	-	-	-	110
Comprehensive income for the period attributable to equity holders of the parent	109	-	-	-	109
Comprehensive income for the period attributable to non-controlling interests	1	-	-	-	1
	110	-	-	-	110

NOTE 2:- BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS (Cont.)

j. First-time adoption of new IFRSs, Amendments to IFRSs and new Interpretations (Cont.):

	Year ended December 31, 2011				
		Change in respect of			
	Before retrospective adoption	IFRS 11	IFRS 10	IAS 19	After retrospective adoption
	U.S. dollars in millions				
Net sales	3,436	(12)	5	-	3,429
Cost of sales	2,918	(4)	3	(5)	2,912
Gross profit	518	(8)	2	5	517
Operating income	133	-	1	-	134
Income before taxes on income	100	-	-	6	106
Net income	83	-	-	6	89
Items that may not be subsequently reclassified to profit or loss	-	-	-	(5)	(5)
Total items that may be subsequently reclassified to profit or loss	(5)	-	-	-	(5)
Total comprehensive income for the period	78	-	-	1	79
Comprehensive income for the period attributable to equity holders of the parent	79	-	(1)	-	78
Comprehensive income for the period attributable to non-controlling interests	(1)	-	2	-	1
	78	-	1	-	79

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES

a. Operating cycle:

The Company (by itself and through its subsidiaries) operates in diverse areas of activity and therefore its ordinary operating cycle generally exceeds one year, particularly with respect to work according to construction contracts and orders whose performance exceeds one year. Accordingly, current assets and current liabilities include items that are held for disposal within the operating cycle (about three years).

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

b. Investments in subsidiaries, associates and joint ventures:

1. Control and consolidated financial statements:

When the Company is exposed or holds rights to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee, then control is exercised by the Company over that investee and the investee is classified as a subsidiary. The Company reassesses its control over a subsidiary in the occurrence of changes in facts and circumstances.

The consolidated financial statements present the Group's financial statements as a single economic entity effective from the date of obtaining control until the date that such control ceases. Accordingly, significant intragroup balances and transactions and unrealized gains resulting from intragroup transactions are eliminated in full in the consolidated financial statements.

The financial statements of subsidiaries are prepared using uniform accounting policies as those of the Company with respect to similar transactions and events under similar circumstances. Moreover, the financial statements of the Company and of the subsidiaries are prepared as of the same dates and periods.

2. Non-controlling interests:

Non-controlling interests represent the equity in subsidiaries not attributable, directly or indirectly, to the Group.

Changes in interests after control is obtained that do not involve loss of control are accounted for as equity transactions. The difference between the consideration paid or received and the amount of adjustment of non-controlling interests is carried directly to equity. In the event of changes in such interests, the Company reattributes amounts in respect of balance of other comprehensive income and non-controlling interests.

3. Issue of put option to non-controlling interests:

A put option that is issued by the Group to non-controlling interests and is settled in cash or using another financial instrument is recognized as a liability in the amount of the present value of the exercise increment. In subsequent periods, changes in the value of the liability in respect of issued put options are recognized in profit or loss using the effective interest method.

The Group's share of the earnings of a subsidiary includes the share of the non-controlling interests that were issued the put option by the Group.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

b. Investments in subsidiaries, associates and joint ventures (Cont.):

4. Loss of control:

When the Company loses control over a subsidiary, it derecognizes the subsidiary's assets (including any goodwill allocated to the subsidiary) and liabilities and the non-controlling interests in the subsidiary (including other comprehensive income attributed thereto) according to their carrying amount as of the date of loss of control. In addition, the Company classified to profit or loss or directly carries to retained earnings any amounts recognized in the past in other comprehensive income relating to said subsidiary on the same basis as would have been required had the Company itself directly disposed of the related assets or liabilities.

The proceeds received and any remaining investment in the subsidiary are recognized at fair value on the date of loss of control. Any difference from the disposal is recognized as gain or loss in profit or loss.

5. Business combinations:

A business combination occurs when the Company first obtains control over a subsidiary or a separate entity. The Group accounts for business combinations using the acquisition method. According to this method, the Company identifies the buyer, sets the acquisition date and recognizes the identifiable assets acquired and liabilities assumed at fair value. Other components of non-controlling interests are measured at fair value as of the acquisition date unless another measurement basis is required according to IFRS.

In a business combination achieved in stages, the acquisition date is the date on which the Company first obtains control over the acquiree. In a business combination achieved in stages, the Company remeasures the equity interests in the acquiree that had been held by the acquirer prior to obtaining control at the acquisition date fair value while recognizing the resulting gain or loss.

The Company measures the consideration delivered based on the fair value of the assets delivered, the liabilities assumed and the equity instruments issued. Any costs that can be attributed to the business combination are recognized as an expense when incurred, excluding costs of issuance of the Company's equity or debt instruments.

When the consideration delivered includes a contingent consideration, the Company measures the contingent consideration on the acquisition date at fair value. In subsequent periods, the contingent consideration is adjusted based on the occurrence or non-occurrence of future events and on the relevant estimates. Changes in the fair value of the contingent consideration are recognized in profit or loss for the period.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

b. Investments in subsidiaries, associates and joint ventures (Cont.):

5. Business combinations (Cont.):

The Group recognizes goodwill on the acquisition date as the excess of the acquisition consideration and the amount of non-controlling interests over the net identifiable assets acquired and liabilities assumed. In subsequent periods, goodwill is measured at cost less accumulated impairment losses.

If the business combination settles the previous relationship established between the acquirer and the acquiree, the Group deducts from/adds to the consideration delivered in the business combination the lower of the amount of any settlement provisions prescribed in the contract and the amount by which the contract is favorable or unfavorable from the acquirer's perspective compared to the terms of similar or identical current transactions in the market and recognizes this amount in profit or loss.

6. Joint arrangements:

Joint arrangements are arrangements in which the Company has joint control. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

a) Joint ventures:

In joint ventures the parties that have joint control of the arrangement have rights to the net assets of the arrangement. As from January 1, 2012, joint ventures are accounted for at equity. In the year ended December 31, 2011, the Company's rights in joint ventures were accounted for pursuant to IAS 31 using the proportionate consolidation method.

b) Joint operations:

In joint operations the parties that have joint control of the arrangement have rights to the assets and obligations for the liabilities relating to the arrangement. The Company recognizes in relation to its interest its share of the assets, liabilities, revenues and expenses of the joint operation.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

b. Investments in subsidiaries, associates and joint ventures (Cont.):

7. Investments in associates:

Associates are companies in which the Group has significant influence over the financial and operating policies without having control. The investment in an associate is accounted for using the equity method unless the investment (or part thereof) is classified as held for sale pursuant to IFRS 5.

8. Investments accounted for at equity:

The Group's investments in associates and joint ventures are accounted for using the equity method. Under the equity method, the investment in the associate or in the joint venture is presented at cost with the addition of post-acquisition changes in the Group's share of net assets, including other comprehensive income of the associate or the joint venture. Profits and losses resulting from transactions between the Group and the associate or the joint venture are eliminated to the extent of the interest in the associate or in the joint venture.

Goodwill relating to the acquisition of an associate or a joint venture is presented as part of the investment in the associate or the joint venture, measured at cost and not systematically amortized. Goodwill is evaluated for impairment as part of the investment in the associate or in the joint venture as a whole.

The investment in an associate accounted for at equity as a whole is tested for impairment if there are indications pursuant to the provisions of IAS 39 that the investment in the associate may be impaired.

The accounting policies applied in the financial statements of the associate or the joint venture are uniform and consistent with the policies applied in the financial statements of the Group.

When the Company's share of the losses of the associate or joint venture approximate or exceed its rights in the associate, the Company ceases to recognize its share of additional losses. Once the Company's rights are reduced to zero, additional losses are only recognized if the Company incurred legal or constructive liabilities or if payments were made for that company. Earnings generated after the date of recognition of losses are only recognized if the Company's share of the earnings equals its unrecognized share of the losses.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

b. Investments in subsidiaries, associates and joint ventures (Cont.):

8. Investments accounted for at equity (Cont.):

An increase in the holding rate in an associate or joint venture is accounted for using the acquisition method only in respect of the change in holding rate. A decrease in the holding rate in an associate is accounted for as derecognition of the relative share of the investment while recording a gain or loss. The Company also reclassifies the relative amount recognized in other comprehensive income based on the accounting treatment that would have been required had the associate disposed of the related assets or liabilities itself.

On the date of loss of significant influence or joint control, the Group measures any remaining investment in the associate or the joint venture at fair value and recognizes in profit or loss the difference between the fair value of any remaining investment plus any proceeds from the sale of the investment in the associate or the joint venture and the carrying amount of the investment on that date.

c. Cash equivalents:

Cash equivalents are considered as highly liquid short-term investments with an original maturity of three months or less from the date of investment which are redeemable into cash on demand and are exposed to immaterial risk of changes in value.

d. Financial instruments:

1. Financial assets:

A financial asset is recognized when the Company becomes a party to the instrument's contractual provisions. A financial asset is classified on the investment date into one of three categories according to the purpose for which it was purchased. The accounting treatment of the categories that are relevant to the Company is as follows:

a) Financial assets at fair value through profit or loss:

Financial assets held for trading or designated upon initial recognition at fair value through profit or loss - this category of financial assets is measured at fair value and the changes in fair value are carried to profit and loss. Directly attributable transaction costs are recognized in profit and loss as incurred.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

d. Financial instruments (Cont.):

b) Loans and receivables:

Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are initially measured at fair value with the addition of directly attributable transaction costs. After initial recognition, these assets are measured at amortized cost using the effective interest method and less any impairment losses.

c) Available-for-sale financial assets:

Non-derivative financial assets that are designated as available for sale or are not classified in any of the other categories of financial assets. Available-for-sale financial assets are initially measured at fair value with the addition of directly attributable transaction costs. After initial recognition, available-for-sale financial assets are measured at fair value and the changes in fair value are generally directly recognized as a separate component in other comprehensive income and retained in equity other than changes in the fair value attributed to dividends in respect of equity instruments, accrued effective interest and exchange rates on debt instruments.

Notwithstanding the aforementioned, investments in equity instruments without a quoted market price and whose fair value cannot be measured reliably will be measured at cost.

2. Financial liabilities:

A financial liability is recognized when the Company becomes a party to the instrument's contractual provisions. A financial liability is initially recognized at fair value less transaction costs that can be directly attributable to assuming or issuing the financial liability excluding financial liabilities which are measured at fair value through profit or loss on the date of initial recognition.

Financial liabilities are classified into one of the following categories:

a) Financial liabilities at fair value through profit or loss:

Financial liabilities at fair value through profit or loss consist of financial liabilities held for trading and financial liabilities designated upon initial recognition at fair value through profit or loss - this category of financial liabilities is measured at fair value and the changes in fair value are carried to profit and loss. The transaction costs attributable to these liabilities are recognized in profit and loss as incurred.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

d. Financial instruments (Cont.):

2. Financial liabilities (Cont.):

b) Financial liabilities at amortized cost:

Financial liabilities in this category such as loans from banks and other credit providers are initially measured at fair value with the addition of directly attributable transaction costs. After initial recognition, these liabilities are measured using the effective interest method.

3. Impairment and reversal of impairment of financial assets:

The Company assesses at the end of each reporting period whether there is any objective evidence of impairment of a financial asset or group of financial assets. If there is objective evidence of impairment, the accounting treatment is as follows:

a) Impairment of financial assets carried at amortized cost:

The amount of the loss is the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not yet been incurred) discounted at the financial asset's original effective interest rate. The amount of the loss is carried to profit and loss.

As for trade receivables, an allowance for doubtful accounts is recognized when there is objective evidence that the Company will not be able to collect its debts.

The balance of trade receivables is presented net of the allowance for doubtful accounts which is specifically calculated for debts whose collection is doubtful according to management.

If in a subsequent period an impairment loss decreases and the decrease can be objectively attributed to an event that occurred after the impairment was recognized, the impairment loss is reversed, provided that the reversal does not cause the carrying amount to the financial asset to exceed the amortized cost that would have been recorded on the date of reversal of impairment had the impairment not been recorded in profit and loss.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

d. Financial instruments (Cont.):

3. Impairment and reversal of impairment of financial assets (Cont.):

b) Impairment of financial assets presented at cost:

The amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return of a similar financial asset. This type of impairment loss is not reversed.

c) Impairment of available-for-sale financial assets:

The difference between the acquisition cost (less principal payments and any amortization) and the fair value less impairment losses in respect of the same financial asset which had been previously carried to profit and loss will be reclassified from equity to profit and loss. Impairment losses previously recognized in profit and loss for equity instruments are not reversed through profit and loss.

If in a subsequent period the fair value of a debt instrument increases and the increase can be attributed to an event that occurred subsequent to the date of recognition of an impairment loss, the impairment loss will be reversed through profit and loss.

4. Derivatives and embedded derivatives:

Separated derivatives and embedded derivatives are measured at fair value through profit or loss and classified as held for trading unless they are designated as qualifying accounting hedges.

In the case of hybrid instruments, including embedded derivatives, the Company measures and recognizes an embedded derivative separately from the host contract when the economic risks and characteristics of the embedded derivative are not closely related to the economic risks and characteristics of the host contract, when a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative and when the hybrid instrument as a whole is not measured at fair value through profit or loss.

The Company's debentures (series A) are linked to the dollar, but not below the base rate, and represent a hybrid instrument. As for hybrid financial instruments, the embedded derivatives can be separated from the hybrid financial instruments or the entire financial instruments can be measured at fair value. The Company designated its entire debentures (series A) at fair value through profit or loss and accounts for them accordingly. See information also in Note 20b below.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

d. Financial instruments (Cont.):

5. Offsetting financial instruments:

Financial assets and financial liabilities are offset and the net amount is presented in the statement of financial position if there is a legally enforceable right to set off the recognized amounts and there is an intention either to settle on a net basis or to realize the asset and settle the liability simultaneously.

6. Derecognition of financial instruments:

a) Financial assets:

A financial asset is derecognized when the contractual rights to the cash flows from the financial asset expire or the Company has transferred its contractual rights to receive cash flows from the financial asset or assumes an obligation to pay the cash flows in full without material delay to a third party and has transferred substantially all the risks and rewards of the asset under certain conditions.

b) Financial liabilities:

A financial liability is derecognized when it is extinguished, that is when the obligation is discharged or cancelled or expires. When an existing financial liability is exchanged with another liability from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is accounted for as an extinguishment of the original liability and the recognition of a new liability at fair value. The difference between the carrying amount of the exchanged liability and the consideration paid or the fair value of the new recognized liability is carried to profit and loss.

7. Hedge accounting:

The Company designates certain financial instruments, generally derivatives, as hedges. On the date of creating the hedge, the Company documents the hedge relations and the objective of the Company's strategy and risk management when creating the hedge. The Company verifies whether the hedge is expected to be highly effective when creating the hedge and on an ongoing basis.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

d. Financial instruments (Cont.):

7. Hedge accounting (Cont.):

a) Fair value hedges:

The change in the fair value of qualifying derivatives that are designated as hedges is recognized in profit or loss. The change in the fair value of the hedged item attributed to the hedged risk is recognized as a change in the hedged item against profit and loss. These changes are presented in profit and loss under the relevant items.

In respect of fair value hedges of financial assets or liabilities that are measured at amortized cost, the change in the carrying amount of these items in respect of the adoption of hedge accounting is amortized to profit and loss until the maturity date using the effective interest method.

The Company reverses hedge accounting when the hedging instrument expires, is sold, cancelled or disposed of or when the hedge no longer qualifies as accounting hedge.

The Company designated a cash flow swap transaction in respect of payments of debentures (series B) (swapping NIS cash flows bearing fixed interest with dollar cash flows bearing variable interest) as a fair value hedge, see also Notes 20b and 23 below.

b) Cash flow hedges:

The effective portion of the changes in fair value of qualifying derivatives designated as ash flow hedges is recognized directly in equity. The ineffective portion of the changes in fair value is directly recognized in profit and loss. Amounts recognized directly in equity are classified to profit and loss in periods in which the hedged item affects profit and loss.

The Company reverses hedge accounting when the hedging instrument expires, is sold, cancelled or disposed of or when the hedge no longer qualifies as accounting hedge. Cumulative changes on the date of hedge reversal that were directly included in equity are retained in equity unless they arise from a forecast transaction when it is no longer forecast.

The Company designated certain forward and foreign currency option transactions as hedging instruments in respect of the risk of changes in the NIS-dollar exchange rate in connection with salary payments in NIS. The Company accounts for these hedge transactions as cash flow transactions, see also Note 23 below.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

d. Financial instruments (Cont.):

7. Hedge accounting (Cont.):

The Company designated a cash flow swap transaction in respect of payments of debentures (series C) (swapping NIS cash flows bearing fixed interest with dollar cash flows bearing fixed interest) as a cash flow hedge, see also Notes 20b and 23 below.

e. Income receivable from work in progress, net and payables for work in progress, net:

Income receivable from construction contracts which according to generally accepted accounting principles should be recognized as income reflects the gross amount for which no invoices have been issued yet that is expected to be collected from customers in respect of work performed up to that date. These amounts are separately calculated for each construction contract (see Note 8) and measured at the costs incurred with the addition of the income component less charges issued to customers, losses recognized and less and advance received up to the amount of the income receivable. If the amount is negative, it is presented in payables for work in progress, net.

g. Prepaid expenses in respect of service contracts:

Prepaid expenses in respect of service contracts are separately calculated for each service contract and presented in the statement of financial position in the amount of the accumulated costs in excess of the income attributable to the contract which should be recognized on the statement of financial position date.

h. Inventories and inventory in process:

1. General inventory of raw materials, parts, products and items that is not allocated to a project in progress is estimated at the lower of cost or net realizable value less write downs of inventory held for aircraft maintenance that is reusable. Cost if determined as follows:

   a) Reusable inventory held for aircraft maintenance - at identifiable cost.
   b) Inventory of products (mainly business jets) - at identifiable cost.
   c) Other inventory - using the moving average method.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

h. Inventories and inventory in process (Cont.):

2. Inventory in process consists of work in progress and is presented at cost but not in excess of net realizable value. Cost includes direct costs of materials, labor and indirect manufacturing expenses.

3. Non-current inventory consists of undesignated inventory that is not expected to be realized in the Company's ordinary operating cycle.

4. Inventories and inventory in process are presented net of provisions for slow-moving inventory.

i. Property, plant and equipment:

1. Items of property, plant and equipment are presented at cost including direct acquisition costs, less accumulated depreciation, less accumulated impairment losses and less any related investment grants and excluding day-to-day servicing expenses. The Company recognizes the cost of certain spare parts of property, plant and equipment as incurred as part of the carrying amount of property, plant and equipment.

   The cost of an item of property, plant and equipment comprises the initial estimate of the costs of dismantling and removing the item and restoring the site on which the item is located.

2. Items of property, plant and equipment with a cost that is significant in relation to the total cost of the item is depreciated separately using the component method. Depreciation expenses are recognized in profit and loss for each period unless they are included in the carrying amount of another asset.

   Depreciation is calculated on a straight-line basis over the useful life of the assets at annual rates. The Company examines the residual value, useful life and depreciation method of items of property, plant and equipment at least at each fiscal year-end and any changes are accounted for as a change in accounting estimate.

   Leasehold improvements are depreciated on a straight-line basis over the shorter of the lease term and the expected life of the improvement.

3. As for impairment, see paragraph q below.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

j. Leases:

1. In lease agreements, the lessor transfers to the lessee the right to use an asset for a predetermined period in return for one or several payments. There are two types of leases: finance leases (which transfer substantially all the risks and benefits incidental to the ownership of the asset regardless of the transfer of the proprietary right at the end of the lease period) and operating leases (non-finance leases).

2. The Company as lessor:

   The Company records assets under operating leases in accordance with the nature of the assets and recognizes income from the lease on a straight-line basis over the lease term. Initial direct costs incurred in holding operating lease negotiations are added to the carrying amount of the leased asset and therefore recognized as an expense on the same basis as the lease income. In addition, in each period, the Company recognizes depreciation expenses in respect of depreciable assets owned by it that are leased under operating leases. The depreciation policy regarding these assets is consistent with the depreciation policy of the depreciable assets owned by the Company, see Note 13 below.

3. The Company as lessee:

   The Company recognizes operating lease fees as an expense using the straight-line method over the lease term, including the option period on the date of signing the lease that is likely to be exercised.

4. Lease of land and buildings:

   When the lease consists of components of land and buildings, the Company separately evaluates the classification of each component as operating lease or finance lease according to the provisions of IAS 17 regarding leases. In determining whether the land component represents operating lease or finance lease, the Company takes into account that land normally has an indefinite economic life.

   The amount prepaid by the Company for a finance lease is classified in the statement of financial position under property, plant and equipment and is depreciated using the straight-line method over the term of the lease and the extension option.

   Buildings constructed on land leased from the Israel Land Administration are classified as property, plant and equipment in view of their designated use.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

k. Intangible assets:

1. Separately acquired intangible assets are measured on initial recognition at cost including directly attributable costs. Intangible assets acquired in a business combination are measured at fair value at the acquisition date. Expenditures relating to internally generated intangible assets, excluding capitalized development costs, are recognized in profit or loss when incurred.

2. In subsequent periods, intangible assets are presented at cost less accumulated amortization and less accumulated impairment losses.

3. Research and development expenditures:

   Research expenditures are recognized in profit and loss when incurred (see paragraph o below). An intangible asset arising from a development project or from the development phase of an internal project is recognized when the following conditions are met:

   a) The technical feasibility of completing the intangible asset so that it will be available for use or sale can be demonstrated.

   b) The Company intends to complete the intangible asset and use or sell it.

   c) The Company is able to use or sell the intangible asset.

   d) The Company is able to demonstrate how the intangible asset will generate future economic benefits.

   e) There are available adequate technical, financial and other resources to complete the development and use or sale of the intangible asset.

   f) The expenditure attributable to the intangible asset during its development can be measured reliably.

   As for Government investment grants in respect of research and development, see paragraph m below.

4. Amortization period and method:

   a) The Company assesses for each intangible asset whether it has a definite or indefinite useful life. The Company annually reviews whether the assessment that the asset's useful life is indefinite can be sustained. Changes in the Company's assessments are accounted for as change in accounting estimate.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

k. Intangible assets (Cont.):

4. Amortization period and method (Con.):

   b) The depreciable amount of an intangible asset with a definite useful life is systematically allocated over its useful life. The Company uses the straight-line method and recognizes amortization expenses for each period in profit and loss, unless they are included in the carrying amount of another asset.

   c) The Company reviews the useful life and amortization method used at least at each fiscal year-end. Changes are accounted for as changes in accounting estimates in accordance with generally accepted accounting principles.

   d) An intangible asset with an indefinite useful life is not amortized.

5. As for the impairment of intangible assets, see paragraph q below.

6. Internally generated goodwill in the Company has not been recognized as an intangible asset. As for goodwill arising from the acquisition of an investee, see paragraph b(5) above.

l. Borrowing costs:

Borrowing costs are recognized as an expense as incurred, unless they can be directly attributed to the acquisition, construction or production of qualifying assets in which case they are capitalized to the cost of those assets over the construction period. The capitalization of borrowing costs commences when expenditures for the asset are incurred, the activities to prepare the asset are in progress and borrowing costs are incurred and ceases when substantially all the activities to prepare the qualifying asset for its intended use or sale are complete. During extended periods in which active development ceases, the Company suspends the capitalization of borrowing costs. As of the date of the financial statements, no borrowing costs have been capitalized.

m. Government grants:

1. Government grants, excluding Chief Scientist grants, are only recognized when there is reasonable assurance that the grants will be received and the Company/the Group will comply with the attached conditions.

2. As for the presentation of investment grants in respect of property, plant and equipment, see paragraph i(a) above.

3. Investment grants in respect of property, plant and equipment are recognized in profit or loss over the periods and at the rates in which depreciation expenses are recognized in respect of property, plant and equipment.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

m. Government grants (Cont.):

4. Government grants received from the Office of the Chief Scientist in Israel ("OCI") for research and development activities in respect of which the Company has undertaken to pay royalties to the State based on actual future sales arising from the funded R&D are recognized as a liability to the extent that the grants are expected to be repaid to the State. When the liability to the State does not bear market interest, it is recognized at fair value according to market interest on the date of receipt of the grant. The difference between the consideration received from the OCI and the liability recognized in the statement of financial position upon receipt of the grant is recorded as reimbursement of research expenses or as a decrease in capitalized development costs, as applicable. The repayment of the liability to the OCI is reviewed in each reporting period and changes in the liability arising from a change in expected royalties are recognized in profit or loss.

n. Provisions:

A provision is recognized in the financial statements when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The amount recognized as a provision is the best estimate of the expense required for settling the existing liability as of the statement of financial position date at its present value (with the effect of the time value being material).

In connection with the aforesaid, the Company is accountable for the quality of the products sold to customers or of the work performed for customers for periods of one to ten years after supply or completion. In order to cover this liability, a provision in included in the financial statements based on management's estimate in view of past experience. The Company also records specific provisions in respect of certain jobs, as needed.

o. Research expenses:

Research expenses and development expenses that do not meet the capitalization conditions discussed in Note 3k above, net of participation by the OCI and others, are carried to profit and loss as incurred.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

p. Revenue recognition:

1. Revenues from work in progress according to construction contracts:

Revenues from work in progress according to construction contracts are recognized pursuant to the provisions of IAS 11 by the percentage of completion method when the following criteria are met: the revenues are known or can be estimated reliably, collection is probable, costs related to performing the work are determinable or can be reasonably determined, there is no substantial uncertainty regarding the Company's ability to complete the contract and meet the contractual terms and the percentage of completion can be estimated reliably.

The percentage of completion is determined by the Company based on the nature of the contract, including on the basis of the proportion of actual costs incurred to date to the estimated total costs ("cost ratio") and on the basis of completion of a tangible part of the project. In most construction contracts, the completion percentage is determined according to the cost ratio.

An expected loss on a contract is recognized immediately irrespective of the stage of completion.

If not all the criteria for recognition of revenue from construction contracts are met, then revenue is recognized only to the extent of costs whose recoverability is probable ("zero profit margin" presentation).

Revenues from contracts based on the cost recovery method are carried on an ongoing basis at the rate of cost aggregation.

2. Revenues from sale of products:

Revenues from sale of products are recognized when all the significant risks and rewards of ownership of the products have passed to the buyer, the amount of revenues can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company and the costs incurred or to be incurred in respect of the transaction can be measured reliably.

The Company recognizes revenues from certain projects that are characterized by a serial process of product manufacturing and assembly for the purpose of sale that do not represent construction contracts as revenues from sale of products.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

p. Revenue recognition (Cont.):

3. Revenues from services:

Revenues from the rendering of services are recognized by reference to the stage of completion at the end of the reporting period when all the following criteria are met:

a) The amount of revenues can be measured reliably.

b) It is probable that the economic benefits associated with the transaction will flow to the Company.

c) The percentage of completion of the transaction at the end of the reporting period can be measured reliably.

d) The costs incurred or to be incurred in respect of the transaction can be measured reliably.

The percentage of completion is determined on the basis of the proportion of actual costs incurred at the end of the reporting period to the estimated total costs of the transaction. Revenues from providing aircraft maintenance services are recorded simultaneously with the actual number of flight hours accumulated in each contract.

Revenues from the use of satellites and from the provision of other services are included based on the period of use or service.

Revenues from the lease of UAVs are carried on a relative basis based on the lease period.

4. Revenues from sale agreements that contain multiple elements are allocated to the various accounting units and recognized for each accounting unit separately. The revenues that will be recognized in the financial statements will only include the amounts received and/or receivable by the Company itself. Therefore, amounts collected for third parties, including for sales promotion, do not constitute revenues.

5. In cases where the Group acts as agent or broker without bearing any of the risks and rewards derived from the transaction, revenue is presented on a net basis. In contrast, if the Group acts as the principal and bears the risks and rewards derived from the transaction, revenue is presented on a gross basis.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

p. Revenue recognition (Cont.):

6. Revenues from interest, royalties or dividends:

   Interest income is recognized using the effective interest method.

   Revenues from royalties are recognized as they accrue in accordance with the substance and terms of the relevant agreement.

   Dividends received from investments are recognized when the equity instrument holder's right to receive the dividend is established.

7. Revenues are measured at the fair value of the consideration received or receivable by the Company. Accordingly, revenues received under extraordinary credit terms (compared to standard market credit terms and the Company's credit policy) and/or the existence of an alternative means of payment for the same transaction with different credit terms require bifurcation of the sale consideration between the sale component and the financing component. The bifurcation is done at market interest.

q. Impairment:

The Company examines at the end of each reporting period whether there are indications of impairment of its various assets which are within the scope of IAS 36. As for intangible assets with an indefinite useful life, the Company reviews impairment once a year even if there are no indications of impairment. If there are indications of impairment, the Company estimates the recoverable amount of the asset. The recoverable amount is the higher of the fair value less costs of sale of the asset (or cash-generating unit) and the value in use. The value in use is the present value of the expected future cash flows from the asset or the cash-generating unit. If the recoverable amount is lower than the asset's carrying amount, the Company recognizes an impairment loss and writes down the carrying amount to the recoverable amount. The Company recognizes impairment losses immediately in profit and loss.

If the recoverable amount of a single asset cannot be estimated, the Company calculates the recoverable amount of the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are principally independent of cash inflows from other assets or groups of assets. The Company examines the impairment of a cash-generating unit at the end of each reporting period.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated from the date of acquisition to the cash-generating units that are expected to benefit from the business combination.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

q. Impairment (Cont.):

The Company recognizes an impairment loss of a cash-generating unit if and only if the recoverable amount of the unit is lower than its carrying amount. In such event, the Company allocates the impairment loss to a decrease in the value of the unit assets, first against the goodwill allocated to the unit and subsequently to the other assets pro rata to their carrying amount. These losses are carried immediately to profit and loss.

In each reporting period, the Company evaluates whether there are indications that the impairment loss of an asset, excluding goodwill, that had been recognized in previous periods no longer exists or has been reduced. When such indications exist, the Company calculates the asset's recoverable amount. Impairment loss is only reversed when changes have occurred in the estimates used to determine the asset's recoverable amount from the latest date of recognition of the impairment loss. An increase in the carrying amount of an asset, excluding goodwill, as a result of the reversal of an impairment loss will not exceed the carrying amount that would have been determined (less depreciation or amortization) if an impairment loss had not been recognized in previous years. An impairment loss of goodwill is not reversed.

r. Employee benefits:

1. Short-term employee benefits:

   Short-term employee benefits include salaries, recreation and social security contributions and are recognized as expenses as the services are rendered. A liability in respect of a cash bonus or a profit-sharing plan is recognized when the Group has a legal or constructive obligation to make such payment as a result of past service rendered by an employee and a reliable estimate of the amount can be made.

   The Company classifies the benefit as a short-term employee benefit when it is expected to be settled in full before 12 months have elapsed from the end of the annual reporting period in which the employees provide the relevant service.

2. Post-employment benefits and long-term employee benefits:

   According to labor laws and agreements in Israel and the Group's policy, the Group companies are required to pay severance to employees or are terminated and under certain conditions also to employees who resign or retire. The Company's obligation to pay severance is in the context of Section 14 to the Severance Pay Law. See also Note 21 below.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

r. Employee benefits (Cont.):

The Company's obligation to pay severance to its employees in accordance with Section 14 to the Severance Pay Law is accounted for as a defined contribution plan. The Company recognizes the amount of contribution as an expense, except for irregular items, concurrently with the receipt of labor services from the employee. Amounts that have not yet been paid are recognized as a liability. Contributions made in excess of the required amounts reduce the Company's future payments.

The Company has a long-term liability to employees such as adjustment grant, holiday gifts and sick pay as detailed in Note 21. These liabilities are measured using actuarial methods by independent actuaries according to the projected unit credit method. The present value of the liabilities was determined by discounting the expected future cash flows (after taking into account the expected salary increase rate) based on the interest rates of Government bonds denominated in the currency in which the benefits are paid whose term until maturity approximates the term of the respective severance pay liability. Cost of current service, cost of past services, settlement gains or losses and net interest on the net liability (asset) in respect of defined benefit plan are all recognized in profit or loss.

Defined benefit plan - remeasurements of the net liability (asset) in respect of defined benefit plan recognized in other comprehensive income include actuarial gains and losses, return on plan assets, excluding amounts included in net interest on the net liability (asset) in respect of defined benefit plan and any change in the effect on the asset ceiling, excluding amounts included in net interest on the net liability (asset) in respect of defined benefit plan.

Remeasurements of the net liability (asset) in respect of defined benefit plan recognized in other comprehensive income are not reclassified to profit or loss in subsequent periods.

The plan assets are funds deposited by the Company in certain institutions in respect of its liabilities to pay severance to some of its employees on an ongoing basis such as pension funds and qualifying insurance policies. As of the date of the financial statements, the Company has no amounts that meet the definition of plan assets.

3. Provision for vacation pay which management has decided is redeemable upon employee retirement is recorded based on an actuarial evaluation and is classified as a long-term employee liability.

4. Termination benefits:

   The liability in respect of employee termination benefits is recognized when there is a significant liability for employee termination before the legal retirement date, among others, in the context of a specific formal plan or for providing benefits in the context of an offer made to encourage voluntary retirement and when the liability can be estimated.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

s. Supplier discounts:

Current supplier discounts are included in the financial statements upon receipt.

Supplier discounts received at the end of the year and in respect of which the Company is not obligated to comply with certain targets, are recognized in the financial statements proportionately as the purchases entitling the Company to said discounts are made.

Supplier discounts for which the Company is required to meet certain targets, such as a minimum amount of annual purchases (either quantitative or monetary), an increase in purchases compared to previous periods, etc. are recognized in the financial statements in proportion to the purchases made by the Company during the year that qualify for the target, provided that it is expected that the targets will be achieved and the amount of the discount can be reasonably estimated. The estimate as to meeting the targets is based, among others, on past experience, on the Company's relationship with the suppliers and on the expected amount of purchases from the suppliers in the remaining period.

t. Taxes on income:

1. The financial statements comprise deferred taxes in respect of temporary differences between financial reporting and tax reporting. These differences mainly arise from differences between the depreciated balance of depreciable assets in the financial statements and the amounts that will remain in the future as depreciation for income tax purposes from certain items measured at fair value in the financial statements without a corresponding reconciliation for tax purposes, from the gap in the timing of recording certain expenses and income and from the balance of carry-forward tax losses.

2. Deferred tax assets and deferred tax liabilities are measured at the expected applicable tax rates in the period during which the asset is realized or the liability settled based on the tax rates that have been enacted or substantively enacted by the reporting date.

3. The Company and subsidiaries create a deferred tax asset in respect of all the offsettable temporary differences if taxable earnings are expected against which the temporary differences can be offset.

4. The Company did not create a deferred tax liability in respect of temporary differences created for investments in investees. These temporary differences may be taxable if the Company realizes the investments in the investees since these investments were purchased for the purpose of holding and development and the Company has no intention of realizing them.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

t. Taxes on income (Cont.):

5. The Company may be subject to additional tax in the event of dividend distribution by investees. This additional tax has not been accounted for in the financial statements in respect of subsidiaries since the Company's policy is not to cause a taxable dividend distribution. As for associates, a deferred tax liability has been recognized in respect of the additional tax in the event of dividend distribution by the associate, excluding the earnings that will not be distributed as dividends in the foreseeable future based on agreements.

6. The Company/subsidiary creates a deferred tax asset/liability in respect of temporary differences in respect of the assets and liabilities presented in the statement of financial position and their tax base measured in adjusted amounts until December 31, 2007 or until the end of the reporting period, as applicable.

7. Deferred tax liabilities in respect of temporary differences relating to unrealized mutual profits created in the context of intragroup transactions between the Company, subsidiaries and/or associates are measured at the tax rates applicable to the company holding the asset after the transaction is completed.

8. The Company may be taxed for distributing earnings that are tax exempt as long as they are not distributed.

9. Current taxes and deferred taxes are carried directly to equity if the tax relates to items that were recognized in the current period or in previous periods directly in equity.

u. Operating segments:

The Group's operating segment reporting framework is based on the manner in which the information is reviewed by the Company's Chief Operating Decision Maker. The accounting policies underlying the operating segments are consistent with the accounting policies described in this note.

v. Transactions with controlling shareholders:

1. An asset transferred to the Company from the controlling shareholder therein is presented in the entity's financial statements at fair value on the transfer date. Any difference between the amount of the consideration for the asset and its fair value is carried to equity.

2. An asset transferred from the Company to the controlling shareholder therein is derecognized in the entity's financial statements at fair value on the transfer date. Any difference between the fair value and the carrying amount of the asset on the transfer date is carried as gain or loss and the difference between the amount of the consideration for the asset on the transfer date and its fair value is carried to equity.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

v. Transactions with controlling shareholders (Cont.):

3. When assuming the entity's liability to a third party, in whole or in part, by the controlling shareholder, the liability is derecognized from the entity's financial statements at fair value on the derecognition date and the difference between the carrying amount of the liability and its fair value on the derecognition date is carried as gain or loss whereas the difference between the fair value of the liability on the derecognition date and the amount of the consideration for the liability is carried to equity.

4. Loan granted to the controlling shareholder or received from the controlling shareholder is presented on the date of initial recognition in the entity's financial statements as an asset or liability, as applicable, at its fair value and the difference between the amount of the loan received or granted and the fair value on the date of initial recognition is carried to equity. After initial recognition, the loan is stated in the Company's financial statements at amortized cost using the effective interest method.

As of the date of the financial statements, no such transactions were conducted.

w. Earnings per share:

Earnings per share were computed pursuant to the provisions of IAS 33 according to which, among others, the Company calculates basic earnings per share for the income or loss attributable to equity holders of Ordinary shares of the Company. Basic earnings per share are computed by dividing the income or loss attributable to equity holders of Ordinary shares of the Company by the weighted average number of outstanding Ordinary shares during the period.

x. Statement of cash flows:

1. Taxes paid are classified under cash flows from operating activities and disclosure is provided to the overall amount of taxes paid.

2. Dividends paid are classified under cash flows from financing activities.

3. Interest paid and interest received are classified under cash flows from operating activities.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

y. Effect of new IFRSs, Amendments to Standards and new Interpretations in the period prior to adoption:

1. **IFRS 9, "Financial Instruments" ("IFRS 9"):**

a) In November 2009, the IASB issued IFRS 9, the first part of Phase 1 of a project to replace IAS 39, "Financial Instruments: Recognition and Measurement", which focuses on the classification and measurement of financial assets. According to IFRS 9, upon initial recognition, all financial assets should be classified into one of two measurement categories: amortized cost or fair value.

As for investment in debt instruments, IFRS 9 states that they will be measured at fair value through profit or loss unless both of the following conditions are met in which case they will be measured at amortized cost:

1) The financial asset is held within a business model whose objective is to hold assets in order to collect the contractual cash flows.

2) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (the instrument is managed on the basis of contractual yield).

Notwithstanding the aforesaid, upon initial recognition, the Company may designate a debt instrument that meets both of the abovementioned conditions as measured at fair value through profit or loss if this designation eliminates or significantly reduces a measurement or recognition inconsistency ("accounting mismatch") that would have otherwise arisen. After initial recognition, reclassification between the measurement categories is not permitted unless the Company fundamentally modifies its business model for managing financial assets or unless the reclassification is required.

As for investment in equity instruments, according to IFRS 9, they should be measured at fair value through profit or loss. Nevertheless, if equity instruments are not held for trading, upon initial recognition, the Company may choose to recognize all the changes in the equity instrument's fair value in other comprehensive income (excluding dividend income). Reclassification from other comprehensive income to profit or loss is not permitted. Moreover, there is no need for impairment testing. This election is final and irrevocable.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

y. Effect of new IFRSs, Amendments to Standards and new Interpretations in the period prior to adoption (Cont.):

1. **IFRS 9, "Financial Instruments" ("IFRS 9") (Cont.):**

b) In October 2010, the IASB issued another part of IFRS 9 regarding financial liabilities. The accounting treatment prescribed by IFRS 9 is not materially different from the provisions set forth in IAS 39 regarding financial instruments: recognition and measurement with respect to most issues pertaining to financial liabilities, other than as described below:

1) Liabilities designated to fair value (except liabilities for the provision of loans and financial guarantee contracts designated at fair value through profit or loss) - based on IFRS 9, the change in fair value is periodically bifurcated into two components - credit risk is recognized in other comprehensive income and the outstanding change in fair value is recognized in profit or loss, unless the bifurcation results in an accounting mismatch in which case it will not be performed. Amounts carried to other comprehensive income will not be reclassified to profit or loss.

2) IFRS 9 reverses the exceptions regarding measurement at cost of derivatives that constitute liabilities in respect of equity instruments that cannot be measured at fair value reliably. These derivatives will be measured at fair value.

c) In November 2013, the IASB issued another part of IFRS 9 which mainly focuses on hedge accounting.

The hedge accounting model pursuant to IFRS 9 compared to the existing model in IAS 39 is based on principles, is less complicated and better reflects an entity's risk management activity in the financial statements. The main changes introduced in the new model are as follows:

1) Simplifying the hedge effectiveness test, including the elimination of the 80%-125% quantitative range.

2) Eliminating the limitations on the risks that can be hedged.

3) Determining that non-derivative financial instruments may qualify as hedging instruments.

4) Adding more comprehensive disclosure requirements for an entity's risk management activities.

The Company is evaluating the possible impact of IFRS 9 but is presently unable to assess its effect, if any, on the financial statements.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

y. Effect of new IFRSs, Amendments to Standards and new Interpretations in the period prior to adoption (Cont.):

2. **Amendment to IAS 32, "Financial Instruments: Presentation regarding Offsetting Financial Assets and Financial Liabilities" ("IAS 32R"):**

In December 2011, the IASB issued IAS 32R which mainly clarifies the criteria included in IAS 32.42(a) whereby an entity "currently has a legally enforceable right of set-off" and clarifies the methods of gross settlement which may be viewed as net settlement.

IAS 32R will be adopted retrospectively from the financial statements for annual periods beginning on January 1, 2014 or thereafter. Earlier application is permitted by providing disclosure and by concurrently adopting the Amendment to IFRS 7.

The Company is evaluating the possible impact of IAS 32R but is presently unable to assess its effect, if any, on the financial statements.

NOTE 4:- CASH AND CASH EQUIVALENTS

a. Composition:

	December 31,	
	2013	**2012**
	U.S. dollars in millions	
Cash	**246**	141
Short-term deposits	**528**	364
Total	**774**	505

b. The majority of deposits are in dollars and bear interest. The weighted average interest rate as of December 31, 2013 is 0.42% (December 31, 2012 - 2.23%).

NOTE 5:- SHORT-TERM FINANCIAL ASSETS

a. Composition:

	December 31, 2013				December 31, 2012			
	Unlinked	**CPI linked**	**Linked to foreign currency**	**Total**	**Unlinked**	**CPI linked**	**Linked to foreign currency**	**Total**
	U.S. dollars in millions							
Financial assets at fair value through profit or loss:								
Government bonds (1)	**103**	**85**	**100**	**288**	91	79	92	262
Corporate debentures (2)	**3**	**14**	**129**	**146**	3	14	118	135
Total debentures	**106**	**99**	**229**	**434**	94	93	210	397
Shares				**-**				1
Mutual funds				**283**				184
Derivatives held for trading not designated as hedging instruments				**1**				4
Derivatives held for trading designated as hedging instruments				**37**				47
Deposits (3)			**167**	**167**			15	15
Designated deposits (4)			**31**	**31**			136	136
Restricted deposits (5)			**183**	**183**				-
Total				**1,136**				**784**

NOTE 5:- SHORT-TERM FINANCIAL ASSETS (Cont.)

b. Additional information:

1. The Group holds Government bonds that bear annual interest of about 1-6%. The maturity dates of the bonds range between one year and ten years from the date of the financial statements.

2. The Group holds marketable corporate debentures that bear annual interest of about 1-6%. The maturity dates of the debentures range between one year and four years from the date of the financial statements.

3. The deposits bear interest of about 0.1-1.1% and mature in a period of three to twelve months. Accordingly, the fair value of the deposits approximates their carrying amount.

4. Designated deposits include dollar deposits provided in favor of banks which issued guarantees to the Company's customers in a total of approximately $ 12 million. The deposits will be gradually reduced over the sale transaction period. This item also includes a deposit in Euro held as a hedge in connection with an engagement in Euro with a supplier in a total of approximately $ 19 million. The deposits bear interest of 0.13%.

5. Dollar deposits pledged in favor of banks which issued advance guarantees to customers. The deposits will be gradually reduced over the sale transaction period. The deposits bear interest of 0.16-0.43%.

6. For details of expected maturities, see Note 23c(3) below.

NOTE 6:- AVAILABLE-FOR-SALE SECURITIES

a. The movement in the investment in securities which were designated by the Company as available-for-sale securities:

	2013	**2012**
	U.S. dollars in millions	
Balance at beginning of year	**40**	98
Acquisitions	**7**	-
Sales (including interest), net	-	(58)
Changes in fair value carried to other comprehensive income	-	-
Balance at end of year	**47**	**40**

NOTE 6:- AVAILABLE-FOR-SALE SECURITIES (Cont.)

b. The available-for-sale securities represent dollar corporate debentures in a total of $ 3 million and dollar Government bonds in a total of $ 44 million bearing interest of about 5.1-5.5%. The maturity dates of the Government bonds range between three and five years from the date of the financial statements.

In 2013, the Company recorded interest income of approximately $ 2 million (2012 - approximately $ 2 million) in the statement of comprehensive income in respect of investments in debt instruments included in the category of available-for-sale securities. The maximum exposure to credit risk in respect of the available-for-sale securities as of the reporting date is equivalent to their fair value.

NOTE 7:- TRADE RECEIVABLES

a. Composition:

	December 31,	
	2013	2012
	U.S. dollars in millions	
Open accounts		
Local customers	**81**	91
Israel Ministry of Defense (1)	**161**	102
Foreign customers	**229**	240
Total open accounts	**471**	**433**
Income receivable	**11**	**10**
Less - allowance for doubtful accounts		
Balance at beginning of year	**5**	6
Charge during the year	-	2
Decrease in respect of collected or written-off debts, net	-	(3)
Balance at end of year	**5**	**5**
Total	**477**	**438**

b. Additional information:

1. Balance with interested parties, see Note 35 below.
2. Major customers, see Note 25b below.
3. As for linkage bases, see Note 23i below.
4. As for aging of trade receivables, see Note 23e below.

NOTE 8:- INCOME RECEIVABLE FROM WORK IN PROGRESS, NET

Composition:

	December 31,	
	2013	2012
	U.S. dollars in millions	
Costs accrued for work according to construction contracts	**5,657**	5,728
Recognized profits, net	**587**	616
Less - progress billings	**(5,115)**	(5,317)
Total costs incurred and profits recognized less recognized losses that exceed progress billings	**1,129**	1,027
Less - advances received	**(433)**	(200)
Total income receivable from work in progress, net	**696**	827

NOTE 9:- OTHER ACCOUNTS RECEIVABLE

Composition:

	December 31,	
	2013	2012
	U.S. dollars in millions	
Government authorities	**7**	29
Advances to suppliers and sales promotion agents	**153**	220
Employees	**5**	10
Prepaid expenses - interested parties	**8**	13
Prepaid expenses and accrued income	**13**	11
Other	**14**	18
Total	**200**	**301**

NOTE 10:- INVENTORIES AND INVENTORY IN PROCESS

a. Composition:

	December 31,			
	2013			2012
	Gross amount	Work in progress reclassified to non-current assets	Carrying amount	Carrying amount
	U.S. dollars in millions			
Inventories and inventory in process:				
Raw materials, parts and auxiliary materials	205	-	**205**	182
Inventory of products/business jets in process (c)	141	-	**141**	128
Inventory of hardware and spare parts	5	-	**5**	6
Inventory of work in progress (b)	232	(7)	**225**	214
Less - provision for slow-moving inventories	(23)	-	**(23)**	(25)
Total	**560**	**(7)**	**553**	505

b. Critical engagement in the industry of aero-assemblies:

1. As of the date of financial statements, the Company has entered into agreements with Alenia Aermacchi S.P.A ("Alenia") and with Boeing for the development and manufacture of various types of aero subassemblies for Boeing 787 as follows:

a) Agreement with Alenia

Effective from 2005, the Company signed an agreement with Alenia for build-to-spec developing and manufacturing of aero subassemblies for the Boeing 787 base structure for which Alenia serves as chief subcontractor. In October 2011, an agreement was signed between the Company and Alenia for determining the Company's monetary consideration both for the preproduction stages and for the subassemblies manufactured by the Company for Alenia.

As of the date of the financial statements, the Company manufactured for Alenia about 171 subassemblies of tail segments of which about 159 subassemblies were supplied, and also manufactured about 165 subassemblies of body segments of which about 154 subassemblies were supplied.

NOTE 10:- INVENTORIES AND INVENTORY IN PROCESS (Cont.)

b. Critical engagement in the industry of aero-assemblies (Cont.):

1. As of the date of financial statements, the Company has entered into agreements with Alenia Aermacchi S.P.A ("Alenia") and with Boeing for the development and manufacture of various types of aero subassemblies for Boeing 787 as follows (Cont.):

a) Agreement with Alenia (Cont.)

On September 20, 2013, the Company was informed by Alenia that Boeing is in the process of reassigning the responsibility for conducting certain parts of the project from Alenia to Boeing, including in this context the agreement between Alenia and the Company thereby turning the Company into Boing's chief subcontractor for this section of the project without changing the contents of the project. The Company estimates that becoming Boing's chief subcontractor as discussed above is not expected to have a material effect.

b) Agreement with Boeing

In 2007, an agreement was signed with Vought Aircraft Industries Inc. ("Vought"). In 2009, the entire activity of Vought in the context of the Boeing 787 project including its rights and obligations towards the Company were assigned to Boeing and starting from that date, the Company serves as chief subcontractor for Boeing for this section of the project.

In December 2010, the Company and Boeing reached an agreement for determining the monetary consideration for the development and preproduction components. The consideration will be carried over several aircraft as determined in the agreement.

As of the date of the financial statements, the Company is holding negotiations with Boeing for adjusting the monetary consideration for subassemblies manufactured by it following the changes commissioned and/or approved by Boeing, as applicable, whose performance involved material added costs. At this stage, in view of the prolongation of the negotiations, the Company does not expect the negotiations to end before June 2014.

As of the date of the financial statements, the Company manufactured for Boeing about 207 subassemblies, of which about 195 were supplied.

In respect of the manufacturing of the subassemblies, the Company recognized revenues that can be measured reliably and are expected to be acceptable to Boeing.

NOTE 10:- INVENTORIES AND INVENTORY IN PROCESS (Cont.)

b. Critical engagement in the industry of aero-assemblies (Cont.):

2. Claims/demands:

   In October 2012, the Company received a letter from Boeing, which had acquired the rights of Vought (in keeping with its demands of January 2011), in which it was argued that due to the Company's violations (according to Boeing - failure to supply certain subassemblies based on specs), it is demanding compensation in the amount of approximately $ 16 million for all the damages caused by such violations. In the Company's response to Boeing, it rejects such allegations and argues that the non-supply of said subassemblies based on specs resulted from Boeing's failures in managing the project and the subcontractors and that since the manufacturing of the subassemblies in the project is conducted based on the build to print method according to the blueprints delivered to the Company by Boeing, the blueprints are to blame for the fact that the manufactured subassemblies do not match the specs.

3. In 2012, the Company recorded a provision for loss totaling approximately $ 14 million in order to reflect the adjustment of cost to the estimated selling price of the subassemblies to Boeing and in order to reflect the Company's assessment of the chances of said demand.

4. The Company estimates that no additional monetary losses will be incurred as a result of the issues detailed above.

c. Represents inventory of business jets in process in a total of approximately $ 141 million for which no orders exist as of the date of the financial statements.

NOTE 11:- LONG-TERM LOANS AND RECEIVABLES

a. Composition:

	December 31,	
	2013	**2012**
	U.S. dollars in millions	
Notes collectible (b1) (b2)	**-**	2
Long-term customer credit (b2) (b4)	**30**	5
Long-term funds (b3)	**46**	39
Total	**76**	46

NOTE 11:- LONG-TERM LOANS AND RECEIVABLES (Cont.)

b. Additional information:

1. Notes received from a customer which are held until 2016, linked to the dollar and bearing interest of six-month Libor+1% (as of December 31, 2013 - the overall interest rate is 1.42%) and presented less a current maturity of approximately $ 5 million (December 31, 2012 - approximately $ 5 million).

2. Maturity dates:

	December 31, 2013	December 31, 2012
	U.S. dollars in millions	
First year	**4**	6
Second year	**4**	6
Third year	**4**	6
Total current maturity (*)	**12**	18
Fourth year	**22**	6
Fifth year and thereafter	**8**	1
Total	**30**	7

(*) Current maturities are presented according to the Company's operating cycle, see Note 3a above.

3. Central severance pay funds.

4. Dollar financing agreement with a customer bearing interest of 2.37%; the first maturity date is expected in 2017.

NOTE 12:- INVESTMENTS IN SUBSIDAIRIES, ASSOCIATES AND JOINT VENTURES

a. Major subsidiaries (1):

	Rate of equity and voting rights	
	December 31,	
	2013	2012
	%	
Elta Systems Ltd.	100	100
IAI North America Inc.	100	100
Stark Aerospace Inc.	100	100
Elta North America Inc.	100	100
I.A.I. ASIA Pte Ltd.	100	100
European Advanced Technology S.A.	100	100
Mardan Holdco Pte Ltd.	100	100
ImageSat International N.V. (ISI) (2)	46.4	46.4
Lardosa Investment B.V.	100	100
D.T.S. Ltda.	50	50
Elbatech Ltd.	50	50
Tamuz F.T.K. Solutions Ltd. (2) (3)	44.375	-

(1) Excluding Elta Systems Ltd., the Company's investment in all the other subsidiaries is immaterial.

(2) A subsidiary since September 2013. Before that date, the company was accounted for as an associate. See details in Note 12b below.

(3) 88.75% of the share capital held by Elbatech.

b. Material business combination in the reporting period - investment in ImageSat International N.V. ("ISI"):

1. The Company holds about 46.4% of the issued and outstanding share capital of ISI which markets satellite images taken by electro-optical observation satellites in high resolution.

   The Company holds (convertible and non-convertible) debentures issued by ISI with a par value of approximately $ 87 million that were purchased by the Company in several transactions in 2009 and 2011 from foreign partnerships which at the time also held minority interests in ISI in an overall amount of approximately $ 77 million. On November 12, 2013, the debenture agreement was amended, the maturity date of the debentures was deferred by one year to September 30, 2015 and the annual interest rate on the debentures was lowered from 9% to 6% effective from the date of amendment.

   In 2013, until the date of initial consolidation, ISI's debentures accrued interest and discount amortization of approximately $ 5 million (in 2012 - approximately $ 5 million). In 2013 and 2012, ISI repaid part of the debentures and accrued interest thereon in a total of approximately $ 13 million and $ 10 million, respectively.

NOTE 12:- INVESTMENTS IN SUBSIDAIRIES, ASSOCIATES AND JOINT VENTURES (Cont.)

b. Material business combination in the reporting period - investment in ImageSat International N.V. ("ISI") (Cont.):

2. On September 9, 2013 ("the engagement date" or "the business combination date"), ISI, the Company and other entities signed several agreements as detailed below:

   Claim settlement agreement

   a) ISI, the Company and Elbit Electro-Optical El-Op Systems Ltd. ("El-Op") signed a settlement agreement with additional shareholders in ISI ("the minority shareholders") who had initiated legal proceedings against ISI, the Company, El-Op and several directors in ISI in which the minority shareholders waive all existing and future claims and allegations (see also Note 22a(8) below). In the context of the settlement agreement, ISI paid the minority shareholders an amount of approximately $ 7.8 million with the addition of a variable future amount that is contingent on the scope of ISI's future engagements with certain customers. See details of the contingent consideration below.

   Agreement for the purchase of ISI shares by foreign company

   b) ISI signed a loan agreement with a third party ("the foreign company") whereby ISI loaned the foreign company a sum of approximately $ 3 million bearing interest for ten years ("the loan"), designed for the purchase of ISI shares held by El-Op and the minority shareholders. ISI has the option of demanding the early repayment of the loan at any time.

   c) According to the loan terms, should ISI demand the early repayment of the loan, the foreign company will be granted a put option and ISI will be granted a call option for selling/purchasing ISI's shares to/from the foreign company at a price equivalent to the amount of the loan with the addition of accrued interest. At its discretion, ISI may locate another party to purchase the shares through the exercise of the options.

   d) The Company continues to hold about 46.4% of the share capital of ISI and the foreign company holds about 53.6% of ISI's share capital. As long as the loan is not repaid, ISI's shares that are held by the foreign company are pledged in favor of ISI to secure the repayment of the loan. During such time, the pledged shares will not confer any voting rights in general meetings, excluding in the issue of appointing directors.

   e) According to the agreement, ISI's board of directors will be comprised of four or six directors half of whom will be appointed by the Company and the other half by a 65% majority of ISI's entire shareholders.

   f) Following said engagements, the previous shareholders' agreements in ISI were cancelled.

NOTE 12:- INVESTMENTS IN SUBSIDAIRIES, ASSOCIATES AND JOINT VENTURES (Cont.)

b. Material business combination in the reporting period - investment in ImageSat International N.V. ("ISI") (Cont.):

3. Through the business combination date, the Company's interests in ISI were accounted for in the Company's financial statements as an investment in an associate at equity. Following the engagement in said agreements that replaced the previous shareholders' agreements, and although the Company does not hold the majority of ISI's shares and is not entitled to appoint more than half of the members on its board, pursuant to generally accepted accounting principles, the Company consolidates ISI's financial statements in its financial statements since the third quarter of 2013.

4. The Company's management assumes that had the business combination taken place on January 1, 2013, the effect on the Group's revenues and income in the year ended December 31, 2013 would have been an addition of approximately $ 20 million and $ 5 million, respectively. In determining said amounts, the Company's management assumed that the fair value adjustments on the business combination date are identical to the adjustments that would be obtained had the business combination taken place on January 1, 2013.

5. Details of the consideration transferred in the business combination:

	U.S. dollars in millions
Fair value of ISI's equity rights held by the Group prior to the business combination	3
Fair value of the Company's investment in promissory notes issued by ISI (settlement of a pre-existing relationship)	70
Total	**73**

6. Contingent consideration:

According to the agreement, ISI undertook, among others, to pay the minority shareholders a variable future earnout that is contingent on ISI's future sales. As of the business combination date, the value of the liability in respect of the contingent consideration was estimated in an immaterial amount.

7. The effect of the business combination on profit or loss:

a) In the context of the business combination, a gain of approximately $ 14 million was recognized from the remeasurement to fair value of the Company's investment in ISI's equity rights prior to the business combination date. This gain was recorded in other income in profit and loss.

NOTE 12:- INVESTMENTS IN SUBSIDAIRIES, ASSOCIATES AND JOINT VENTURES (Cont.)

b. Material business combination in the reporting period - investment in ImageSat International N.V. ("ISI") (Cont.):

7. The effect of the business combination on profit or loss (Cont.):

b) Settlement of a pre-existing relationship with the acquiree in the business combination:

The difference between the fair value of the Company's investment in debentures issued by ISI and its carrying amount prior to the business combination date of approximately $ 3 million was recognized as settlement of a pre-existing relationship with the acquiree in the business combination and carried to finance income. See details of the Company's investment in ISI's debentures in subparagraph b(2) to this note above.

8. Assets and liabilities consolidated for the first time in the context of the business combination:

	U.S. dollars in millions
Current assets	36
Fixed assets	31
Order backlog	5
Customer relations	7
Deferred taxes	-
Goodwill	2
Current liabilities	(8)
Non-current liabilities	-
	73

9. Material valuation:

In calculating the fair value of the Company's investment in ISI prior to the business combination date and in calculating the intangible assets and liabilities acquired, the Company relied on the work of an independent outside appraiser.

10. Non-controlling interests:

In view of the terms of the above engagement, including the existence of the put and call options in connection with the loan granted by ISI to the foreign company for the purchase of ISI shares from the minority shareholders, the Company does not recognize non-controlling interests in respect of its investment in ISI.

NOTE 12:- INVESTMENTS IN SUBSIDAIRIES, ASSOCIATES AND JOINT VENTURES (Cont.)

b. Material business combination in the reporting period - investment in ImageSat International N.V. ("ISI") (Cont.):

11. Costs relating to the business combination:

    The Group bore legal and other costs relating to the business combination in immaterial amounts.

12. In 2006, in the context of an offering of debentures executed by a wholly-owned subsidiary of ISI totaling approximately $ 30 million, ISI recorded a first degree charge on its future income expected to be received from certain customers from the use of the Eros A and Eros B satellites. As of the date of approval of the financial statements, the Company has an obligation to the holders of debentures to repay the outstanding unpaid balance of debentures in the event that ISI is unable to fulfill its obligations for providing satellite operating services and the Company fails to meet its undertaking to replace ISI as an alternative service provider. As of the financial statement date, the outstanding unpaid balance of debentures approximates $ 1 million. Based on legal opinion, the Company's management believes that no loss is anticipated from the Company's obligation to holders of debentures of ISI's subsidiary.

13. As for legal claims and additional information, see Note 22a(8) below.

c. Financial data of immaterial investees accounted for at equity:

1. Composition:

	Associates	
	December 31,	
	2013	2012
	U.S. dollars in millions	
Investments at equity:		
Cost of shares	**80**	110
Group's share of post-acquisition losses	**(57)**	(95)
Dividends received	**(12)**	(12)
Loans granted	**15**	13
Amortization for unrealized gain	**-**	(5)
Provision for impairment	**(4)**	(2)
Total	**22**	9
Other investments:		
Debentures	**-**	78
Total	**22**	87

NOTE 12:- INVESTMENTS IN SUBSIDAIRIES, ASSOCIATES AND JOINT VENTURES (Cont.)

c. Financial data of immaterial investees accounted for at equity (Cont.):

2. Data of the carting amount of the investment and the Company's share of earnings or losses of immaterial investees accounted for at equity:

	Holding rate	Carrying amount of the investment -December 31, 2013	Carrying amount of the investment -December 31, 2012	Carrying amount of the investment -December 31, 2013	Carrying amount of the investment -December 31, 2012
		U.S. dollars in millions			
Joint ventures:					
PSF Conversion LLP	50% (1)	(5)	-	(5)	1
Becontree Hungary Ltd.	50%	-	-	-	2
M&B Conversions Limited	50%	10	11	(1)	-
G-Nius Unmanned Ground Systems Ltd.	50%	(1)	-	(1)	(1)
Tor - Advanced Flight Training	50% (1)	1	1	-	-
Gal-El	50% (1)	1	1	-	-
Total joint ventures		6	13	(7)	2
Associates:					
ImageSat International N.V.	46.4% (2)	-	67	-	-
Tiltan Systems Engineering Ltd.	36% (3)	-	4	(1)	-
AMS Holding Srl.	19%	-	1	(3)	-
IACIT	40%	12	-	-	-
STELCOMMS	49%	2	1	1	-
Other		2	1	-	-
Total associates		16	74	(3)	-
Total		22	87	(10)	2

(1) Limited partnership.

(2) A subsidiary effective from September 2013. Until that date it was accounted for as an associate, see details in Note 12b above.

(3) In 2013, the Company recorded a provision for impairment of its investment in Tiltan totaling approximately $ 2 million.

NOTE 13:- PROPERTY, PLANT AND EQUIPMENT

a. Composition as of December 31, 2013:

	Land, buildings and service installations	Machinery, equipment and tools	Vehicles and transport equipment	Office furniture and equipment	Total
	U.S. dollars in millions				
Cost					
Balance at beginning of period	**818**	**551**	**142**	**216**	**1,727**
Acquisitions and in-house manufacturing	**46**	**32**	**18**	**14**	**110**
Additions for first-time consolidation	**-**	**31**	**-**	**-**	**31**
Disposals during the period	**(4)**	**(15)**	**(3)**	**(12)**	**(34)**
Balance at end of period	**860**	**599**	**157**	**218**	**1,834**
Accumulated depreciation					
Balance at beginning of period	**(413)**	**(433)**	**(95)**	**(159)**	**(1,100)**
Additions during the period (1)	**(27)**	**(37)**	**(14)**	**(15)**	**(93)**
Disposals during the period	**3**	**15**	**1**	**12**	**31**
Balance at end of period	**(437)**	**(455)**	**(108)**	**(162)**	**(1,162)**
Depreciated balance at end of period	**423**	**144**	**49**	**56**	**672**
Depreciated balance at beginning of period	**405**	**118**	**47**	**57**	**627**

(1) Includes impairment loss of machinery, equipment and tools totaling approximately $ 4 million, see Note 30 below.

NOTE 13:- PROPERTY, PLANT AND EQUIPMENT (Cont.)

b. Composition as of December 31, 2012:

	Land, buildings and service installations	Machinery, equipment and tools	Vehicles and transport equipment	Office furniture and equipment	Total
	U.S. dollars in millions				
Cost					
Balance at beginning of period	792	535	125	214	1,666
Acquisitions and in-house manufacturing	32	32	23	20	107
Additions for first-time consolidation	-	-	-	-	-
Disposals during the period	(6)	(17)	(5)	(18)	(46)
Balance at end of period	818	550	143	216	1,727
Accumulated depreciation					
Balance at beginning of period	(394)	(416)	(83)	(158)	(1,051)
Additions during the period	(25)	(34)	(16)	(18)	(93)
Disposals during the period	6	17	4	17	44
Balance at end of period	(413)	(433)	(95)	(159)	(1,100)
Depreciated balance at end of period	405	117	48	57	627
Depreciated balance at beginning of period	398	119	42	56	615

c. Additional information regarding real estate held by the Company:

1. Composition:

	December 31, 2013	December 31, 2012
	U.S. dollars in millions	
Real estate and building rights:		
Freehold and under capitalized lease	**1**	**1**
Under non-capitalized lease	**11**	**11**
Total	**12**	**12**
Less - depreciation	**7**	**7**
Balance	**5**	**5**

NOTE 13:- PROPERTY, PLANT AND EQUIPMENT (Cont.)

c. Additional information regarding real estate held by the Company (Cont.):

2. The Company's activities and plants are performed and located on real estate covering an overall area of some 3,500 thousand sq. m., most of which in the Company's main area of activity in the vicinity of Ben-Gurion Airport.

   The Company's main real estate rights are leasehold rights for a period of 49 years which are generally renewed for an additional period of 49 years, subject to the limitations and conditions prescribed in the lease agreements. The Company also holds real estate properties by virtue of ownership rights (or properties with rights to be registered as owners, as applicable), licenses for use or rent. Most of the Company's rights derive from its agreements with the Israel Land Authority and some based on engagements with others. The Company's rights with respect to some of the real estate properties are not regulated and with respect to some of the real estate properties no lease agreements have been signed at the conclusion of the development agreements underlying these properties. Moreover, most of the Company's leasehold rights in the properties have not yet been registered in the name of the Company and/or subsidiaries (as applicable) at the Land Registry Office.

   As of the reporting date, the Ben-Gurion Airport facility area is defined as a regional area (that is not municipally owned by any local or regional authority).

3. Additional information:

   a) Capitalized leasehold rights from the Israel Land Authority for an area of some 150 thousand sq. m., non-capitalized leasehold rights from the Israel Land Authority for an area of about 3,000 thousand sq. m., real estate rights that are licensed from the Israel MOD for an area of about 150 thousand sq. m. and the Group's freehold real estate rights in an area of some 39 thousand sq. m.

   b) The lease is for periods ending between 2014 and 2032 with a right for extension by another 49 years, subject to the limitations and conditions prescribed in the lease agreements.

   c) The majority of the Group's buildings are located on land that is leased from the Israel Land Authority until 2014-2032 (some with an option for extension by another 49 years). In respect of some of the Group's rights no lease agreements have been signed. The Company's management estimates that no material exposure is expected, if any, as a result of the aforesaid.

NOTE 13:- PROPERTY, PLANT AND EQUIPMENT (Cont.)

d. Depreciation rates:

	%
Buildings and service installations	2-10 (mainly 4)
Machinery, equipment and tools	10-20 (mainly 15)
Vehicles and transport equipment	10-20 (mainly 20)
Computers, office furniture and equipment	10-25 (mainly 10)

e. Additional information:

1. The cost of property, plant and equipment is presented net of investment grants received in their respect. As of December 31, 2013, the balance of investment grants approximates $ 2 million (December 31, 2012 - approximately $ 2 million).

2. Engagements signed in respect of property, plant and equipment as of December 31, 2013 total approximately $ 33 million.

3. The Israeli Government allows the Company to use the State's buildings, installations and equipment for taking orders from Government authorities and institutions. The Company is entitled to use these assets for performing work for others in return for usage fees. These assets are held at the Company's expense and responsibility and are not presented as assets in its financial statements. The usage fees paid in 2013, 2012 and 2011 amounted to approximately $ 0 thousand, $ 4 thousand and $ 23 thousand, respectively.

4. Fully depreciated assets at December 31, 2013 that are still in use in a total of $ 826 million.

5. As for charges, see Note 22d below.

f. Based on the requirement of the Government's unit for licensing security enterprises, in 2011, the Company conducted a historic land survey aimed at collecting the entire relevant information regarding potential ground pollution in the Company's properties near the Ben-Gurion Airport, in Be'er-Yaacov, Yahud, Ashdod, Be'er-Sheva and the Golan Heights. The Company maintains close contact with the Ministry of Environmental Protection for the continued performance of the required surveys. To the best of the Company's knowledge, a Government resolution requires Government companies whose real estate was found to be polluted to perform ground treatment work. In view of the nature of the Company's operations, it is not impossible that various pollutants will be found in the abovementioned properties. Prior to conducting thorough land surveys, the Company is unable to assess the monetary expenditure that might be incurred for treating any ground pollution.

NOTE 14:- INTANGIBLE ASSETS, NET

a. Composition as of December 31, 2013:

	Software	Intangible assets under development (c)	Knowhow	Customer relations and order backlog	Goodwill	Total
	U.S. dollars in millions					
Cost						
Balance at beginning of period	**109**	**123**	**13**	**-**	**2**	**247**
Acquisitions and in-house development	**10**	**22**	**-**	**-**	**-**	**32**
Additions for first-time consolidation	**-**	**-**	**-**	**14**	**3**	**17**
Disposals during the period	**-**	**-**	**-**	**-**	**-**	**-**
Balance at end of period	**119**	**145**	**13**	**14**	**5**	**296**
Accumulated depreciation						
Balance at beginning of period	**(89)**	**(57)**	**(9)**	**-**	**-**	**(155)**
Additions during the period	**(10)**	**(8)**	**(3)**	**(1)**	**-**	**(22)**
Disposals during the period	**-**	**-**	**-**	**-**	**-**	**-**
Balance at end of period	**(99)**	**(65)**	**(12)**	**(1)**	**-**	**(177)**
Depreciated balance at end of period	**20**	**80**	**1**	**13**	**5**	**119**
Depreciated balance at beginning of period	**20**	**66**	**5**	**-**	**2**	**92**

NOTE 14:- INTANGIBLE ASSETS, NET (Cont.)

b. Composition as of December 31, 2012:

	Software	Intangible assets under development	Knowhow	Customer relations and order backlog	Goodwill	Total
	U.S. dollars in millions					
Cost						
Balance at beginning of period	104	119	12	-	2	237
Acquisitions and in-house development	6	5	1	-	-	12
Additions for first-time consolidation	-	-	-	-	-	-
Disposals during the period	-	(1)	-	-	-	(1)
Balance at end of period	110	123	13	-	2	248
Accumulated depreciation						
Balance at beginning of period	(80)	(54)	(5)	-	-	(139)
Additions during the period	(10)	(4)	(3)	-	-	(17)
Disposals during the period	-	-	-	-	-	-
Balance at end of period	(90)	(58)	(8)	-	-	(156)
Depreciated balance at end of period	20	65	5	-	2	92
Depreciated balance at beginning of period	24	66	7	-	2	98

NOTE 14:- INTANGIBLE ASSETS, NET (Cont.)

c. Intangible assets under development include capitalized costs in respect of the development of G280 business jets, the development of the Taxiboat vehicle and developments in connection with licenses for passenger aircraft conversion into cargo configuration.

d. Depreciation rates:

	%
Computer software	10-17 (mainly 10)
Intangible assets under development	Based on business plan but not more than 10 years
Knowhow	25
Customer relations and order backlog	10-20

NOTE 15:- CURRENT MATURITIES OF DEBENTURES AND OTHER CREDIT PROVIDERS

a. Composition:

	Linkage basis	Interest rate at 31.12.13	December 31, 2013	December 31, 2012
			U.S. dollars in millions	
Credit from non-bank corporations	Dollar	5.40%	**18**	13
<u>Current maturities of long-term liabilities</u>				
Loans from other credit providers	CPI		**3**	4
Debentures (series A) (*)	Dollar linked	1.28%	**144**	266
Debentures (series B), less swap (*)	Unlinked	4.95%	**82**	40
Interest payable on debentures (series C)	-	4.10%	**7**	-
Total			**254**	323

(*) See Note 20 below.

b. As for charges and guarantees, see Notes 22c and 22d below.

NOTE 16:- TRADE PAYABLES

Composition:

	December 31, 2013	December 31, 2012
	U.S. dollars in millions	
Open accounts	**226**	182
Accrued expenses	**284**	237
Total	**510**	419

NOTE 17:- OTHER ACCOUNTS PAYABLE

Composition:

	December 31, 2013	December 31, 2012
	U.S. dollars in millions	
Employees and payroll accruals	**336**	297
Current maturity of employee benefit liabilities	**92**	97
Other liabilities	**104**	86
Total	**532**	480

NOTE 18:- PROVISIONS

a. Composition:

	Provision for warranty (b)	Provision for legal claims (c)	Liability to the OCI (d)	Total
	U.S. dollars in millions			
Balance at January 1, 2012	40	3	3	46
Charge for the year	45	9	-	54
Exercised/written-off provisions	(25)	(1)	-	(26)
Balance at December 31, 2012	**60**	**11**	**3**	**74**
Movement in 2013				
Charge for the year	**58**	**7**	-	**65**
Exercised/written-off provisions	**(36)**	**(1)**	-	**(37)**
Balance at December 31, 2013	**82**	**17**	**3**	**102**

NOTE 18:- PROVISIONS (Cont.)

b. Provision for warranty:

The provision for warranty was recognized with respect to anticipated warranty claims in respect of products sold or jobs performed for which the Company has provided warranty for the quality of the products supplied or the work performed. The provision is based on estimated prepared in accordance with past experience.

c. Legal claims:

Several claims and demands have been filed against the Company and subsidiaries in the ordinary course of business in an aggregate of approximately $ 35 million. Based on the Company's legal counsel, adequate provisions totaling approximately $ 17 million were included in the financial statements in respect of these claims and demands.

In addition, there are claims pending against the Company which management believes are covered by appropriate insurance policies and are handled by and at the responsibility of the insurance companies.

d. Liabilities to the OCI:

The Company and its subsidiaries have a liability to pay royalties to the Office of the Chief Scientist in Israel ("the OCI") at rates ranging between 2% and 5% of sales of products developed with the OCI's participation in research and development expenses up to the participation amount in dollars. The Company recorded a provision in its books to the extent that the grant will be repaid to the OCI in capitalized values.

NOTE 19:- PAYABLES FOR WORK IN PROGRESS, NET

Composition:

	December 31,	
	2013	**2012**
	U.S. dollars in millions	
Total payables for work in progress	**2,318**	2,000
Advances deducted from work in progress	**(433)**	(200)
Total	**1,885**	1,800

NOTE 20:- DEBENTURES

a. Composition:

	Linkage basis	S&P's Maalot rating	Interest rate at 31.12.13	Effective interest rate at 31.12.13	December 31, 2013 Total before current maturities	2013 Current maturities	2013 Total less current maturities	2012 Total less current maturities
					U.S. dollars in millions			
Debentures (series A)	Dollar linked	AA (stable)	1.28%	1.00%	**144**	**(144)**	**-**	-
Debentures (series B)	Unlinked	AA (stable)	4.95%	3.57%	**141**	**(94)**	**47**	90
Swap transaction in debentures (series B)					**(18)**	**12**	**(6)**	(8)
Debentures (series C)	Unlinked	AA (stable)	4.10%	3.59%	**346**	**-**	**346**	-
Swap transaction in debentures (series C)					**(41)**	**-**	**(41)**	-
Total					**572**	**(226)**	**346**	82

NOTE 20:- DEBENTURES (Cont.)

b. Additional information:

1. Debentures (series A):

On May 29, 2007, the Company issued to the public NIS 1,000,000,000 par value of debentures (series A) of the Company. The principal of the debentures (series A) is repayable in two equal annual installments on June 1 of each of the years 2013 and 2014. The interest on the debentures is repayable in semi-annual installments on June 1 and December 1 of each of the years 2007 through 2013 (inclusive) and on June 1, 2014.

The principal and interest on the debentures (series A) are linked to the U.S. dollar exchange rate at the base rate as follows: if the exchange rate equals or is lower than the base rate, the exchange rate will be the base rate with the base rate set as NIS 4.14 per US$ 1.

According to these terms, the debentures (series A) represent a hybrid instrument that consists of an embedded derivative (linked to the dollar at a minimum exchange rate of NIS 4.14 per US$ 1). The Company designated the hybrid contract as a financial liability at fair value through profit or loss. As of the financial statement date, the carrying amount of the debentures approximates $ 144 million, similarly to the amount payable by the Company in the future based on the U.S. dollar exchange rate as of the financial statement date. The total cumulative change in fair value from the date of issuance represents an increase in the liability by $ 23 million (in 2013, the change in fair value represented a decrease in the liability by approximately $ 1 million. By the end of 2012, the change in fair value represented an increase in the liability by approximately $ 24 million).

In October 2008, the Company's Board resolved to allow the Company's CEO and CFO to repurchase up to 20% of the debentures (series A) issued by the Company or through a subsidiary based on economic considerations. As of the financial statement date, no such repurchase has been performed.

2. Debentures (series B) in swap transaction:

On November 4, 2009, the Company issued to the public NIS 450,000,000 par value of debentures (series B). The debentures (series B) bear annual interest of 4.95% (principal and interest unlinked to any index or currency). The interest is calculated and payable in semi-annual installments on May 1 and November 1 of each calendar year from May 1, 2010 through May 1, 2017 (inclusive). The principal is payable in three equal consecutive installments on May 1 of each of the years 2015 through 2017 (inclusive).

NOTE 20:- DEBENTURES (Cont.)

b. Additional information (Cont.):

2. Debentures (series B) in swap transaction (Cont.):

The Company chose to record a fair value hedge on the exposure to the dollar and the NIS interest arising from the debenture terms. For the purpose of the hedge, the Company signed a cross currency swap contract with a bank in respect of cash receipts totaling NIS 450 million at fixed annual interest of 4.95%, unlinked, against payments of $ 119 million at variable interest of Libor plus a margin. The principal and interest cash swap dates are based on the dates set forth in the issuance of the debentures (series B).

The carrying amount of the debentures under the hedge is $ 123 million compared to $ 130 million representing the Company's liability to the holders of the debentures (based on the dollar exchange rate on the financial statement date).

3. Debentures (series C) in swap transaction:

On January 8, 2013, the Company issued to the public NIS 1,200,000,000 par value of debentures (series C). The debentures (series C) bear fixed annual interest of 4.1% (principal and interest unlinked to any index or currency). The interest is calculated and payable in semi-annual installments on January 1 and July 1 of each calendar year from July 1, 2013 through January 1, 2021 (inclusive). The principal is payable in four equal consecutive installments on January 1 of each of the years 2018 through 2021 (inclusive).

The Company chose to record a cash flow hedge on the exposure to the dollar and the NIS interest arising from the debenture terms. For the purpose of the hedge, the Company signed a cross currency swap contract with a bank in respect of cash receipts totaling NIS 1.2 billion at fixed annual interest of 4.1%, unlinked, against payments of $ 318 million at fixed interest of 3.1%. The principal and interest cash swap dates are based on the dates set forth in the issuance of the debentures (series C).

The carrying amount of the debentures under the hedge is $ 305 million compared to $ 346 million representing the Company's liability to the holders of the debentures (based on the dollar exchange rate on the financial statement date).

NOTE 21:- EMPLOYEE BENEFIT LIABILITIES, NET

a. Composition:

	December 31,	
	2013	**2012**
	U.S. dollars in millions	
Employee benefit liability, net (b)	**323**	306
Liability for employees under early retirement (h)	**27**	32
Total	**350**	338

b. Defined contribution plans:

In June 2006, the Company and its subsidiary and the workers' representatives signed a collective agreement that settles the issue of pension accruals in the Company and applies to all its employees ("the pension agreement").

The Company makes current contributions to various provident funds (including in Mivtachim The Workers Social Insurance Fund Ltd. ("Old Mivtachim" or Amitim"), in Menorah Mivtachim Pension and Insurance ("Menorah") and in other provident funds including in IAI's compensation fund) as required by applicable labor laws in order to guarantee its entire employees' legal pension rights.

Section 14 to the Severance Pay Law, 1963 ("Section 14") applies to employees who retire, including in the event of demise, and the Company's obligations in their respect are fully covered by the Company's current contributions to provident funds. The amounts deposited in the provident funds are subject to Section 14 and are not under the Company's control or management. Accordingly, the financial statements do not reflect such amounts or their respective liabilities.

In the event of termination only, according to the pension agreement, part of the Company's accruals will replace severance pay pursuant to Section 14 as follows:

1. With respect to employees who are insured under Old Mivtachim, the Company is obligated to pay full severance pay (100%) pursuant to the Severance Pay Law, 1963. Employees who are terminated are entitled to receive the amounts accrued in their respect based on the 6% and 2.33% contribution schemes and to 100$ severance pay at the least. If the amounts accrued based on the 6% and 2.33% contribution schemes are lower than the predetermined severance pay, the Company will complete the gap to 100%. If the amounts accrued as above exceed 100%, the Company may withdraw the difference only from the 2.33% contribution scheme. It should be noted that as a rule, the Company does not terminate employees under this scheme. Such employees terminate their work relations with the Company only when reaching retirement age or under an early retirement plan.

NOTE 21:- EMPLOYEE BENEFIT LIABILITIES, NET (Cont.)

b. Defined contribution plans (Cont.):

2. With respect to employees who are not covered by an old pension fund and are insured under New Mivtachim, they are partially subject to the provisions of Section 14 (72%). Accordingly, the Company has no obligation in respect of employees under this scheme who retire or are terminated (in excess of current contributions). As for the difference, such employees who are terminated are entitled to the higher of the amounts accrued in the 2.33% contribution scheme or supplementing the 28%.

3. All other employees are fully subject to the provisions of Section 14 and accordingly, in the event of termination, the Company has no obligation to such employees in excess of its current contributions.

The Company's obligations to supplement amounts payable to employees in the event of termination as explained in subparagraphs (1) and (2) above are accounted for as termination benefits.

c. Defined benefit plan and other long-term employee benefits:

1. Grants and benefits upon retirement:

According to labor agreements in the Company and in a subsidiary ("Elta"), employees who retire from the Group are entitled to the following benefits:

a) Employees who retire are entitled to an adjustment grant in the amount of one monthly salary and a grant for non-utilization of sick days of up to three monthly salaries. The Company recognizes this benefit liability based on an actuarial calculation.

b) Employees who retire due to disability are entitled to 40% of their salary for severance pay calculation multiplied by the number of years of seniority in addition to five monthly salaries. The Company recognizes this benefit liability based on an actuarial calculation.

c) The survivors of employees who have passed away are entitled to three monthly salaries. According to generally accepted accounting principles, the cost of this benefit is only recognized in the event of the demise of an employee during service.

NOTE 21:- EMPLOYEE BENEFIT LIABILITIES, NET (Cont.)

c. Defined benefit plan and other long-term employee benefits (Cont.):

2. Post-retirement liability for benefits to retired employees - holiday gift:

   The Company's retired employees receive a benefit in the form of holiday gifts. The Company's liabilities in respect of these costs are accrued over the employment term. The Company includes the liability in respect of expected costs in the post-employment period in its financial statements based on an actuarial calculation.

3. Liability for vacation pay:

   The long-term liability for vacation pay reflects the liability which the Company's management believes is intended to be redeemed upon employees' retirement on a LIFO basis. The outstanding liability in for vacation pay is included in current liabilities.

d. Actuarial assumptions:

The principal actuarial assumptions underlying defined benefit plans and other long-term benefit liabilities as of the financial statement date are as follows:

1. The mortality rates and disability rates are based on the rates published in the Ministry of Finance's insurance circular 2012-3-4.

2. The retirement age was calculated based on the Retirement Age Law at 67 years for both men and women.

3. A real salary increase rate of 2%.

4. The discount rate (excluding the liability for holiday gifts) is based on the yield on linked Government bonds during a similar period to the period of the liability. As of the financial statement date, the discount interest rate is 2.41%.

e. Analysis of sensitivity to principal actuarial assumptions:

	Change in actuarial assumption	Increase in assumption	Decrease in assumption
	%	U.S. dollars in millions	
Employee benefit liability	Unchanged	**323**	**323**
Discount rate	1%	300	348
Salary increase rate	1%	338	308

NOTE 21:- EMPLOYEE BENEFIT LIABILITIES, NET (Cont.)

f. Composition of employee benefit liabilities:

Movement in the present value of defined benefit obligation

	Sick benefit	Retirement benefit	Holiday gifts	Disability benefit	Passover gifts for retired employees	Provision for vacation	Total
	U.S. dollars in millions						
Balance at January 1, 2012	**71**	**38**	**22**	**36**	**20**	**96**	**283**
Current service cost	**3**	**1**	**-**	**2**	**-**	**5**	**11**
Interest cost	**4**	**1**	**1**	**2**	**-**	**-**	**8**
Total severance paid	**(3)**	**(1)**	**-**	**(3)**	**-**	**-**	**(7)**
Actuarial loss (gain)	**3**	**3**	**(2)**	**1**	**-**	**-**	**5**
Exchange rate differences	**2**	**1**	**-**	**1**	**-**	**2**	**6**
	80	**43**	**21**	**39**	**20**	**103**	**306**
Balance at January 1, 2013							
Current service cost	**4**	**(1)**	**1**	**2**	**7**	**6**	**19**
Interest cost	**3**	**1**	**1**	**2**	**1**	**5**	**13**
Total severance paid	**(5)**	**(2)**	**-**	**(2)**	**(3)**	**(6)**	**(18)**
Actuarial loss (gain)	**6**	**(3)**	**1**	**(19)**	**-**	**(5)**	**(20)**
Exchange rate differences	**6**	**3**	**2**	**2**	**2**	**8**	**23**
Balance at December 31, 2013	**94**	**41**	**26**	**24**	**27**	**111**	**323**

g. New salary agreement in the public sector:

In April 2011, a salary agreement was signed in the public sector according to which public sector employees will receive an overall salary increment of 7.25% over a period of four years from January 2009 through the end of December 2012. The salary increment will be paid on four dates: in the January 2011 salary - a 2.25% increment, in the January 2012 salary - additional increment up to a total 4.00% increment, in the January 2013 salary - additional increment up to a total 6.25% increment and in the July 2013 salary - additional increment up to a total 7.25% increment. The agreement includes several progressive components. Public sector employees to whom the agreement applies received in 2011 a non-recurring bonus of NIS 2,000 each, regardless of the salary bracket. In addition, the rate of pension accruals and deductions will be raised by 2% as follows: in January 2011 - 0.5% increase in deduction from the employee and 0.5% increase in employer's contribution and starting from January 2013 - another 0.5% increase in deduction from the employee and 0.5% increase in employer's contribution. Based on this agreement, the Company's management and workers' union signed an agreement for the realization of said provisions effective from 2011.

NOTE 21:- EMPLOYEE BENEFIT LIABILITIES, NET (Cont.)

h. Early retirement and termination benefits:

1. Liabilities for early retirement benefits

a) The Company recognizes expenses and liabilities in respect of early retirement when it incurs a significant obligation without real possibility of cancellation.

b) Employees who retire early are entitled to a monthly allowance until they reach the legal mandatory retirement age and are also entitled to other bonuses and rights.

c) The Group's liabilities for covering the costs of early retirement of employees before they reach the legal mandatory retirement age are included in the financial statements at present value (at a 0% discount rate linked to the CPI based on the yield on Government bonds for similar periods to the early pension periods).

d) The retiring employees are granted a guarantee by financial entities and banks for payment of the pension allowance until they reach retirement age. Through the date of the financial statements, total guarantees amount to approximately $ 118 million. As for the indemnification agreement with a financial entity, see Note 22a(5) below.

e) The amounts paid by the Company are updated based on Mivtachim's articles regarding update of ordinary pension upon payment of national salary increments at the full rate of the increase in the CPI in the relevant period. The interest and linkage difference added to the value of the early retirement liability are carried to profit and loss as incurred.

f) With respect to the retired employees who are entitled to the Company's participation in contribution fees, the participation is linked to the CPI for every single month. In the context of an agreement signed between the Company and Mivtachim, the Company has undertaken to pay Mivtachim management fees of 2% of early pension or allowance paid to each employee.

2. Reorganization plan

According to a multiannual plan adopted by the Company in stages, in 2013, 178 employees retired at a cost of approximately $ 38 million (in 2012 - 255 employees at a cost of approximately $ 51 million, in 2011 - 171 employees at a cost of approximately $ 45 million).

NOTE 21:- EMPLOYEE BENEFIT LIABILITIES, NET (Cont.)

h. Early retirement and termination benefits:

1. Composition:

	December 31,	
	2013	**2012**
	U.S. dollars in millions	
Liabilities for early retirement and pension pay (1)	**119**	129
Less - current maturities (2)	**(92)**	(97)
Total	**27**	32

(1) Includes a liability to Mivtachim in respect of pension pay to early retired employees, a liability for contribution fees to secure their rights until retirement age and a liability for paying management fees to Mivtachim.

(2) Current maturities are presented according to the Company's operating cycle, see Note 3a above.

2. Expected maturity dates of liabilities for early retirement and pension pay:

	December 31,	
	2013	**2012**
	U.S. dollars in millions	
First year	**41**	44
Second year	**30**	31
Third year	**21**	22
Total current maturities	**92**	97
Fourth year	**12**	14
Fifth year and thereafter	**15**	18
Total long-term liabilities	**27**	32
Total	**119**	129

NOTE 22:- CHARGES, GUARANTEES, CONTINGENT LIABILITIES AND COMMITMENTS

a. Contingent liabilities

1. The Company and s subsidiary, as any other entity which uses knowhow or equipment of the Ministry of Defense in the context of security exports, are committed to pay royalties to the MOD for such use. Accordingly, the Company and the subsidiary have entered into an indefinite agreement with the MOD according to which the companies pay royalties at a uniform rate of 1.1% on all receipts from security exports, net of certain expenditures, as detailed in the agreement. The royalties are calculated on the entire security exports (and its components), including exports whose manufacture did not use any of the MOD's knowhow or equipment, excluding exports which are defined in specific agreements and excluding exports whose customer or end user is the MOD. Under certain conditions and by mutual agreement, export transactions that use the MOD's knowhow or equipment will bear additional predetermined royalties at a specific percentage.

   In 2011, 2012 and 2013, the total royalties paid by the Company to the MOD in respect of the above agreement amounted to approximately $ 15 million, $ 20 million and $ 26 million, respectively.

2. The Company and a subsidiary have obligations for mutual purchase transactions totaling $ 1,086 million as of December 31, 2013. The mutual purchase obligation is in respect of predetermined projects and is carried until 2023. If the companies fail to meet this obligation, they are liable to face penalties ranging between 5% and 10%. As of the balance sheet date, the companies are in compliance with all their mutual purchase obligations and no material penalties have been imposed on them in respect thereof.

3. Compliance with financial covenants

   The Company has entered into financing, credit, bank service and guarantee agreements in its operating activities with several Israeli banks and financial entities as well as a deed of trust for debentures (series C) in the context of which the Company has undertaken to meet the following financial covenants:

NOTE 22:- CHARGES, GUARANTEES, CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)

a. Contingent liabilities (Cont.)

3. Compliance with financial covenants (Cont.)

Financial covenants	**Financial covenants towards banks and financial institutions** (a) The amount of the Company's tangible equity at the end of each quarter shall not be lower than $ 600 million as disclosed in its consolidated financial statements. Notwithstanding the aforesaid, tangible equity that is lower than $ 600 million but not lower than $ 550 million for a maximum period of four consecutive quarters will not be viewed as violation of this financial covenant; (b) The ratio of the Company's tangible equity to total adjusted balance sheet at the end of each quarter shall not be lower than 23% as disclosed in its (solo) stand-alone financial statements; (c) The Company's debt coverage ratio as disclosed in its consolidated financial statements and in the Company's and Elta's (solo) obligo reports at the end of each calendar year will not exceed 7.3; (d) The Company's consolidated debt service ratio at the end of each calendar year will not be lower than 5; (e) The Company's (solo) stand-alone debt service ratio at the end of each calendar year will not be lower than 3.5. **Financial covenants towards holders of debentures (series C)** (f) The ratio of the Company's tangible equity to total adjusted balance sheet at the end of each calendar quarter shall not be lower than 20% as disclosed in its (solo) stand-alone financial statements; (g) The ratio of the Company's net financial debt to its annual EBITDA at the end of each calendar quarter will not exceed 4 as disclosed in its consolidated financial statements.
The date of the lender's verification of the compliance with the financial covenants	Financial covenants (a), (b), (f) and (g) above - once a quarter; financial covenants (c)-(e) - once at the end of each calendar year.
The results of the calculation of financial covenants at December 31, 2013	(a) Tangible equity - $ 993 million. (b) and (f) - ratio of tangible equity to total adjusted balance sheet - 36%. (c) Debt coverage ratio - 5.0. (d) Consolidated debt service ratio - 6.0. (e) (Solo) debt service ratio - 4.1. (g) Financial debt to EBITDA ratio - (5.98).

NOTE 22:- CHARGES, GUARANTEES, CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)

a. Contingent liabilities (Cont.)

3. Compliance with financial covenants (Cont.)

Collateral	**Banks** An undertaking not to create charges without the banks' advance written consent, excluding charges to secure specific credit for financing the acquisition of a specific asset/project; not to sell or transfer (other than sales in the ordinary course of business) a material asset [1] of its assets and/or part thereof without the banks' advance written consent. **Holders of debentures (series C)** An undertaking not to create any charges on the assets owned by the Company and/or part thereof to secure any debts or liabilities in addition to the existing charges on the date of issuance of the debentures unless with the advance consent of the holders of the debentures by a special decision. Notwithstanding the aforesaid, the Company may record charges or conduct actions as agreed between the parties in the deed of trust of the debentures (series C), including: a charge in favor of the State of Israel; a charge for securing specific credit for the acquisition of a specific asset/company or for financing a project; a charge on deposits, cash, cash equivalents; and changes or amendments to existing charges.
Grounds for early repayment	**Banks and financial institutions** In any event where the Company fails to meet the financial covenants or violates any of its liabilities, each of the banks may demand the immediate repayment of all or part of the Company's debts and liabilities towards it and collect them with any additional amount that it believes will cover the losses and/or expenses incurred to the bank for placing the debt for immediate repayment. Moreover, in the occurrence of any of the following events, each of the banks may demand the immediate repayment of the Company's debts towards it: (i) the control of the Company is transferred to a third party in the context of the legal adoption of the privatization of the State's interests in the Company which results in a deviation by any of the banks from the limitations regarding a single borrower/a group of borrowers or any other related limitation; (ii) after the transfer of control as discussed in (i) above, any of the banks decides at its exclusive discretion that another change in control of the Company as opposed to the status on the date of transfer of control from the State (control as defined in the Securities Law) has taken place. **Holders of debentures (series C)** The debentures (series C) will be repayable immediately, among others if the series of debentures issued to the public by the Company is placed for immediate repayment; or if another debt assumed by the Company from any bank or financial institution (including Government institution) (excluding a non-recoverable debt) that exceeds $ 150 million is placed for immediate repayment.

[1] "**Material asset**" - a single asset whose value exceeds $ 150 million or several assets which cumulatively exceed $ 300 million in a single calendar year.

NOTE 22:- CHARGES, GUARANTEES, CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)

a. Contingent liabilities (Cont.)

3. Compliance with financial covenants (Cont.)

3.1 Definitions of terms relating to the financial covenants towards banks and financial institutions

"**Obligo report**" **-** report produced to the bank every quarter with details of bank guarantees issued at the Company's (solo) request and at Elta's (solo) request based on categories of bank advance guarantees to customers, other (non-advance) bank guarantees to customers, bank guarantees granted to retiring employees and other bank guarantees. If total bank guarantees of the subsidiaries held by the Company (except Elta) and/or by Elta which are not included in the obligo report exceed $ 50 million, these bank guarantees will also be included in the obligo report.

"**Tangible equity**" **-** equity attributable to equity holders of the parent (excluding non-controlling interests) as disclosed in the financial statements, including outstanding share capital, undistributed retained earnings and reserves and less intangible assets such as goodwill, patents, trademarks, trade names, copyright etc. (but excluding pre-manufacturing development stage intangible assets such as computer software and excluding goodwill created in the acquisition of a certain company) and less goodwill created from the fair value remeasurement of equity rights in an acquired investee prior to obtaining control. For the removal of doubt, the definition of equity does not include revaluation reserve in respect of property, plant and equipment created from the adoption of a revaluation model in the period succeeding the establishment of the financial covenants.

"**Interest expenses**" **-** the total arising from multiplying the total monetary debt (less total interest payable in respect of debentures) by annual interest of Libor + the weighted average rate of interest margins on long-term dollar loans and NIS loans (underlying a swap transaction) as disclosed in the Company's annual financial statements.

"**Debt service operating income**" (EBITDA) **-** the cumulative amount of earnings from operations according to the latest annual financial statements before finance expenses, finance income, taxes and with the addition of depreciation and amortization expenses in the period, employee retirement expenses and other expenses and less other income. For the removal of doubt, the definition and calculation of EBITDA will not include the items of revaluation gains/losses of investment property and capital gains/losses as detailed below.

NOTE 22:- CHARGES, GUARANTEES, CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)

a. Contingent liabilities (Cont.)

3. Compliance with financial covenants (Cont.)

3.1 Definitions of terms relating to the financial covenants towards banks and financial institutions (Cont.)

"**Critical investments in property, plant and equipment**" **-** the amount of accrued depreciation in the year ended on the balance sheet date in the item of computers, office furniture and equipment in the note on property, plant and equipment in the consolidated balance sheet or as disclosed in the Company's (solo) stand-alone balance sheet based on its liabilities.

"**Debt coverage ratio**" **-** the result of dividing total debts and liabilities (les cash) by the debt service operating income (EBITDA).

"**Debt service ratio**" **-** the result of dividing the debt service operating income (EBITDA) by the amount of interest expenses, bank commissions and critical investments in property, plant and equipment.

"**Consolidated debt service ratio**" **-** debt service ratio whose components are defined or calculated according to the Company's consolidated financial statements and the Company's and Elta's (solo) stand-alone obligo reports.

"**The Company's (solo) stand-alone debt service ratio**" **-** debt service ratio whose components are defined or calculated according to the Company's (solo) stand-alone financial statements and the Company's (solo) stand-alone obligo report.

"**Libor**" **-** six-month Libor interest as of December 31 of each calendar year.

"**Adjusted balance sheet**" **-** balance sheet less the lower of total cash or total payables for work in progress.

"**Cash**" **-** the overall amount of balance sheet items as detailed below: cash and cash equivalents, short-term financial assets and available-for-sale securities in current assets as disclosed in the Company's financial statements and amounts pledged in favor of financial corporation for securing the Company's liabilities thereto in respect of a guarantee issued by said financial corporation at the Company's request and are included in different balance sheet items than those specified above.

NOTE 22:- CHARGES, GUARANTEES, CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)

a. Contingent liabilities (Cont.)

3. Compliance with financial covenants (Cont.)

3.1 Definitions of terms relating to the financial covenants towards banks and financial institutions (Cont.)

"**Total financial debt**" - the cumulative amount of the following balance sheet items: short-term credit, current maturities of long-term liabilities, long-term loans, debentures, current maturities of debentures and interest payable on debentures.

"**Total debts and liabilities**" - the cumulative amount of total financial debt with the addition of the balance of bank advance guarantees granted to customers (100%), with the addition of 50% of the balance of other (non-advance) bank guarantees granted to customers, with the addition of the balance of bank guarantees granted to the Company's and Elta's retired employees (100%) and with the addition of other bank guarantees (100%) as featured in the obligo report.

"**Bank commissions**" - the total arising from multiplying the total balance of bank guarantees granted to various customers (with the addition of bank guarantees granted to the Company's and Elta's employees who retired early and with the addition of the balance of other bank guarantees all as disclosed in the obligo report) with an annual commission of 0.3%.

3.2 Definitions of terms relating to the financial covenants towards holders of debentures (series C)

"**Financial statements**" - the Company's consolidated or (solo) stand-alone annual and interim financial statements, as applicable, issued by it in conformity with generally accepted accounting principles that consist, among others, of a balance sheet, statement of profit and loss, statement of cash flows, statement of changes in equity and any other statement or note as required according to accounting principles and/or the qualified authorities.

NOTE 22:- CHARGES, GUARANTEES, CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)

a. Contingent liabilities (Cont.)

3. Compliance with financial covenants (Cont.)

3.2 Definitions of terms relating to the financial covenants towards holders of debentures (series C) (Cont.)

"**Tangible equity**" - equity attributable to equity holders of the Company (excluding non-controlling interests) as disclosed in the financial statements, including outstanding share capital, undistributed retained earnings and reserves and less intangible assets such as goodwill, patents, trademarks, trade names, copyright etc. (but excluding pre-manufacturing development stage intangible assets such as computer software and excluding goodwill created in the acquisition of a certain company) and less goodwill created from the fair value remeasurement of equity rights in an acquired investee prior to obtaining control. For the removal of doubt, the definition of equity does not include revaluation reserve in respect of property, plant and equipment created from the adoption of a revaluation model.

"**Adjusted balance sheet**" **-** balance sheet less the lower of total cash or total payables for work in progress.

"**Cash**" **-** the overall amount of balance sheet items as detailed below: cash and cash equivalents, short-term financial assets and available-for-sale securities in current assets as disclosed in the Company's financial statements and amounts pledged in favor of financial corporation for securing the Company's liabilities thereto in respect of a guarantee issued by said financial corporation at the Company's request and are included in different balance sheet items than those specified above.

"**Balance sheet**" and "**payables for work in progress**" - as defined and stated in the financial statements.

"**The Company's net financial debt**" **-** the cumulative amount of the following balance sheet items: short-term credit from banks and other credit providers, debentures and long-term loans from banks and other credit providers less cash, all as disclosed in the Company's consolidated financial statements for the end of the relevant period.

NOTE 22:- CHARGES, GUARANTEES, CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)

a. Contingent liabilities (Cont.)

3. Compliance with financial covenants (Cont.)

3.2 Definitions of terms relating to the financial covenants towards holders of debentures (series C) (Cont.)

"**Annual EBITDA**" - relating to the period of 12 months preceding the date of the Company's latest financial statements - the cumulative amount of operating income before finance expenses, finance income and taxes with the addition of depreciation and amortization expenses in the period, with the addition of employee retirement expenses, with the addition of other expenses and less other income.

4. The engagements in the agreements for which the abovementioned financial covenants have been undertaken do not result in a change in the Company's credit scopes in said banks. The Company's overall obligo scope (mainly guarantees) in said banks as of the report date approximates $ 3,150 million.

5. The Company has signed indemnification agreements with two Israeli insurance companies ("**the insurance companies**") in which the insurance companies undertook that, subject to the provisions of the agreements, they will provide guarantees in various amounts from time to time to secure the repayment of amounts payable to the Company's employees for monthly pension allowances based on the retirement plan adopted by the Company. In one insurance company, the Company utilized the credit facility in full and it has not been renewed since December 31, 2012. This company will not continue to issue new guarantees. The other insurance company has undertaken to provide guarantees whereby the linked balance of the entire guarantees shall not exceed a total of NIS 205 million ($ 55 million). According to the indemnification agreements, the Company has undertaken to indemnify the insurance companies, subject to the provisions of the agreement, in respect of any payment, damage and expense incurred to them due to or in connection with guarantees issued by them as discussed above. The Company has undertaken towards the insurance companies that on December 31 of each calendar year during the period of the agreement, it will comply with the financial covenants to financial entities as detailed in paragraph 3 above and will not create any charge on its assets (excluding a fixed charge to secure specific credit for financing the acquisition of a certain asset or for financing a certain project) and will not transfer them not in the ordinary course of business without the insurance companies' advance written consent. As of the report date, the balance of guarantees provided by the insurance companies based on the indemnification agreements as above total approximately $ 77 million. In addition, bank guarantees were provided by a local bank in favor of additional employees who retired early to secure payments to such employees. The balance of bank guarantees provided by the local bank as of the report date approximates $ 41 million.

NOTE 22:- CHARGES, GUARANTEES, CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)

a. Contingent liabilities (Cont.)

6. Pursuant to the Law for the Encouragement of Capital Investments, 1959, a subsidiary received Government grants for investments in property, plant and equipment made in the context of the enterprise expansion program approved by the Investment Center and certain tax benefits. The receipt of such grants and tax benefits is contingent on complying with the terms of the letter of approval. If the subsidiary fails to meets such terms it will be required to repay the grants and benefits with the addition of arrears interest from the date of receipt. The subsidiary's management believes that the subsidiary is complying with the terms of the letter of approval.

7. The Company does not pay lease fees for certain real estate properties provided for its disposal by the Israel Land Administration and the MOD. The Company's management estimates that the annual lease fees are immaterial and should the Company be required to pay lease fee for said properties, the scope of exposure for these fees will be immaterial.

8. In April 2010, a motion was filed with the District Court by a group of minority shareholders in ISI (then an associate of the Company) for approval of a class action on behalf of ISI against the Company and Elbit Electro-Optical El-Op Systems Ltd. ("El-Op"), then shareholders in ISI, and against several directors in ISI which had been appointed on behalf of the Company and El-Op. On July 18, 2010, the Company filed a motion for dismissal of the motion for approval in limine. In May 2011, the Court rendered its verdict whereby it accepted the motion for dismissal and ordered the dismissal of the motion for approval. On June 29, 2011, the plaintiffs appealed the District Court's verdict to dismiss the motion for approval of a class action in limine to the Supreme Court. In September 2013, ISI, the Company, Elbit and El-Op signed a settlement with the minority shareholders in ISI whereby the minority shareholders waive all existing and future claims and arguments, including the motion for approval of a class action as above. In the settlement, ISI paid the minority shareholders approximately $ 7.8 million and agreed to pay an additional variable future amount that is contingent on ISI's new engagements with certain customers. See also Note 12b above.

NOTE 22:- CHARGES, GUARANTEES, CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)

a. Contingent liabilities (Cont.)

9. In April 2007, the special administrator of the regulated pension funds that include Mivtachim applied to the Company in a letter and asked it to return to Mivtachim the management fees that had been deducted by the Company from the contribution fees delivered to Mivtachim on behalf of the Company's employees. The Company was also requested in the letter to deliver to Mivtachim all the funds deposited in the management fee account/s and produce details of the management fee account movements as they had been over the years from the date of the initial agreement signed between the Company and Mivtachim on July 15, 1969, including amounts that had been offset and details of certain expenses and amounts expensed for the purpose of the wellbeing of the Company's employees as well as a current update. According to the letter, Mivtachim's calculation reveals that the current balance in the management fee fund is NIS 30 million. The Company estimates that the only impact, if any, of this will be on its cash flows. In October 2007, Mivtachim filed a claim against the Company, the New General Federation of Laborers in Israel and the National Association of Israel Aerospace Industries Employees Ltd. regarding their duty to account. Mivtachim seeks a duty to account remedy including accounts of the amounts offset by the Company from the effective date of the management fee agreement. Following a hearing held in February 2008, Mivtachim was asked to inform the Labor Court whether it wishes to amend the letter of claim in view of arguments of unclarity.

10. In the second half of 2006, the legal authorities in the country of a material customer launched an investigation of several former senior government officials in that country regarding alleged offenses of providing payments or benefits in connection with the approval of arms purchase transactions from various countries, including a transaction for the purchase of an arms system from the Company that had been signed in 2000. The transaction was not signed before the customer had finalized a long and painstaking process of verification in which the Company's arms system beat competing systems. The Company denies any association or knowledge in connection with the offenses under investigation. In the majority of the Company's engagements with said material client in recent years, a standard format was included as determined by the customer in all its engagements with combat system suppliers. According to the standard format, the Company affirmed and represented to the customer, similarly to all of the customer's combat system suppliers, that it had not hired any entity for promoting or recommending the engagement with the Company at the customer's government or among the customer's officers and that it had not paid or undertaken to pay or provide a benefit to such factor in order to promote or recommend the engagement with the Company at the customer's government or among the customer's officers.

NOTE 22:- CHARGES, GUARANTEES, CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)

a. Contingent liabilities (Cont.)

10. (Cont.)

The standard format imposed by the customer in all its engagements as well as in the engagement with the Company states that if it is proven to the customer's satisfaction that a supplier has violated its undertakings as above, that supplier will pay the customer the entire amount paid to the government factor in connection with the engagement. Moreover, the supplier will not be allowed to enter into any engagement with the customer for a period of five years and the customer will have the right to consider the cancellation of the relevant engagement without entitling the supplier to any compensation and even require the supplier to return all the amounts received in the context of the relevant engagement plus interest and/or the customer will have the right to cancel its other engagements with this supplier and be granted the relevant remedies. Any violation of the undertakings in the standard format by the supplier exposes the supplier to the customer's predetermined sanctions as described therein.

In the event of violation of the provisions in the standard format by the Company or anyone on its behalf as a result of which the customer decides to exercise its rights pursuant thereto, the Company is likely to sustain critical damage to its business activities and financial results. If the customer decides to demand recovery of amounts in respect of all the projects in progress that have not yet been delivered to it and is granted such recovery, which the Company believes is unlikely to happen, the theoretical amount of reversing all the earnings (after tax) that had been recognized in the past could reach approximately $ 60 million as of the date of the approval of the financial statements. As stated above, the Company denies any association or knowledge in connection with the offenses under investigation. The Company estimates that the chances of the material customer will exercise its rights as discussed above are low and therefore no provision was recorded in respect of the claim in the financial statements.

To the best of the Company's knowledge (based on public reports issued through the media), in December 2013, the police force in the material customer's country of residence recommended that the investigation case be closed.

11. As for Boeing's demand in connection with the manufacture of subassemblies, see Note 10b(2) above.

NOTE 22:- CHARGES, GUARANTEES, CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)

a. Contingent liabilities (Cont.)

12. Following the non-renewal of export licenses by the Government of Israel in 2011, a subsidiary of the Company was forced to discontinue a system supply project for a foreign customer.

    The Group's management estimates that the non-renewal of the export licenses will result in failure to complete the project with the foreign customer. Accordingly, the Company reversed the revenues that had been recorded in the past in a total of $ 37 million and the gross costs accumulated in the project in a total of $ 27 million in the statement of comprehensive income for 2011. The costs accumulated in the project in a total of $ 27 million represent the costs incurred to the Company from the manufacture of the inventory of products in the project which has not yet been delivered to the foreign customer and which the Company estimates it is more likely than not that it will be able to sell to another customer. The Company estimates that the carrying amount of this inventory is lower than its net realizable value.

    In 2012, guarantees that had been provided by the Company to the foreign customer in connection with the cancelled project were forfeited. Moreover, the subsidiary had provided the foreign customer an additional guarantee of approximately $ 3 million. Based on legal opinion, the Group's management believes that it is more likely than not that this additional guarantee will not be forfeited. In addition, based on the Company's legal counsel, management anticipates that it is more likely than not that the customer does not have the right to claim additional funds for the project's discontinuance and that if a claim is nevertheless filed against the Company for the project's discontinuance, it is more likely than not that the claim will be denied. Consequently, as of the financial statement date, the Company did not record any provision in respect of the additional guarantee and/or said claims.

b. Commitments

1. Operating lease of vehicles:

    The Company has entered into operating lease agreements of vehicles totaling approximately $ 20 million per annum for a period of three years until 2015 with an option for extension until 2016.

2. As for engagements for the purchase of property, plant and equipment, see Note 13e(2) above.

NOTE 22:- CHARGES, GUARANTEES, CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)

c. Guarantees provided

As of December 31, 2013, the Company has provided guarantees totaling approximately $ 2,748 million consisting mostly of bank guarantees granted to customers in the ordinary course of business.

d. Collaterals and charges

1. To secure a subsidiary's compliance with the terms of the letter of approval received from the Investment Center in the context of the Law for the Encouragement of Capital Investments, 1959 (see note on property, plant and equipment), a floating unlimited charge has been recorded on the subsidiary's fixed and current assets in favor of the State of Israel.

2. The Company has undertaken towards various lenders not to create additional charges (negative charges) on its property and assets without obtaining advance written consent, except in certain predetermined cases.

NOTE 23:- FINANCIAL INSTRUMENTS

a. Determination of fair value of financial instruments:

Cash and cash equivalents Short-term trade and other receivables Short-term trade and other payables	Due to their nature, fair value approximates the carrying amount
Traded assets and liabilities	Based on quoted market price in an active market on the report date
Derivative financial instruments	When derivatives are not traded in an active market, fair value is measured using a model that takes into consideration inputs such as market risks, credit risks etc.

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

b. Fair value hierarchy:

1. The Company classifies the measurement of its financial instruments using the fair value hierarchy which reflects the nature of the inputs used in the measurement as follows:

   Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities.

   Level 2 - inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly (as prices) or indirectly (as derived from prices).

   Level 3 - inputs that are not based on observable market data (valuation techniques which use inputs that are not based on observable market data).

2. Inputs of fair value hierarchy of financial instruments measured at fair value and recognized in the statement of financial position:

	December 31, 2013		
	Level 1	**Level 2**	**Total**
	U.S. dollars in millions		
Financial assets:			
Financial assets at fair value through profit and loss:			
Marketable debentures	434	-	434
Derivatives held for trading and not designated as hedging instruments	-	1	1
Derivatives held for trading and designated as hedging instruments	-	37	37
Shares	-	-	-
Mutual funds	283	-	283
Other financial assets	381	-	381
Available-for-sale financial assets:			
Debentures	47	-	47
	1,145	**38**	**1,183**

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

b. Fair value hierarchy (Cont.):

2. Inputs of fair value hierarchy of financial instruments measured at fair value and recognized in the statement of financial position (Cont.):

	December 31, 2013		
	Level 1	Level 2	Total
	U.S. dollars in millions		
Financial liabilities:			
Financial assets at fair value through profit and loss or capital reserve:			
Derivatives held for trading and designated as hedging instruments	-	5	5
Liabilities in respect of debentures	144	-	144
Swaps *	-	(58)	(58)
	144	**(53)**	**91**

* Swaps - transactions to hedge debentures (series B and C), see information in Note 20 above.

	December 31, 2012		
	Level 1	Level 2	Total
	U.S. dollars in millions		
Financial assets:			
Financial assets at fair value through profit and loss:			
Marketable debentures	397	-	397
Derivatives held for trading and not designated as hedging instruments	-	4	4
Derivatives held for trading and designated as hedging instruments	-	47	47
Shares	1	-	1
Mutual funds	184	-	184
Other financial assets	151	-	151
Available-for-sale financial assets:			
Debentures	40	-	40
	773	**51**	**824**

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

b. Fair value hierarchy (Cont.):

2. Inputs of fair value hierarchy of financial instruments measured at fair value and recognized in the statement of financial position (Cont.):

	December 31, 2012		
	Level 1	Level 2	Total
	U.S. dollars in millions		
Financial liabilities:			
Financial assets at fair value through profit and loss or capital reserve:			
Derivatives held for trading and designated as hedging instruments	-	5	5
Liabilities in respect of debentures	266	-	266
Swaps *	-	(9)	(9)
	266	**(4)**	**262**

* Swaps - transactions to hedge debentures (series B and C), see information in Note 20 above.

3. Data of the fair value of financial liabilities whose carrying amount does not approximate their fair value:

	December 31, 2013	
	Fair value, Level 1	Carrying amount
	NIS in thousands	
Financial liabilities:		
Marketable debentures (series B)	140	141
Marketable debentures (series C)	362	346

c. Financial risk management policy:

The Group's activities expose it to various financial risks such as currency risk, interest risk (both fair value and cash flow risks relating to changes in interest rates), price risk and credit risk. The Group's comprehensive risk management policy focuses on activities that reduce to a minimum any possible adverse effects on the Group's financial performance. Among others, the Group utilizes derivative financial instruments in order to hedge certain exposures to risks.

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

c. Financial risk management policy (Cont.):

The officers in charge of financial risk management in the Company

Risk management is conducted by the finance organization under the supervision of the CFO. The finance organization identifies, assesses and defines financial risks in collaboration with the Group's operating units.

The Group's Board has established a policy and procedures for using financial instruments in order to protect the Group against fluctuations in foreign currency exchange rates and secure the Group's cash flow. The use of financial instruments is only allowed through banks and stock exchanges.

1. Exchange rate risk

The Group has currency exposure that arises mainly from engagements in currencies other than the U.S. dollar or from excess non-dollar or dollar-linked assets or liabilities since the Group's functional currency is the dollar.

A change in the dollar exchange rate in relation to the NIS is liable to affect operating results given that although the majority of revenues are generated in foreign currency (mainly in dollars), some of the expenses (mainly salary expenses) are incurred in NIS. The Group hedges the exposure to the dollar-NIS exchange rate by holding certain cash equivalents and short-term investments in nominal or CPI-linked NIS or using futures or dollar put/call options.

The exchange rates of the various currencies in relation to the dollar are also liable to affect operating results if material currency exposure is created due to engagements in foreign currency other than the dollar. The exposure to non-dollar foreign currencies has been defined as follows: up to $ 150 thousand - no hedge; up to $ 1 million - internal hedge (internal hedge: the Group's offset of the exposure underlying an engagement against the exposure in respect of liabilities provided that the offset is carried out in the same exposure currency that is not the dollar); amounts in excess of $ 1 million up to $ 5 million - external or internal hedge at the discretion of the VP of Finance and Treasury (external hedge: through financial institutions); amounts in excess of $ 5 million - - external or internal hedge at the CFO's discretion. The hedges are designed both for put and call options. The Company has also decided to conduct exchange rate hedging transactions in respect of part of its future salary payments. At its discretion, the Group conducts future transactions for hedging foreign currency exchange rates against the dollar and/or uses options.

As of December 31, 2013, the Group has currency hedges ranging between NIS 3.46 and NIS 3.90.

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

c. Financial risk management policy (Cont.):

1. Exchange rate risk (Cont.)

The Group attaches considerable significance to reducing exchange rate risk. This issue is internally discussed by the finance organization once a week headed by the VP of Finance and Treasury, once a month headed by the CFO and once a quarter headed by the Group's Board in the context of discussing the financial statements.

As of the report date, the Group has excess NIS liabilities (linked and unlinked) totaling approximately $ 125 million which are exposed to fluctuations in the NIS-dollar exchange rate.

Sensitivity to changes in dollar/NIS exchange rate

	Effect on income before tax		Fair value	Effect on income before tax	
	10%	5%	3.471	-5%	-10%
	U.S. dollars in millions				
Forward transactions and accounting seller's options	(55.45)	(31.68)	31.70	45.71	98.96
Forward transactions and accounting non-seller's options	(1.42)	(0.81)	0.80	1.17	2.54
CPI-linked corporate debentures	(1.13)	(0.59)	12.39	0.65	1.38
Unlinked NIS corporate debentures	(0.24)	(0.13)	2.67	0.14	0.30
CPI-linked Government bonds	(7.77)	(4.07)	85.50	4.50	9.50
Unlinked Government bonds	(9.01)	(4.72)	99.21	5.22	11.01
Unlinked Government bonds at variable interest	(0.36)	(0.19)	3.91	0.21	0.44
NIS corporate debentures at variable interest	(0.05)	(0.03)	0.54	0.28	0.59
NIS debenture principal	(25.31)	(13.26)	278.46	14.66	30.94
NIS short-term deposits at fixed interest	(8.13)	(14.26)	89.43	4.71	9.94
Debentures (series A)	10.94	5.76	(144.37)	(6.37)	(13.45)
Debentures (series B) *	12.73	6.67	(140.04)	(7.37)	(15.56)
Debentures (series C) *	32.91	17.24	(362.04)	(19.05)	(40.23)
Accounting hedge swaps	(47.43)	(24.84)	57.87	27.46	57.96
Firm commitment - suppliers	109.49	57.35	(1,204.44)	(63.39)	(133.83)
Firm commitment - customers	(1,007.00)	(503.50)	10,003.00	503.50	1,007.00
CPI-linked NIS loans	0.18	0.10	(2.02)	(0.11)	(0.22)
Total	**(996.95)**	**(510.91)**	**8,816.04**	**511.92**	**1,027.27**

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

c. Financial risk management policy (Cont.):

2. Price risk

The Group has exposure to risks arising from changes in quoted market prices of securities held by it. As of December 31, 2013, the Group has a securities portfolio that is mainly comprised of investment in debentures.

3. Interest rate risk

The Group's interest rate risk arises from debentures issued by the Company and loans received by it. Financial liabilities that bear variable interest rates expose the Group to interest rate risk in respect of cash flows whereas financial liabilities that bear fixed interest rates expose the Group to interest rate risk in respect of fair value. The Group's policy is to manage the finance costs attributable to interest by using a mix between variable interest and fixed interest on the Group's long-term loans.

In addition, the Group is exposed to interest rate risk in respect of short-term and long-term financial investments that bear variable and fixed interest rates and is consequently also exposed to changes in market interest rates.

Most of the Group's monetary balances are invested for the short term or bear variable interest and consequently, the Group is able to minimize interest rate risk in respect of cash flows.

Following is an analysis of the effect of changes in interest rates on the reporting date on equity and profit or loss (assuming that all other variables, particularly foreign currency exchange rates, remain constant):

Analysis of sensitivity to changes in dollar interest

	Effect on income before tax		**Fair value**	**Effect on income before tax**	
	10%	**5%**	**3.471**	**-5%**	**-10%**
	U.S. dollars in millions				
Dollar corporate debentures	(1.06)	(0.53)	128.99	0.53	1.06
Dollar Government bonds	(0.60)	(0.30)	99.60	0.30	0.60
Available-for-sale securities	(0.29)	(0.15)	47.00	0.15	0.29
Accounting hedge swaps	3.33	1.67	57.87	(1.68)	(3.38)
Debentures (series A)	0.00	0.00	(144.37)	0.00	0.00
Total	**1.38**	**0.69**	**189.09**	**(0.70)**	**(1.43)**

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

c. Financial risk management policy (Cont.):

3. Interest rate risk (Cont.)

The table below presents the carrying amount of groups of financial instruments that are exposed to fair value and/or cash flow risk in respect of interest rate based on the earlier of contractual maturity dates or dates of redetermination of prices:

December 31, 2013

Financial assets								
Cash and cash equivalents (*)	4	774	-	-	-	-	-	37
Dollar loans granted (*)	11	2	2	3	3	3	24	5
Notes receivable	11	2	2	1	-	-	-	202
Designated and restricted deposits	5	19	-	183	-	-	-	132
Dollar corporate debentures	5	8	19	48	43	14	-	14
NIS corporate debentures	5	2	3	3	6	-	-	227
Dollar Government bonds	5	24	37	50	38	34	44	61
NIS Government bonds	5	8	11	20	17	5	-	-
Financial liabilities								
Long-term loans:								
Linked NIS loan (*)	15	2	-	-	-	-	-	1,454
		841	**74**	**308**	**107**	**56**	**68**	**2,132**

(*) These assets/liabilities bear fixed interest.

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

c. Financial risk management policy (Cont.):

3. Interest rate risk (Cont.)

Analysis of sensitivity of cash flows to changes in dollar interest on issued debentures (series A)

	1%	0.5%	3.471	(0.5%)	(1%)
	U.S. dollars in millions				
Issued debentures (series A)	(0.53)	(0.27)	(144.37)	0.19	0.15

Analysis of sensitivity of cash flows to changes in NIS interest on issued debentures (series B)

	1%	0.5%	3.471	(0.5%)	(1%)
	U.S. dollars in millions				
Issued debentures (series B) *	3.00	1.51	(140.04)	(1.54)	(3.11)
Swaps	2.25	1.14	8.10	(1.22)	(2.58)

The Company issued debentures (series B) in an amount of NIS 450 million which represent a hedged exposure. The Company conducted a cash flow swap transaction totaling NIS 450 million at fixed NIS interest of 4.95%, unlinked, against cash flow of $ 124 million at variable interest of Libor plus a margin, representing a hedging item for the exposure of debentures (series B).

	Par value		Fair value	
	Long	Short	Long	Short
	U.S. dollars in millions			
Accounting hedge swap	-	124	-	8

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

c. Financial risk management policy (Cont.):

3. Interest rate risk (Cont.)

Analysis of sensitivity of cash flows to changes in NIS interest on debentures (series C)

	1%	0.5%	3.471	(0.5%)	(1%)
	U.S. dollars in millions				
Issued debentures (series C) *	16.43	8.34	(362.04)	(8.61)	(17.49)
Swap	13.79	7.00	49.77	(7.49)	(15.85)

The Company issued debentures (series C) in an amount of NIS 1,200 million which represent a hedged exposure. The Company conducted a cash flow swap transaction totaling NIS 1,200 million at fixed NIS interest of 4.1%, unlinked, against cash flow of $ 318 million at fixed interest of 3.1%, representing a hedging item for the exposure of debentures (series C).

	Par value		Fair value	
	Long	Short	Long	Short
	U.S. dollars in millions			
Accounting hedge swap	-	317	-	50

d. Credit risk:

1. Cash and short-term investments

The Group holds cash and cash equivalents and short-term deposits in Israeli banks which are financial institutions with high credit ratings.

2. Customers

The Group mainly performs military and civilian product development and manufacturing projects for various customers, some of which leading local aviation companies and aircraft manufacturers and some of which government offices of various countries around the world which finance the transactions through government budgets. Some of the foreign customers' debts are secured by credit insurance. The Group performs ongoing customer credit evaluations while examining the customers' financial condition. The Group records an allowance for doubtful accounts specifically for debts whose collection is doubtful according to the Company's management. The Company provides the Board periodic reports of the status of customer debts and the allowance for doubtful accounts. The Company has foreign trade insurance to cover several projects.

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

d. Credit risk (Cont.):

2. Customers (Cont.)

Table of aging of customer debts

	Customer debt in the Company's credit facility	Debt in arrears of up to 60 days from maturity date	Debt in arrears of 61-120 days from maturity date	Debt in arrears of over 120 days from maturity date	Total
	U.S. dollars in millions				
Balance at December 31, 2013	306	80	31	65	482
Less - allowance for doubtful accounts	-	-	-	(5)	(5)
Net balance	306	80	31	60	477

Until March 15, 2014, an amount of $ 354 million was collected. The Company believes that the outstanding debt will be collected and that no allowance is needed for doubtful accounts.

Table of aging of principal customer debts

	Customer debt in the Company's credit facility	Debt in arrears of up to 60 days from maturity date	Debt in arrears of 61-120 days from maturity date	Debt in arrears of over 120 days from maturity date	Total
	U.S. dollars in millions				
Customer A	11	4	15	7	37
Customer B	(1)	9	(1)	1	8
Customer C	28	6	1	3	38
Interested parties	16	3	1	3	23
Total	**54**	**22**	**16**	**14**	**106**

3. Investment in debentures

The Group maintains low exposure to credit risk in connection with its investments in corporate debentures and Government bonds by investing in debentures and bonds rated between A and AAA (according to S&P Maalot) in keeping with the Board's policy. The Company's VP of Finance and Treasury approves investment decisions and receives a monthly analysis report of held debentures. If the credit rating of a certain debenture series drops below A, the Group sells the debentures as soon as possible. Exceptional cases of purchasing debentures not based on said rating must be approved by the Group's CFO.

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

d. Credit risk (Cont.):

3. Investment in debentures (Cont.)

Maximum exposure in respect of credit risk

	Carrying amount	
	2013	2012
	U.S. dollars in millions	
Cash and cash equivalents	**774**	505
Financial assets:		
Deposits	**381**	151
Forward contracts	**38**	51
Investments in corporate debentures and Government bonds:		
Rated AAA	**251**	209
Rated AA+	**38**	27
Rated AA	**27**	36
Rated AA-	**60**	33
Rated A+	**32**	47
Rated A	**26**	45
Rated A-	-	-
Rated BBB+	-	-
Rated BBB	-	-
Shares	-	1
Reserves	**283**	184
Total investments	**717**	582
Total financial assets	**1,136**	784
Total available-for-sale securities	**47**	40
Trade and other receivables	**677**	739
Total maximum exposure in respect of credit	**2,634**	2,068

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

e. Liquidity risk:

1. Liquidity risk arises from the Group's working capital management and from finance expense and repayment of principal on the Group's debt instruments. Liquidity risk consists of the risk that the Group will have difficulties in meeting obligations relating to financial liabilities.

   The Group's policy is to secure that the cash held by the Group will always suffice for repaying its liabilities when they mature. For this purpose, the Group strives to hold cash balances (or adequate credit lines) that will allow it to meet expected undertakings for a period of at least 90 days. In addition, the Group acts to minimize the liquidity risk by fixing the interest rates (and accordingly the cash flows) on long-term loans.

   The Company's Board decided that the cash balances (including deposits and investments in short-term securities) at any given time will not be lower than at least $ 800 million. As of the date of the financial statements, it is likely that the Group has sufficient liquid sources for meeting all its liabilities.

2. Compliance with financial covenants

   See Note 22a(3) above.

3. Financial liabilities

   The financial liabilities are included in the balance sheet under the following items:

	Note	December 31, 2013	December 31, 2012
		U.S. dollars in millions	
Current liabilities:			
Credit from banks and other credit providers	15	254	323
Other financial liabilities	23	5	1
Trade payables	16	510	419
Other accounts payable	17	532	480
		1,301	1,223
Non-current liabilities:			
Debentures	20	346	82
Liabilities to banks and other credit providers	15	-	-
Other long-term financial liabilities	21	350	338
		696	420

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

e. Liquidity risk (Cont.):

3. Financial liabilities (Cont.)

Following is the analysis of contractual maturity dates of financial assets and liabilities based on the relevant interest rates and exchange rates:

December 31, 2013

	Within 30 days	1-12 months	1-3 years	3-5 years	Over 5 years	Total
	U.S. dollars in millions					
Non-derivative						
Short-term loans from banks	-	-	-	-	-	-
Trade payables	-	510	-	-	-	510
Other accounts payable	262	166	104	-	-	532
Provisions	-	-	102	-	-	102
Non-convertible debentures	-	42	191	157	44	434
Loans from others	-	2	-	-	-	2
Derivatives						
Forward contracts on exchange rates that do not qualify as hedges	-	1	-	-	-	1
Total	**262**	**721**	**397**	**157**	**44**	**1,581**

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

e. Liquidity risk (Cont.):

3. Financial liabilities (Cont.)

December 31, 2012

	Within 30 days	1-12 months	1-3 years	3-5 years	Over 5 years	Total
	U.S. dollars in millions					
Non-derivative						
Short-term loans from banks	-	-	-	-	-	-
Trade payables	-	422	-	-	-	422
Other accounts payable	245	149	89	-	-	483
Provisions	-	-	73	-	-	73
Non-convertible debentures	-	15	167	189	26	397
Loans from others	-	2	2	-	-	4
Derivatives						
Forward contracts on exchange rates that do not qualify as hedges	-	4	-	-	-	4
Total	245	592	331	189	26	1,383

f. Hedges not recognized for accounting purposes:

Engagements in dollar/NIS options that are not recognized for accounting purposes:

Purchased put options in foreign currency:

Sale of $ 10 million in consideration of NIS 36 million.

Written call options in foreign currency:

Purchase of $ 10 million in consideration of NIS 38 million.

	Par value		Fair value	
	Long	Short	Long	Short
	U.S. dollars in millions			
Call options not recognized as hedges for accounting purposes	-	10.0	-	-
Put options not recognized as hedges for accounting purposes	-	10.0	-	0.4

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

f. Hedges not recognized for accounting purposes (Cont.):

The Company's objective in entering into option transactions is to guarantee the receipt of NIS amounts for financing the Company's liabilities mainly in respect of salary payments and payments to suppliers. The maximum holding of options in the reporting period was $ 10 million par value in short.

g. Hedges that recognized for accounting purposes:

1. The Company chose to perform a cash flow hedge on the exposure to the dollar and to the NIS interest arising from the terms of the debentures. For the purpose of the hedge, the Company simultaneously signed a cross currency swap contract with a bank for cash flows of NIS 450 million at fixed annual interest of 4.95%, unlinked, against payments of $ 119 million at variable interest of Libor plus a margin. The principal and interest cash swap dates are based on the dates set forth in the issuance of the debentures (series B).

2. The Company chose to perform a cash flow hedge on the exposure to the dollar and to the NIS interest arising from the terms of the debentures. For the purpose of the hedge, the Company simultaneously signed a cross currency swap contract with a bank for cash flows of NIS 1,200 million at fixed annual interest of 4.1%, unlinked, against payments of $ 318 million at fixed interest of 3.1%. The principal and interest cash swap dates are based on the dates set forth in the issuance of the debentures (series C).

3. The Company chose to perform a cash flow hedge of a firm commitment in Euro with a supplier. For the purpose of the hedge, the Company designated a Euro deposit as a hedging instrument.

4. The Company chose to perform a cash flow hedge on part of its future salary payments. For the purpose of the hedge, the Company designated NIS/dollar forward transactions as hedging instruments. As of the balance sheet date, the Company has forward transactions at a scope of $ 779 million at rates that range between NIS 3.4 and NIS 3.9 from January 19, 2014 through December 15, 2014. The fair value of the forward transactions approximates $ 32 million and was carried to capital reserve from cash flow hedges. In 2013, the total amounts realized out of hedges approximate $ 86 million and were included in cost of sales and in general and administrative expenses.

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

h. Linkage bases report as of December 31, 2013:

	In or linked to dollar	In CPI-linked NIS	In or linked to Euro	In or linked to other currencies	In unlinked NIS	Non-monetary	Total
	U.S. dollars in millions						
Cash and cash equivalents	648	-	2	14	110	-	774
Short-term financial assets (*)	633	98	19	-	386	-	1,136
Available-for-sale securities	47	-	-	-	-	-	47
Trade receivables	173	-	13	17	274	-	477
Income receivable from work in progress, net (*)	596	-	-	5	95	-	696
Other accounts receivable	169	-	3	1	27	-	200
Taxes receivable	-	82	-	-	-	-	82
Prepaid expenses in respect of service contracts	-	-	-	-	-	47	47
Inventories and current inventory in process, net (*)	-	-	-	-	-	553	553
Long-term inventory in process (*)	-	-	-	-	-	7	7
Long-term loans and receivables	30	-	-	-	46	-	76
Investments in associates	-	-	-	-	2	20	22
Deferred taxes	-	-	-	-	-	98	98
Property, plant and equipment, net	-	-	-	-	-	672	672
Intangible assets, net	-	-	-	-	-	119	119
Total assets	**2,296**	**180**	**37**	**37**	**940**	**1,516**	**5,006**
Current maturities of debentures and other credit providers	237	2	-	6	9	-	254
Short-term financial liabilities	5	-	-	-	-	-	5
Trade payables	353	-	16	19	122	-	510
Other accounts payable	129	92	2	4	305	-	532
Provisions	85	-	-	-	17	-	102
Payables for work in progress	1,779	-	-	-	106	-	1,885
Debentures	346	-	-	-	-	-	346
Employee benefit liabilities, net	8	27	-	-	315	-	350
Total liabilities	**2,942**	**121**	**18**	**29**	**874**	**-**	**3,984**
Excess (shortage) of assets over liabilities	**(646)**	**59**	**19**	**8**	**66**	**1,516**	**1,022**

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

Linkage bases report as of December 31, 2012:

	In or linked to dollar	In CPI-linked NIS	In or linked to Euro	In or linked to other currencies	In unlinked NIS	Non-monetary	Total
	U.S. dollars in millions						
Cash and cash equivalents	121	-	5	11	368	-	505
Short-term financial assets	365	96	42	2	279	-	784
Available-for-sale securities	40	-	-	-	-	-	40
Trade receivables	268	-	11	17	142	-	438
Income receivable from work in progress, net	726	-	-	7	94	-	827
Other accounts receivable	230	-	5	3	63	-	301
Taxes receivable	-	69	-	-	-	-	69
Prepaid expenses in respect of service contracts	-	-	-	-	-	40	40
Inventories and current inventory in process, net	-	-	-	-	-	505	505
Long-term inventory in process	-	-	-	-	-	16	16
Long-term loans and receivables	7	-	-	-	39	-	46
Investments in associates	-	-	-	-	1	86	87
Deferred taxes	-	-	-	-	-	83	83
Property, plant and equipment, net	-	-	-	-	-	627	627
Intangible assets, net	-	-	-	-	-	92	92
Total assets	**1,757**	**165**	**63**	**40**	**986**	**1,449**	**4,460**
Current maturities of debentures and other credit providers	310	4	-	8	1	-	323
Short-term financial liabilities	1	-	-	-	-	-	1
Trade payables	293	-	14	13	99	-	419
Other accounts payable	127	97	-	5	251	-	480
Provisions	59	-	-	-	15	-	74
Dividend payable	4	-	-	-	-	-	4
Payables for work in progress	1,708	-	-	-	92	-	1,800
Debentures	82	-	-	-	-	-	82
Employee benefit liabilities, net	12	32	-	-	294	-	338
Total liabilities	**2,596**	**133**	**14**	**26**	**752**	**-**	**3,521**
Excess (shortage) of assets over liabilities	**(839)**	**32**	**49**	**14**	**234**	**1,449**	**939**

NOTE 23:- FINANCIAL INSTRUMENTS (Cont.)

i. The Group's capital management policy:

See Note 1 above.

NOTE 24:- EQUITY

a. Share capital:

1. Composition of share capital as of December 31, 2013 and 2012:

	Authorized	Issued and outstanding
	Number of shares	
Ordinary shares of NIS 1 par value each	2,600,000,001	2,559,514,386

2. Rights attached to shares:

Voting rights at the general meeting, rights to dividends and rights to dividends upon liquidation.

3. In its meetings on December 4, 2006 and July 29, 2008, the Company's Board approved bringing before the Company's general meeting a proposal for changing the Company's share capital structure as follows:

a) Each Ordinary share of the Company's authorized (unissued) share capital will be converted into a deferred share of NIS 1 par value. The deferred share will not confer any rights whatsoever other than the right to receive a relative share of excess assets of the Company upon liquidation.

b) Each 50 Ordinary shares of NIS 1 par value each will be consolidated into a single share of NIS 50 par value. Consequently, the authorized share capital of 2,600,000,000 Ordinary shares of NIS 1 par value each will be converted into 52,000,000 Ordinary shares of NIS 50 par value each and the issued and outstanding share capital of 2,559,514,386 Ordinary shares of NIS 1 par value each will be converted into 51,190,288 Ordinary shares of NIS 50 par value each.

As of the date of the financial statements, the changes have not yet been approved by the general meeting.

NOTE 24:- EQUITY (Cont.)

b. Dividend distribution policy:

The Government Companies Authority's policy is that 50% of current net income be distributed as a dividend. According to understandings reached between the Ministry of Finance and the Company:

1. Dividends will be distributed for 2011 through 2013 at a rate of 25% of the Company's accounting net income.

2. In 2011 through 2015, an amount of NIS 32.5 million will be deducted from the dividends payable to the State by the Company for the same years based on the above policy.

3. It was also agreed that in 2011-2015, the Company will receive a bonus of NIS 32.5 million each year.

4. The amounts stated in paragraphs 2 and 3 above will be linked to the CPI.

5. These understandings will be in effect provided that the Company's ownership structure remains as is.

6. The Company will assign the earnings arising from these understandings to investment in research and development.

c. Dividend distribution:

On May 3, 2012, the Company's Board decided to recommend to the general meeting the distribution of a dividend for 2011 totaling $ 12.5 million (25% of the income for 2011 less an amount of NIS 32.5 million ($ 8.5 million) which according to the understandings reached between the State and the Company will be offset from the dividend each year from 2011 through 2015). On December 26, 2012, the Company's Board decided to update its recommendation to the general meeting regarding the dividend distribution from $ 12.5 million to $ 4 million. This update resulted from the Company's management's decision to offset an amount of $ 8.5 million from the dividend in respect of an additional bonus which the Company was supposed to receive in the context of the understandings reached with the MOF on December 21, 2010. On January 2, 2013, the Government Companies Authority approved a dividend distribution of $ 4 million out of taxable earnings, based on the dollar-NIS exchange rate on the date of actual payment. The dividend was distributed in January 2013.

A dividend of $ 17 million was provided for in respect of 2012, representing 25% of the income for 2012. On May 29, 2013, the Company's Board decided to recommend to the general meeting not to distribute a dividend for 2012, subject to the approval of the Government Companies Authority, since the amount that should be offset from the dividend according to the understandings reached with the MOF (including the bonus amount) exceeds the distributable dividend amount.

NOTE 24:- EQUITY (Cont.)

c. Dividend distribution (Cont.):

Following are the amounts and dates underlying dividend distributions in 2011-2013:

Actual distribution date	Distribution amount in U.S. dollars in millions	Comments
November 2011	23.25	Earnings for 2010
January 2013	4	Earnings for 2011
-	-	Earnings for 2012

NOTE 25:- NET SALES

a. Composition:

	Year ended December 31,		
	2013	2012	2011
	U.S. dollars in millions		
Exports	**2,672**	2,533	2,681
Local market	**970**	805	748
Total	**3,642**	3,338	3,429

b. Sales to major customers:

	Year ended December 31,		
	2013	2012	2011
	U.S. dollars in millions		
Israeli Government (*)	**651**	693	638
Customer A	**549**	617	804
Customer B	**344**	312	292
Customer C	**309**	205	138
Total	**1,853**	1,827	1,872

(*) See Note 35 on interested parties.

NOTE 26:- COST OF SALES

Composition:

	Year ended December 31,		
	2013	2012	2011
	U.S. dollars in millions		
Labor	**1,401**	1,416	1,326
Materials	**149**	187	198
Subcontractors	**1,418**	964	1,191
Depreciation and amortization	**105**	103	101
Other manufacturing costs	**386**	378	278
	3,459	3,048	3,094
Less:			
Research and development costs	**(186)**	(160)	(160)
In-house manufacturing of property, plant and equipment	**(66)**	(50)	(62)
Changes in inventories ad work in progress	**(87)**	(8)	40
Total	**3,120**	2,830	2,912

NOTE 27:- RESEARCH AND DEVELOPMENT EXPENSES, NET

Composition:

	Year ended December 31,		
	2013	2012	2011
	U.S. dollars in millions		
Research and development expenses	**186**	160	160
Less - grants and participation by the OCI and others	**(6)**	(4)	(7)
Total	**180**	156	153

NOTE 28:- SELLING AND MARKETING EXPENSES

Composition:

	Year ended December 31,		
	2013	**2012**	**2011**
	U.S. dollars in millions		
Salaries and related expenses	**10**	10	10
Preparation of quotations	**50**	52	42
Foreign representations	**6**	6	6
Travel	**7**	8	8
Other	**16**	15	13
Total	**89**	91	79

NOTE 29:- GENERAL AND ADMINISTRATIVE EXPENSES

Composition:

	Year ended December 31,		
	2013	**2012**	**2011**
	U.S. dollars in millions		
Salaries and related expenses	**109**	100	111
Depreciation	**6**	7	7
Other	**27**	26	14
Total	**142**	133	132

NOTE 30:- OTHER INCOME (EXPENSES), NET

Composition:

	Year ended December 31,		
	2013	2012	2011
	U.S. dollars in millions		
Income			
Gain from disposal of investees (a)	-	-	24
Gain from first-time consolidation of subsidiary (b)	14	-	-
Other (c)	6	2	3
Total	20	2	27
Expenses			
Impairment of property, plant and equipment	4	-	1
Impairment of investment in associate	2	-	-
Other	3	-	-
Total	9	-	1

a. In March 2011, a transaction was completed for the sale of the Company's investment in 30% of the share capital of Elisra Systems Ltd. to Elbit in consideration of $ 67.5 million. The Company recognized a gain of approximately $ 24 million in respect of the sale.

b. A gain from the remeasurement to fair value of the Company's investment in ISI's equity rights prior to the business combination date, see details in Note 12b(7) above.

c. In 2013 includes a gain from a settlement signed between the Company and ISI regarding ISI's repayment of inputs that had been expensed by the Company (including subcontractor costs and El-Op) in manufacturing a satellite for ISI whose manufacture was discontinued at ISI's request in October 2008.

NOTE 31:- FINANCE INCOME (EXPENSE), NET

Composition:

	Year ended December 31,		
	2013	**2012**	**2011**
	U.S. dollars in millions		
Finance expense			
Finance expense from bank transactions	**17**	16	14
Exchange rate differences	**2**	-	-
Finance expense from financial derivative transactions	**1**	-	62
Finance expense from non-bank transactions	**11**	4	9
Finance expense from the Company's debentures	**28**	22	-
Total	**59**	42	85
Finance income			
Finance income from bank transactions	**4**	8	13
Finance income from financial derivative transactions	**-**	5	-
Other finance income	**12**	8	10
Exchange rate differences	**-**	2	3
Finance income from securities	**20**	31	17
Total	**36**	54	43

In 2013, the Company derived gains from financial derivative hedges created against the currency exposure which are not recognized as accounting hedges totaling approximately $ 1 million (in 2012 - a gain of approximately $ 1 million was recorded). As of March 18, 2014, the Company is scheduled to record an additional net gain of approximately $ 9 million from these transactions.

NOTE 32:- TAXES ON INCOME

a. Composition:

	Year ended December 31,		
	2013	**2012**	**2011**
	U.S. dollars in millions		
Current taxes	**(3)**	**37**	**-**
Taxes in respect of prior years	**(1)**	**13**	(3)
	(4)	**50**	(3)
Deferred tax expense (income):			
Creation and reversal of temporary differences	**(13)**	**(30)**	30
Change in tax rates	**(7)**	**(1)**	(10)
Total income tax expense (income)	**(24)**	**19**	17

b. Details of the Group's tax environment:

1. The relevant corporate tax rates in Israel in 2011, 2012 and 2013 are 24%, 25% and 25%, respectively. On July 29, 2013, the Israeli Parliament (the Knesset) approved the Law for Changing National Priorities (Legislative Amendments for Achieving Budget Targets for 2013 and 2014), 2013 ("the Law for Changing National Priorities") which raises the corporate tax rate to 26.5% effective from January 1, 2014.

   The deferred tax balances as of December 31, 2013 are calculated according to the new tax rates that were enacted in the Law for Changing National Priorities based on the tax rates that are expected to apply on the date of reversal. The effect of the change on the financial statements as of December 31, 2013 is reflected in an increase in a deferred tax asset, net of approximately $ 6 million against deferred tax income of approximately $ 7 million and a decrease in equity of approximately $ 1 million.

2. Taxation under inflation:

   Effective from January 1, 2008, the provisions of the Income Tax (Inflationary Adjustments) Law, 1985 ("the Inflationary Adjustments Law") no longer apply and therefore, starting from 2008, the Inflationary Adjustments Law has no impact on the measurement of the operating results of the Company and its subsidiaries (other than certain exceptions and transition provisions). Before that date, results for tax purposes were measured on a real basis. The various adjustments required by the Inflationary Adjustments Law were aimed at reconciling the tax results in nominal values to year-end NIS terms (based on the changes in the CPI). Consequently, there were differences between the carrying amount of assets and their value for deduction from taxable income.

NOTE 32:- TAXES ON INCOME (Cont.)

b. Details of the Group's tax environment (Cont.):

3. Benefits under the Law for the Encouragement of Capital Investments, 1959:

<u>Approved enterprise and beneficiary enterprise - subsidiary</u>

According to the Law for the Encouragement of Capital Investments, 1959 ("the Law"), including Amendment No. 60 to the Law issued in April 2005, a subsidiary is entitled to various tax benefits by virtue of the approved or beneficiary enterprise status granted to it. These tax benefits consist mainly of the following:

a) Reduced tax rates:

During the benefit period - seven years from the date of first generating taxable income from the approved or beneficiary enterprise (provided that the limitation period stipulated in the Law has not yet elapsed) - the Company's income from the approved or beneficiary enterprise is subject to tax at a reduced rate or is tax exempt as follows:

1) Corporate tax on approved enterprise of the lower of 25% instead of the ordinary corporate tax rate or at the rate stipulated in Article 126 to the Income Tax Ordinance (Revised), 1961 ("the Ordinance") in the relevant tax year (see above).

2) Tax exemption on income from the beneficiary enterprise for a period of two years followed by tax at a rate of the lower of 25% or at the rate stipulated in Article 126 to the Ordinance in the relevant tax year for a period of five years.

The relative share of income that is entitled to tax benefits out of taxable income is based on the ratio of the turnover attributed to the approved or beneficiary enterprise to the company's entire turnover.

In general, the turnover attributed to the approved enterprise is calculated according to the increase in the turnover in relation to the base turnover attributed to the year before the year of operation of the approved enterprise or as determined in the letter of approval.

On December 19, 2010, the Company notified the Tax Authority of its beneficiary enterprise status pursuant to the Law. The Company chose the 2009 tax year as the year of election.

On July 15, 2012, the Company notified the Tax Authority of another beneficiary enterprise status pursuant to the Law. The Company chose the 2011 tax year as the additional year of election.

NOTE 32:- TAXES ON INCOME (Cont.)

b. Details of the Group's tax environment (Cont.):

3. Benefits under the Law for the Encouragement of Capital Investments, 1959 (Cont.):

a) Reduced tax rates (Cont.):

According to the Encouragement of Capital Investments (Reduction of Base Turnover) Regulations, 2007, the Company may reduce the base turnover subject to complying with the provisions of said Regulations.

In the distribution of cash dividends from the tax exempt income as above, the Company will be subject to an overall tax rate of 25% in respect of the amount to be distributed.

b) Accelerated depreciation:

The Company is entitled to accelerated depreciation deduction in respect of buildings, machinery and equipment used by the approved enterprise based on the provisions of the Law starting from the year of operation of each asset.

c) The subsidiary is entitled to investment grants from the State of Israel for its investments in buildings and equipment in the context of the approved enterprise. According to the letter of approval of June 30, 2004, the Company received approval for an investment program under the grants track for the expansion of a plant that manufactures military electronics systems in Ashdod for an overall investment of approximately NIS 212 million. On December 30, 2013, the subsidiary received final performance approval for the program from the Investment Center. As of the financial statement date, the Company received an amount of approximately NIS 14.7 million out of a grant of approximately NIS 20 million to which it is entitled according to the letter of approval.

d) Conditions for receiving benefits:

The above described benefits are conditional on meeting the conditions prescribed by the Law, the regulations published thereunder and the letters of approval according to which the investments in the approved enterprise have been completed. Failure to comply with these conditions is liable to lead to the cancellation of the benefits, in whole or in part, and the repayment of the benefit amounts with the addition of arrears interest.

NOTE 32:- TAXES ON INCOME (Cont.)

b. Details of the Group's tax environment (Cont.):

3. Benefits under the Law for the Encouragement of Capital Investments, 1959 (Cont.):

<u>Beneficiary enterprise - the Company</u>

Amendment No. 60 to the Law lists the conditions for receiving tax benefits under the tax benefits track in respect of a beneficiary enterprise. Amendment No. 60 states that enterprises that meet the criteria established in the Law will be entitled to implement the tax benefits in the tax returns filed by them without needing the advance approval of the Investment Center Administration or of the Tax Authority. The principal criteria in the Law for being eligible for the tax benefits are: the enterprise must be an industrial enterprise which exports 25% of the increase in turnover and makes a minimum qualifying investment in the purchase of productive assets.

The Company chose the 2006 tax year as the year of election ("the first expansion program"), the 2008 tax year as the subsequent year of election ("the second expansion program") and the 2011 tax year as the subsequent year of election ("the third expansion program"). Income deriving from a beneficiary enterprise located in the center of Israel is tax exempt for a period of two years from the year in which the company first generates taxable income. According to the Law, the tax exemption is contingent on retaining the tax exempt income in the company. If this tax exempt income is distributed to the controlling shareholder, it will be subject to tax at the lower of a rate of 25% or at the rate stipulated in Article 126 to the Ordinance in the relevant tax year. The tax benefit period of the Company's beneficiary enterprise under the first expansion program began in the 2007 tax year. Due to the Company's accrued tax losses in 2008-2009, the benefit period of the second expansion program began in 2010 and ended in the 2011 tax year. Moreover, due to the Company's accrued tax losses in 2011, the benefit period of the third expansion program began in 2012.

Starting from the end of two tax years beginning in the tax year in which the Company generates taxable income and for a period of five consecutive years, the Company will be subject to tax at the lower of a rate of 25% or at the rate stipulated in Article 126 to the Ordinance in the relevant tax year on its income from the beneficiary enterprise. The benefits are contingent on meeting the criteria established in the Law (percentage of export etc.). As of the report date, the Company is meeting these criteria. The Company has low-volume manufacturing sites in Development Area A for which the Company is claiming tax benefits under the Law.

NOTE 32:- TAXES ON INCOME (Cont.)

b. Details of the Group's tax environment (Cont.):

3. Benefits under the Law for the Encouragement of Capital Investments, 1959 (Cont.):

Furthermore, the Company reduces the base turnovers of its beneficiary enterprise in accordance with the provisions of the Encouragement of Capital Investments (Reduction of Base Turnover) Regulations, 2007 according to which the Company may reduce the base turnovers of its beneficiary enterprise at a rate of 10% per annum from the year of election. In order to reduce the base turnovers, the Company must meet several conditions as prescribed in the above Regulations. The Company meets these conditions. The above Regulations also require the Company to obtain the Chief Scientist's approval for the scope of its R&D expenses. On February 17, 2014, the Company received the Chief Scientist's approval for 2006-2007.

Material amendment to the Law

The Law was amended in the context of the Law for Economic Policy for 2011 and 2012 (Amended Legislation), 2011 ("Amendment No. 68"), effective from January 1, 2011. Amendment No. 68 introduces material and comprehensive changes to the Law regarding industrial enterprises. It also states that a wholly-owned government company is not entitled to the benefits prescribed in the Law and therefore neither the Company nor Elta apply for the tax benefits following the enactment of Amendment No. 68. Nevertheless, the transition provisions of Amendment No. 68 stipulate that the Company's enterprise in its entirety is still eligible for the tax benefits under the Law prior to its amendment until the end of the benefit period. Therefore, the Company and Elta are entitled to receive the tax benefits as they were on the date of approval of Elta's approved enterprise and in the year of election of the Company's and Elta's beneficiary enterprises until the end of the benefit period as specified above.

4. Benefits under the Law for the Encouragement of Industry (Taxation), 1969:

a) The Company and some of its subsidiaries have the status of industrial companies as defined in the Law for the Encouragement of Industry (Taxation), 1969 and are therefore entitled to the following main benefits:

1) Accelerate depreciation rates.
2) Possibility of filing consolidated financial statements with "single production line subsidiaries".

b) The Company and two of its Israeli wholly-owned and controlled subsidiaries file consolidated tax returns.

NOTE 32:- TAXES ON INCOME (Cont.)

c. Foreign subsidiaries

The subsidiaries incorporated outside of Israel are taxed at the tax laws in their country of residence.

1. The tax rates applicable to the income of foreign companies/partnerships in the Group

Country of incorporation	Tax rate	Comments
United States	Federal tax - up to 35% State tax - average of 5%	Withholding tax rate in dividend distribution - 12.5% (subject to the terms of the US-Israel tax treaty)
Singapore	17%	Territorial tax
India	Corporate tax - 30%-34%	
Belgium	Corporate tax - 34% (corporate tax of 33% plus an austerity levy of 3% on this tax)	
Cyprus (partnership)	Profits generated in Cyprus are taxed in the hands of the partners at 12.5%	
Hungary	Gradual corporate tax: 10% on income up to HUF 500 million and 19% on higher income	The Hungarian subsidiary is entitled to a 50% reduction of the corporate tax base on income from weight lifting which forms the majority of its income

2. Distribution of dividends to Israel

Article 126(c) to the Ordinance, which became effective in the context of Amendment No. 132 to the Ordinance (see above), states that a company's taxable income from a dividend originating from income produced or generated outside of Israel or from a dividend originating outside of Israel will be subject to corporate tax of 25%. Following Amendment No. 132 to the Ordinance, an Israeli company which receives a dividend from a foreign company can receive corporate tax credit on the dividend income tax in Israel in the amount of the foreign tax paid outside of Israel on the same income.

NOTE 32:- TAXES ON INCOME (Cont.)

c. Foreign subsidiaries (Cont.)

2. Distribution of dividends to Israel (Cont.)

In connection with the taxation of dividends from foreign companies, an Israeli corporate taxpayer may choose between two options: a tax liability in Israel in respect of a foreign dividend at a rate of 25% simultaneously with a withholding tax credit upon the distribution of the dividend in Israel and a tax liability in Israel in respect of a dividend originating overseas at the ordinary corporate tax rate in Israel (26.5% in 2014 and thereafter) on the amount of the dividend (namely the dividend paid to the taxpayer with the addition of any foreign tax in its respect or in respect of the income from which it derives) simultaneously with a withholding tax credit both for the withheld tax ("direct credit") and for the tax paid by the foreign company on the income from which it derives ("indirect credit"). The indirect credit will be granted for tax paid by both the direct subsidiary of the Israeli company provided that the Israeli company holds at least 25% of the means of control in the foreign subsidiary that distributes the dividend and the sub-subsidiary of the Israeli company that receives the dividend provided that the sub-subsidiary is directly held by the subsidiary at a rate of at least 50%.

3. Transfer pricing in international transactions conducted between related parties

In the context of Amendment No. 132 to the Ordinance (see above), Article 85a to the Ordinance was enacted in which the legislator expressly addresses the determination of transfer pricing in international transactions between parties with special relations (related parties). According to legislation, this article will become effective after the regulations enacted by virtue thereof become effective. In November 2006, the regulations by virtue of Article 85a to the Ordinance were enacted - Income Tax (Determining Market Terms) Regulations, 2006 - and Article 85a became effective. The purpose of Article 85a and the regulations enacted by virtue thereof is to guarantee that prices and/or terms in a transaction between related parties are determined on the same basis as would be determined in a transaction between non-related parties, namely at arm's length (market terms). The regulations establish objective rules to be used by taxpayers in determining market terms for international transactions and to be sued by the tax authorities in inspecting those transactions. The regulations also require taxpayers to meet certain documentation and document presentation duties regarding international transactions.

NOTE 32:- TAXES ON INCOME (Cont.)

d. Final tax assessments

1. The Company and subsidiaries in Israel have received final tax assessments through 2005.

2. The Tax Authority issued tax assessments by decree for 2006-2007 to the Company and a subsidiary after the negotiations between the Company and the tax assessing officer regarding the deduction of certain expenses had failed. The Tax Authority also issued tax assessments to the best of judgment for 2008-2009 to the Company and a subsidiary. The tax amounts in dispute are as follows:

   In 2006 - a reserve of NIS 41 million (approximately $ 10.9 million).
   In 2007 - a reserve of NIS 30 million (approximately $ 8 million).
   In 2008 - a reserve of NIS 41 million (approximately $ 10.8 million).
   In 2009 - a reserve of NIS 35 million (approximately $ 9.2 million).

   As of the financial statement date, the Company filed an appeal with the District Court against the tax assessing officer's decrees for 2006-2007 and intends to file an objection to the tax assessments for 2008-2009.

   Moreover, in accordance with applicable government companies laws and the Government Companies Authority's Director's guidelines, the Company applied to the Attorney General for acting to settle the dispute outside the courthouse. The Attorney General appointed the Deputy Attorney General to handle the dispute. The Company reserves the right to file an appeal with the court insofar as the dispute is not settled to its full satisfaction.

   Due to the preliminary stage of the proceeding, the Company's legal counsel estimates that it is difficult to assess the chances of realization of the decrees. Based on its legal counsel's position, the Company believes that it has recorded adequate provisions under the circumstances.

3. The Company received final deduction assessments through 2008. In addition, the Ramle tax assessing officer issued a deduction assessment not in agreement (to the best of judgment) for the 2009 tax year. The Company argues that the expenses incurred by it in dispute with the tax assessing officer were all incurred in generating income and that it has a well-founded factual infrastructure and references for substantiating its arguments. The Company filed an objection to this assessment.

4. A subsidiary in the United States received final tax assessments through 2010.

5. In the opinion of the Company's management, based on its legal counsel, the Company has recorded adequate provisions in connection with potential liabilities as discussed above.

NOTE 32:- TAXES ON INCOME (Cont.)

e. Taxes on income recognized directly in equity

	Year ended December 31,		
	2013	2012	2011
	U.S. dollars in millions		
Deferred taxes	**5**	**11**	-
Total	**5**	**11**	-

f. Reconciliation between the theoretical tax on pre-tax income and the amount of tax benefits included:

	Year ended December 31,		
	2013	2012	2011
	U.S. dollars in millions		
Income before taxes on income	**51**	**93**	106
Statutory tax rate	**25%**	**25%**	24%
Tax computed on pre-tax income at the statutory tax rate	**13**	**23**	25
Nondeductible expenses (tax exempt income), net	**1**	**3**	-
Differences in measurement basis (dollar against CPI) and others	**(37)**	**(7)**	15
Effect of change in tax rate	**(7)**	**(1)**	(10)
Losses in subsidiaries for which no deferred taxes were recognized	**5**	**(2)**	(4)
Taxes in respect of previous years	**(1)**	**13**	(3)
Effect of benefits for beneficiary enterprise	**(3)**	**(5)**	(1)
Utilization of tax losses and timing differences from previous years for which no deferred taxes were previously recognized	**5**	**(5)**	(5)
Total income tax expenses (income)	**(24)**	**19**	17

NOTE 32:- TAXES ON INCOME (Cont.)

g. Carry-forward tax losses

- According to the provisions of the Ordinance, capital losses that are carried forward can be utilized against capital gains indefinitely. It is also possible to offset capital losses from the sale of assets outside of Israel against capital gains in Israel. The Company has carry-forward capital losses and losses from securities totaling approximately $ 127 million for which no deferred tax asset has been recognized as it is not expected to be utilized in the foreseeable future.

- A foreign subsidiary has carry-forward losses totaling approximately $ 87 million that can be utilized until 2030 for which no deferred tax asset has been recognized as it is not expected to be utilized in the foreseeable future.

h. VAT

The Company is registered for VAT purposes as a licensed dealer (union of dealers) with its subsidiary.

i. Movement in deferred taxes

1. Composition:

	Property, plant and equipment	Employee benefits	Debentures	Other	Total
	U.S. dollars in millions				
Balance at January 1, 2011	(12)	105	(4)	(6)	83
Changes in 2011					
Changes carried to profit and loss	(13)	7	4	(18)	(20)
Changes carried to equity	-	-	-	-	-
Balance at December 31, 2011	(25)	112	-	(24)	63
Changes in 2012					
Changes carried to profit and loss	11	7	3	10	31
Changes carried to equity	-	-	-	(11)	(11)
Balance at December 31, 2012	(14)	119	3	(25)	83
Changes in 2013					
Changes carried to profit and loss	11	21	-	(12)	20
Changes carried to equity	-	(3)	(4)	2	(5)
Balance at December 31, 2013	(3)	137	(1)	(35)	98

2. The deferred taxes are computed at the tax rates that are expected to apply to the Group upon reversal of the temporary differences for which they were created, as detailed in paragraph b above.

NOTE 32:- TAXES ON INCOME (Cont.)

j. The expected realization dates of deferred taxes

	December 31, 2013	December 31, 2012
	U.S. dollars in millions	
Deferred tax assets that are expected to be settled in 12 months	**53**	**28**
Deferred tax assets that are expected to be settled after more than 12 months	**108**	**108**
Deferred tax liabilities that are expected to be settled in 12 months	**(27)**	**(19)**
Deferred tax liabilities that are expected to be settled after more than 12 months	**(36)**	**(34)**
Deferred tax balances, net	**98**	**83**

NOTE 33:- OTHER COMPREHENSIVE INCOME

Disclosure of the tax effects relating to each component of other comprehensive income:

	Year ended December 31, 2013	2012	2011
	U.S. dollars in millions		
Foreign currency translation adjustments of foreign operation:			
Amount before taxes on income	**(2)**	**-**	**-**
Tax benefit (expense)	**-**	**-**	**-**
Net amount after taxes	**(2)**	**-**	**-**
Available-for-sale financial assets:			
Amount before taxes on income	**-**	**(1)**	1
Tax benefit (expense)	**-**	**-**	-
Net amount after taxes	**-**	**(1)**	1
Cash flow hedge:			
Amount before taxes on income	**(2)**	**53**	(6)
Tax benefit (expense)	**(2)**	**(11)**	-
Net amount after taxes	**(4)**	**42**	(6)
Remeasurement of defined benefit plans:			
Amount before taxes on income	**18**	**(5)**	(5)
Tax benefit (expense)	**(3)**	**-**	-
Net amount after taxes	**15**	**(5)**	(5)
Other comprehensive income net of taxes	**9**	**36**	**(10)**

NOTE 34:- BUSINESS SEGMENTS

a. General

An operating segment is a component of the Company:

1. Which is engaged in business activities from which the Company may earn revenues, incur expenses (including revenues and expenses relating to transactions with other components of the Company).
2. Whose operating results are regularly reviewed by the Company's Chief Operating Decision Maker ("CODM") to make decisions about resources to be allocated to the segment and assess its performance.
3. For which discrete financial information is available.

The operating segments are determined based on the information reviewed by the CODM for the purpose of making decisions on allocating resources and assessing performances. The chief reporting format according to business segments is based on the Company's internal and administrative reporting framework.

Pursuant to the aforesaid, the Company operates in five principal operating segments as follows:

1. Bedek Aviation Group - mainly maintenance, renovation and upgrading of aircraft and aircraft engines as well as conversion of passenger aircraft to cargo configuration and aircraft maintenance.
2. Military Aircraft Group - mainly development, manufacture and sale of unmanned air vehicles, upgrading and maintenance of military aircraft and manufacture of aero-assemblies for military aircraft.
3. Systems Missile & Space Group - mainly development, manufacture and sale of attack and defense missile systems, satellites and various space assemblies.
4. Elta Systems Ltd. - engaged in the field of military electronics such as radar systems and electronic warfare.
5. Commercial Aircraft Group - mainly development and manufacture of business jets and development and manufacture of aero-assemblies for civilian aircraft.

The "other" segment consists of additional activities at the Company's level which serve all the operating segments as well as the Engineering Division which mainly plans and develops aircraft and engineering infrastructures at the entity level.

Intersegment transactions

The segment's revenues, expenses and operating results include intersegment transactions. The Company believes that these transactions are recorded at standard market prices similarly to the prices of similar product transactions with external customers. The intersegment results are eliminated when preparing the consolidated financial statements.

NOTE 34:- BUSINESS SEGMENTS (Cont.)

b. Chief reporting on business segments

	Bedek Aviation Group	Military Aircraft Group	Systems Missile & Space Group	Elta Systems Ltd.	Commercial Aircraft Group	Other	Adjustments	Total
	Year ended December 31, 2013							
	U.S. dollars in millions							
Segment revenues	305	680	1,235	902	485	35	-	**3,642**
Intersegment revenues	21	32	33	122	53	114	(375)	-
Total segment revenues	**326**	**712**	**1,268**	**1,024**	**538**	**149**	**(375)**	**3,642**
Cost of sales	335	580	1,070	855	513	142	(375)	**3,120**
Gross profit (loss)	**(9)**	**132**	**198**	**169**	**25**	**7**	**-**	**522**
% of gross profit	**(3%)**	**19%**	**16%**	**16%**	**5%**	**5%**		**14%**
Research and development expenses	4	25	35	35	3	78		**180**
Marketing expenses	2	17	21	19	2	28		**89**
General and administrative expenses	24	22	37	48	19	(8)		**142**
Other expenses (income)	-	3	(19)	-	-	5		**(11)**
Employee retirement expenses	-	-	-	4	-	34		**38**
	30	**67**	**74**	**106**	**24**	**137**		**438**
Operating income (loss)	**(39)**	**65**	**124**	**63**	**1**	**(130)**		**84**
% of operating income (loss)	**(12%)**	**9%**	**10%**	**6%**	**-**	**(87%)**		**2%**
Finance income	2	1	7	13	-	13		**36**
Finance expense	(5)	(1)	(4)	(13)	(12)	(24)		**(59)**
Company's share of earnings of associates	(6)	(1)	-	1	-	(4)		**(10)**
Taxes on income	-	-	-	(9)	-	33		**24**
Net income	**(48)**	**64**	**127**	**55**	**(11)**	**(112)**		**75**
% of net income (loss)	**(15%)**	**10%**	**10%**	**5%**	**(2%)**	**(75%)**		**2%**
Non-controlling interests' share of income								**(2)**
Equity holders of the parent's share of income								**73**

NOTE 34:- BUSINESS SEGMENTS (Cont.)

b. Chief reporting on business segments (Cont.)

	Year ended December 31, 2012							
	Bedek Aviation Group	Military Aircraft Group	Systems Missile & Space Group	Elta Systems Ltd.	Commercial Aircraft Group	Other	Adjustments	Total
	U.S. dollars in millions							
Segment revenues from external customers	448	569	1,063	848	375	35	-	3,338
Intersegment revenues	18	17	32	129	48	106	(350)	-
Total segment revenues	**466**	**586**	**1,095**	**977**	**423**	**141**	**(350)**	**3,338**
Cost of sales	424	465	920	808	438	125	(350)	2,830
Gross profit (loss)	**42**	**121**	**175**	**169**	**(15)**	**16**	**-**	**508**
% of gross profit	**9%**	**21%**	**16%**	**17%**	**(4%)**	**11%**		**15%**
Research and development expenses	5	28	44	40	6	33		156
Marketing expenses	3	21	20	20	2	25		91
General and administrative expenses	25	22	33	52	17	(16)		133
Other income	-	-	(1)	-	-	(1)		(2)
Employee retirement expenses	-	-	-	6	-	45		51
	33	**71**	**96**	**118**	**25**	**86**		**429**
Operating income (loss)	**9**	**50**	**79**	**51**	**(40)**	**(70)**		**79**
% of operating income (loss)	**2%**	**8%**	**7%**	**5%**	**(9%)**	**(49%)**		**2%**
Finance income	2	1	8	14	-	29		54
Finance expense	(1)	(2)	(1)	(8)	(16)	(14)		(42)
Company's share of earnings of associates	2	-	-	-	-	-		2
Taxes on income	-	1	(3)	(24)	-	7		(19)
Net income	**12**	**50**	**83**	**33**	**(56)**	**(48)**		**74**
% of net income (loss)	**3%**	**8%**	**8%**	**3%**	**(13%)**	**(34%)**		**2%**
Non-controlling interests' share of income								**(1)**
Equity holders of the parent's share of income								**73**

NOTE 34:- BUSINESS SEGMENTS (Cont.)

b. Chief reporting on business segments (Cont.)

	Year ended December 31, 2011							
	Bedek Aviation Group	**Military Aircraft Group**	**Systems Missile & Space Group**	**Elta Systems Ltd.**	**Commercial Aircraft Group**	**Other**	**Adjustments**	**Total**
	U.S. dollars in millions							
Segment revenues	590	612	1,002	868	324	33	-	3,429
Intersegment revenues	16	21	31	135	53	106	(362)	-
Total segment revenues	**606**	**633**	**1,033**	**1,003**	**377**	**139**	**(362)**	**3,429**
Cost of sales	553	498	864	819	408	132	(362)	2,912
Gross profit (loss)	**53**	**135**	**169**	**184**	**(31)**	**7**	**-**	**517**
% of gross profit (loss)	**9%**	**21%**	**16%**	**18%**	**(8%)**	**5%**		**15%**
Research and development expenses	5	29	39	43	12	25		153
Marketing expenses	2	16	17	18	2	24		79
General and administrative expenses	26	20	30	47	17	(8)		132
Other expenses (income)	-	2	(4)	(24)	-	-		(26)
Employee retirement expenses	-	-	-	4	-	41		45
	33	**67**	**82**	**88**	**31**	**82**		**383**
Operating income (loss)	**20**	**68**	**87**	**96**	**(62)**	**(75)**		**134**
% of operating income (loss)	**3%**	**11%**	**8%**	**10%**	**(16%)**	**(54%)**		**4%**
Finance income	2	-	7	8	2	24		43
Finance expense	(1)	(3)	(3)	(11)	(14)	(53)		(85)
Company's share of earnings of associates	2	-	11	1	-	-		14
Taxes on income	-	-	(1)	(16)	-	-		(17)
Net income	**23**	**65**	**101**	**78**	**(74)**	**(104)**		**89**
% of net income (loss)	**4%**	**10%**	**10%**	**8%**	**(20%)**	**(75%)**		**3%**
Non-controlling interests' share of income								**(2)**
Equity holders of the parent's share of income								**87**

NOTE 34:- BUSINESS SEGMENTS (Cont.)

c. Additional information

	December 31, 2013							
	Bedek Aviation Group	Military Aircraft Group	Systems Missile & Space Group	Elta Systems Ltd.	Commercial Aircraft Group	Other	Adjustments	Total
	U.S. dollars in millions							
Segment assets								
Current assets	263	363	625	949	328	307	(487)	2,348
Property, plant and equipment and intangible assets	98	115	180	163	114	121	-	791
Investments in associates	5	1	-	16	-	362	(362)	22
Long-term loans and receivables	6	-	25	4	-	41	-	76
Other non-current assets	-	-	-	23	7	91	(16)	105
Unallocated assets	-	-	-	-	-	1,664	-	1,664
Total assets	**372**	**479**	**830**	**1,155**	**449**	**2,586**	**(865)**	**5,006**
Liabilities								
Current liabilities	(119)	(657)	(1,292)	(718)	(251)	(508)	496	(3,049)
Non-current liabilities	(22)	(18)	(34)	(63)	(19)	(194)	-	(350)
Unallocated liabilities	-	-	-	-	-	(584)	-	(584)
Total liabilities	**(141)**	**(675)**	**(1,326)**	**(781)**	**(270)**	**(1,286)**	**496**	**(3,983)**
Total fixed assets								
Balance at January 1, 2013	96	87	122	145	68	108	-	626
Acquisitions in the year ended December 31, 2013	10	21	57	26	9	19	-	142
Depreciation in the year ended December 31, 2013	(14)	(23)	(16)	(17)	(10)	(16)	-	(96)
Balance at December 31, 2013	**92**	**85**	**163**	**154**	**67**	**111**	**-**	**672**

NOTE 34:- BUSINESS SEGMENTS (Cont.)

c. Additional information (Cont.)

	Bedek Aviation Group	Military Aircraft Group	Systems Missile & Space Group	Elta Systems Ltd.	Commercial Aircraft Group	Other	Adjustments	Total
	December 31, 2012							
	U.S. dollars in millions							
Segment assets								
Current assets	268	282	653	829	416	328	(325)	2,451
Property, plant and equipment and intangible assets	102	96	128	152	120	120	-	718
Investments in associates	12	1	67	3	-	329	(324)	88
Long-term loans and receivables	6	-	-	5	-	35	-	46
Other non-current assets	-	-	-	20	16	70	(8)	98
Unallocated assets	-	-	-	-	-	1,059	-	1,059
Total assets	**388**	**379**	**848**	**1,009**	**552**	**1,941**	**(657)**	**4,460**
Liabilities								
Current liabilities	(182)	(426)	(1,249)	(613)	(230)	(412)	325	(2,787)
Non-current liabilities	(21)	(16)	(32)	(60)	(18)	(191)	-	(338)
Unallocated liabilities	-	-	-	-	-	(396)	-	(396)
Total liabilities	**(203)**	**(442)**	**(1,281)**	**(673)**	**(248)**	**(999)**	**325**	**(3,521)**
Total fixed assets								
Balance at January 1, 2012	96	102	112	138	70	97	-	615
Acquisitions in the year ended December 31, 2012	13	13	24	25	8	21	-	104
Depreciation in the year ended December 31, 2012	(13)	(27)	(14)	(18)	(10)	(10)	-	(92)
Balance at December 31, 2012	**96**	**88**	**122**	**145**	**68**	**108**	**-**	**627**

The majority of the Group's assets are located in Israel.

NOTE 34:- BUSINESS SEGMENTS (Cont.)

d. Secondary reporting of geographical segments

	Sales in the year ended December 31, 2013						
	Bedek Aviation Group	Military Aircraft Group	Systems Missile & Space Group	Elta Systems Ltd.	Commercial Aircraft Group	Unallocated activities	Total
	U.S. dollars in millions						
North America	69	203	76	18	417	7	790
South America	19	24	24	44	3	-	114
Europe	71	155	37	159	51	1	474
Asia (excluding Israel)	12	221	491	510	1	(1)	1,234
Africa	31	5	-	3	-	-	39
Australia	-	-	1	20	-	-	21
Israel	103	72	606	148	13	28	970
Total	**305**	**680**	**1,235**	**902**	**485**	**35**	**3,642**

	Sales in the year ended December 31, 2012						
	Bedek Aviation Group	Military Aircraft Group	Systems Missile & Space Group	Elta Systems Ltd.	Commercial Aircraft Group	Unallocated activities	Total
	U.S. dollars in millions						
North America	94	194	98	33	331	7	757
South America	11	20	25	58	1	-	115
Europe	174	139	30	61	30	2	436
Asia (excluding Israel)	22	146	414	548	2	1	1,133
Africa	34	13	-	3	-	-	50
Australia	-	2	1	39	-	-	42
Israel	113	55	495	106	11	25	805
Total	**448**	**569**	**1,063**	**848**	**375**	**35**	**3,338**

NOTE 34:- BUSINESS SEGMENTS (Cont.)

d. Secondary reporting of geographical segments (Cont.)

	Sales in the year ended December 31, 2011						
	Bedek Aviation Group	**Military Aircraft Group**	**Systems Missile & Space Group**	**Elta Systems Ltd.**	**Commercial Aircraft Group**	**Unallocated activities**	**Total**
	U.S. dollars in millions						
North America	287	175	83	28	249	2	824
South America	1	31	15	62	2	-	111
Europe	79	122	26	14	55	1	297
Asia (excluding Israel)	79	194	394	615	3	4	1,289
Africa	37	15	3	3	-	-	58
Australia	-	3	-	39	-	-	42
Israel	107	72	481	107	15	26	808
Total	**590**	**612**	**1,002**	**868**	**324**	**33**	**3,429**

NOTE 35:- BALANCES AND TRANSACTIONS WITH INTERESTED AND RELATED PARTIES

a. The Israeli Government is the controlling shareholder in the Company. Part of the Group's activity consists of performing contracts for Government authorities, Government offices and Government corporations. Part of the business balances and results relating to these contracts are presented separately in the financial statements since they are carried out in the ordinary course of business and under standard commercial terms.

b. According to the Government Companies Authority's guidelines, the Company is required to reconcile balances with interested parties. Despite the Company's requests to receive balance confirmations, interested parties are not in the habit of granting balance confirmations given that their records are managed on a cash basis as opposed to the Company's accrual basis. The Company monitors and confirms the balances that have not yet been collected from interested parties or have not yet been paid by them.

c. As for contingent liabilities and commitments, see Note 22 above.

d. As for payment of real estate usage fees, see Note 13c(3) above.

e. As for real estate provided for the Company's use, see Note 22a(7) above.

f. As for sales to the State, see Note 25b above.

g. As for the engagement with the MOD, see Note 22a(1) above.

h. As for investees, see Note 12 above.

i. Balances with interested and related parties:

	December 31,	
	2013	**2012**
	U.S. dollars in millions	
Trade and income receivable	**342**	299
Other accounts receivable	**89**	80
Trade payables	**20**	7
Payables for work in progress	**122**	115
Investments in investees	**22**	87
The highest receivable during the year	**497**	425

NOTE 35:- BALANCES AND TRANSACTIONS WITH INTERESTED AND RELATED PARTIES (Cont.)

j. Benefits paid to interested parties and key management personnel:

	Year ended December 31,		
	2013	**2012**	**2011**
	U.S. dollars in millions		
Salaries and related expenses	**617**	(***) 1,008	(*) 531
Fees of directors not employed in or on behalf of the Company	**82**	65	(**) 112
Salaries and related expenses to key management personnel	**5,346**	3,568	5,253

The number of people to whom the salaries and benefits relate:

Interested parties employed in or on behalf of the Company	**3**	3	3
Directors not employed in the Company	**9**	9	11
Key management personnel	**19**	18	19

(*) Including the salary of the Chairman of the Board who terminated his tenure in July 2011 and the salary of the new Chairman of the Board who began his tenure in the same month.

(**) Including fees paid to six directors who terminated their office in 2011.

(***) Including the salary of the Chairman of the Board based on a part-time position, the salary of the Company's CEO who retired in June 2011 and the salary of the current CEO for 2012.

NOTE 35:- BALANCES AND TRANSACTIONS WITH INTERESTED AND RELATED PARTIES (Cont.)

k. Transactions with interested parties:

	Year ended December 31,		
	2013	**2012**	**2011**
	U.S. dollars in millions		
Sales	**651**	693	698
Cost of sales	**539**	633	580
Cost of acquisitions	**85**	60	91

As for the payment of royalties to the MOD, see Note 22a(1) above.

NOTE 36:- EARNINGS PER SHARE

Number of shares and net income used in the computation of net earnings per share

	Year ended December 31,		
	2013	**2012**	**2011**
Weighted number of shares (in millions)	2,559	2,559	2,559
Net income (U.S. dollars in millions)	75	74	89

SEPARATE FINANCIAL INFORMATION
AS OF DECEMBER 31, 2013

Pursuant to Regulation 9C to the Securities Regulations
(Periodic and Immediate Reports), 1970

BDO Ziv Haft

Head Office: Amot Bituach House Bldg. B
48 Dereh Menahem Begin Rd.
Tel Aviv 66180, Israel
www.bdo.co.il E-mail: bdo@bdo.co.il

Special auditors' report to the Shareholders of Israel Aerospace Industries Ltd. on the separate financial information in accordance with Regulation 9C to the Israeli Securities Regulations (Periodic and Immediate Reports), 1970

We have audited the accompanying separate financial information presented in accordance with Regulation 9C to the Israeli Securities Regulations (Periodic and Immediate Reports), 1970 of Israel Aerospace Industries Ltd. ("**the Company**") as of December 31, 2013 and 2012 and for each of the three years the latest of which ended on December 31, 2013. This separate financial information is the responsibility of the Company's board of directors and management. Our responsibility is to express an opinion on this separate financial information based on our audits.

The data included in the separate financial information that relate to the balance in respect of certain investees and to the earnings in respect of certain investees are based on the financial statements audited by other auditors.

We conducted our audits in accordance with generally accepted auditing standards in Israel. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the separate financial information is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the separate financial information. An audit also includes assessing the accounting principles used in the preparation of the separate financial information and the significant estimates made by the board of directors and management, as well as evaluating the overall separate financial information presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits, the separate financial information is prepared, in all material respects, in conformity with Regulation 9C to the Israeli Securities Regulations (Periodic and Immediate Reports), 1970.

Tel-Aviv, Israel
March 26, 2014

BDO Ziv Haft
Certified Public Accountants

Tel Aviv: Tel: 972(0)3-6386868 Fax: 972(0)3-6394320
Haifa: Tel: 972(0)4-8680600 Fax: 972(0)4-8620866
Kiryat Shmona: Tel: 972(0)4-6951389 Fax: 972(0)4-6950004
Jerusalem: Tel: 972(0)2-6546200 Fax: 972(0)2-6526633
Be'er Sheva: Tel: 972(0)77-6900700 Fax: 972(0)3-6368714
Be'ne Braq: Tel: 972(0)73-7145300 Fax: 972(0)73-7145317

Separate Financial Information as of December 31, 2013

Amounts of assets, liabilities and equity attributable to the Company itself as the parent

	See also	December 31, 2013	December 31, 2012 (*)
		U.S. dollars in millions	
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	3	631	407
Short-term financial assets	4	989	646
Trade receivables		361	334
Income receivable from work in progress, net		357	427
Other accounts receivable		270	357
Current accounts with investees		37	43
Taxes receivable		98	83
Prepaid expenses in respect of service contracts		47	40
Inventories and inventory in process, net		413	422
Total current assets		**3,203**	2,759
NON-CURRENT ASSETS:			
Inventory in process		7	17
Long-term loans and receivables		72	41
Investments in investees	5	500	467
Deferred taxes	7	83	63
Property, plant and equipment, net		457	444
Intangible assets, net		92	81
Total non-current assets		**1,211**	1,113
Total assets		**4,414**	3,872

(*) Retroactively implemented, see Note 2k to the consolidated financial statements.

The notes to the separate financial information are an integral part thereof.

Amounts of assets, liabilities and equity attributable to the Company itself as the parent

	December 31,	
	2013	2012 (*)
	U.S. dollars in millions	
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Current maturities in respect of debentures and other credit providers	237	311
Short-term financial liabilities	5	1
Trade payables	385	268
Other accounts payable	423	392
Provisions	96	67
Dividend payable	-	4
Payables for work in progress, net	1,632	1,552
Total current liabilities	**2,778**	2,595
NON-CURRENT LIABILITIES:		
Debentures	346	82
Employee benefit liabilities, net	279	266
Total non-current liabilities	**625**	348
CONTINGENT LIABILITIES AND COMMITMENTS		
EQUITY:		
Equity attributable to equity holders of the parent	1,011	929
Total equity	**1,011**	929
Total liabilities and equity	**4,414**	3,872

(*) Retroactively implemented, see Note 2k to the consolidated financial statements.

The notes to the separate financial information are an integral part thereof.

March 26, 2014			
Date of approval of the financial statements	Rafi Maor Chairman of the Board	Joseph Weiss Chief Executive Officer	Eyal Younian Chief Financial Officer

Amounts of revenues and expenses attributable to the Company itself as the parent

	See also	Year ended December 31, 2013	2012 (*)	2011
		U.S. dollars in millions		
Net sales		2,677	2,410	2,500
Sales to investees		65	84	69
Total sales		**2,743**	2,494	2,569
Cost of sales		2,398	2,168	2,245
Gross profit		**345**	**326**	**324**
Research and development expenses		143	115	109
Selling and marketing expenses		69	69	59
General and administrative expenses		87	74	81
Other expenses		4	1	-
Other income		(20)	(2)	(2)
Employee retirement expenses		34	44	41
		318	**301**	**288**
Operating income		**27**	25	35
Finance income		29	41	36
Finance expenses		(52)	(35)	(74)
Company's share of earnings of investees, net		35	38	91
Income before taxes on income		**39**	69	89
Taxes on income	7	33	4	(1)
Net income for the period attributable to Equity holders of the parent		**72**	73	88

(*) Retroactively implemented, see Note 3y to the consolidated financial statements.

The notes to the separate financial information are an integral part thereof.

Amounts of other comprehensive income attributable to the Company itself as the parent

	Year ended December 31,		
	2013	**2012 (*)**	**2011**
	U.S. dollars in millions		
Net income for the period	**72**	73	88
Other comprehensive income net of taxes:			
Items of other comprehensive income (loss) not carried to profit or loss:			
Remeasurement of defined benefit plans, net	**15**	(5)	(5)
Total items of other comprehensive income (loss) not carried to profit or loss	**15**	(5)	(5)
Items of other comprehensive income (loss) that may be carried to profit or loss:			
Capital reserve from cash flow hedge, net	**(4)**	42	(6)
Capital reserve from available-for-sale financial assets	-	(1)	1
Foreign currency translation adjustments of foreign operation	**(1)**	-	-
Total items of other comprehensive income (loss) that may be carried to profit or loss	**(5)**	41	(5)
Total comprehensive income for the period	**82**	109	78

(*) Retroactively implemented, see Note 3y to the consolidated financial statements.

The notes to the separate financial information are an integral part thereof.

Amounts of cash flows attributable to the Company itself as the parent

	Year ended December 31,		
	2013	2012 (*)	2011
	U.S. dollars in millions		
Cash flows from operating activities:			
Net income for the period	**72**	73	88
Adjustments required for presenting cash flows from operating activities:			
Adjustments to profit and loss items:			
Depreciation and amortization (including pre-manufacturing amortization)	**88**	85	82
Finance expense (income)	**2**	(14)	(19)
Taxes on income in profit or loss	**(33)**	(4)	(1)
Company's share of earnings of associates, net	**(35)**	(38)	(91)
Decrease (increase) in value of loan to associate	**(2)**	(6)	2
Impairment of investment in associate	**2**	-	-
Loss from sale of property, plant and equipment and intangible assets	**2**	4	2
Increase (decrease) in respect of employee benefits, net	**24**	12	(12)
Decrease in value of securities measured at fair value through profit or loss, net	**(11)**	(22)	(16)
Decrease (increase) in value of long-term loans and receivables	**(6)**	(3)	4
Change in fair value of financial derivatives, net	**4**	(60)	57
Erosion (revaluation) of debentures	**22**	15	(9)
Gain from remeasurement to fair value of investment in associate in a business combination	**(17)**	-	-
	40	(31)	(1)
Changes in asset and liability items:			
Decrease (increase) in trade receivables	**(27)**	13	(38)
Decrease (increase) in other accounts receivable (including current accounts with investees)	**93**	(177)	27
Decrease (increase) in income receivable	**70**	8	(55)
Decrease (increase) in inventories and inventory in process	**13**	(9)	103
Decrease (increase) in prepaid expenses in respect of service contracts	**(7)**	(12)	3
Decrease (increase) in long-term loans and receivables	**(25)**	8	1
Increase (decrease) in trade payable	**117**	(79)	88
Increase (decrease) in provisions	**29**	23	(9)
Increase (decrease) in payables from work in progress	**80**	41	(90)
Increase (decrease) in other accounts payable (including current accounts with investees)	**31**	13	11
	374	(171)	41
Cash from operating activities:			
Interest paid	**(9)**	(4)	(3)
Interest received	**7**	15	24
Taxes on income paid	**(7)**	(26)	(35)
	(9)	(15)	(14)
Net cash provided by (used in) operating activities	**477**	(144)	114

(*) Reclassified.

The notes to the separate financial information are an integral part thereof.

Amounts of cash flows attributable to the Company itself as the parent

	Year ended December 31,		
	2013	2012 (*)	2011
	U.S. dollars in millions		
Net cash provided by (used in) operating activities (brought forward)	**477**	(144)	114
Cash flows from investing activities:			
Purchase of property, plant and equipment	**(85)**	(78)	(79)
Investment in intangible assets	**(23)**	(8)	(5)
Investment in marketable securities, net	**(129)**	(89)	28
Investment in short-term deposits, net	**(216)**	(82)	(16)
Investments and loans in investees, net	**8**	15	(40)
Dividend received from investee	**15**	40	34
Net cash used in investing activities	**(430)**	(202)	(78)
Cash flows from financing activities:			
Dividend paid	**(4)**	-	(23)
Issuance of debentures (series C)	**318**	-	(7)
Repayment of debentures	**(138)**	-	-
Short-term credit, net	**1**	-	-
Repayment of long-term loans	-	(5)	-
Net cash provided by (used in) financing activities	**177**	(5)	(30)
Increase (decrease) in cash and cash equivalents	**224**	(351)	6
Cash and cash equivalents at the beginning of the year	**407**	755	750
Translation differences from balances of cash and cash equivalents	-	3	(2)
Cash and cash equivalents at the end of the year	**631**	407	754

Non-cash activities

	Year ended December 31,		
	2013	2012 (*)	2011
	U.S. dollars in millions		
Dividend payable	-	4	-

(*) Reclassified.

The notes to the separate financial information are an integral part thereof.

NOTE 1:- GENERAL

a. Following are the financial data of Israel Aerospace Industries Ltd. ("the Company") from the Group's consolidated financial statements as of December 31, 2013, which are issued in the context of the periodic reports ("the consolidated financial statements"), attributable to the Company itself as the parent ("separate financial information"), and presented in accordance with Regulation 9C to the Israeli Securities Regulations (Periodic and Immediate Reports), 1970 ("the Regulation") and the Tenth Addendum to the Israeli Securities Regulations (Periodic and Immediate Reports), 1970 ("the tenth Addendum") regarding an entity's separate financial information.

The separate financial information should be read in conjunction with the consolidated financial statements.

b. In this separate financial information, the terms "subsidiary", "associate", "investee" and "interested party" are as defined in the consolidated financial statements.

c. The accounting policies adopted in this separate financial information are identical to the accounting policies detailed in Note 3 to the Company's consolidated financial statements, subject to the matter discussed in paragraph a) above and as detailed in paragraph c) below.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES ADOPTED IN THE SEPARATE FINANCIAL INFORMATION

The significant accounting policies adopted in this separate financial information are consistent with the accounting policies described in Notes 2 and 3 to the consolidated financial statements, subject to the matter discussed in Note 1a above and as specified below:

a. The separate financial information includes data of the financial position, profit and loss, comprehensive income and loss and cash flows included in the consolidated financial statements and attributable to the Company itself as a parent. The balances of the investments in and operating results of investees are accounted for at equity.

b. The accounting treatment of transactions between the Company and investees:

1. The transactions between the Company and subsidiaries which had been eliminated in the consolidated financial statements were recognized and measured in the separate financial information. The recognition and measurement are based on the principles determined in IFRSs and therefore these transactions were accounted for as transactions with third parties.

2. Net cash flows from transactions with subsidiaries attributable to the Company itself as a parent are presented in operating activities, investing activities and financing activities, as applicable.

NOTE 3:- CASH AND CASH EQUIVALENTS

a. Composition:

	December 31, 2013	December 31, 2012
	U.S. dollars in millions	
Cash	**109**	96
Short-term deposits	**522**	311
Total	**631**	407

b. The majority of deposits are in dollars and bear interest. The weighted average interest rate as of December 31, 2013 is 0.42% (December 31, 2012 - 2.23%).

c. As for linkage terms and interest, see Note 23d to the consolidated financial statements.

NOTE 4:- SHORT-TERM FINANCIAL ASSETS

a. Composition:

	December 31, 2013				December 31, 2012			
	Unlinked	CPI linked	Linked to foreign currency	Total	Unlinked	CPI linked	Linked to foreign currency	Total
	U.S. dollars in millions							
Financial assets at fair value through profit or loss:								
Government bonds (1)	**69**	**55**	**83**	**207**	52	50	79	181
Corporate debentures (2)	**3**	**7**	**98**	**108**	3	6	84	93
Total debentures	**72**	**62**	**181**	**315**	55	56	163	274
Shares				**280**				182
Mutual funds								
Derivatives held for trading not designated as hedging instruments				**-**				4
Derivatives held for trading designated as hedging instruments				**28**				37
Deposits (3)			**152**	**152**			13	13
Designated deposits (4)			**31**	**31**			136	136
Restricted deposits (5)			**183**	**183**			-	-
Total				**989**				646

NOTE 4:- SHORT-TERM FINANCIAL ASSETS (Cont.)

b. Additional information:

1. The Company holds Government bonds that bear annual fixed and variable interest of about 1-6% (about 1-5% in 2012). The maturity dates of the bonds range between one year and ten years from the date of the financial statements.

2. The Company holds marketable corporate debentures that bear annual interest of about 1-6%. The maturity dates of the debentures range between one year and four years from the date of the financial statements.

3. The deposits bear interest of about 0.1-1.1% and mature in a period of three to twelve months. Accordingly, the fair value of the deposits approximates their carrying amount.

4. Including dollar deposits provided in favor of banks which issued guarantees to the Company's customers in a total of approximately $ 12 million. The deposits will be gradually reduced over the sale transaction period. This item also includes a deposit in Euro held as a hedge in connection with an engagement in Euro with a supplier in a total of approximately $ 19 million.

5. Dollar deposits pledged in favor of banks which issued advance guarantees to customers. The deposits will be gradually reduced over the sale transaction period.

NOTE 5:- INVESTMENTS IN INVESTEES

a. Composition:

	December 31,	
	2013	**2012**
	U.S. dollars in millions	
Subsidiaries	**489**	385
Associates	**11**	82
Total	**500**	467

NOTE 5:- INVESTMENTS IN INVESTEES (Cont.)

b. Subsidiaries:

Composition:

	December 31, 2013	December 31, 2012
	U.S. dollars in millions	
Cost of investment in shares	**206**	199
Loans	**87**	16
Company's share of post-acquisition earnings, net	**417**	380
Provision for impairment	**(22)**	(22)
Capital reserve	**4**	1
Unrealized gain	**(1)**	(2)
Dividend received	**(202)**	(187)
Total	**489**	385

c. Associates:

Composition:

	December 31, 2013	December 31, 2012
	U.S. dollars in millions	
Cost of investment in shares	**56**	98
Debentures	**13**	91
Company's share of post-acquisition losses, net	**(54)**	(100)
Provision for impairment	**(4)**	(2)
Capital reserve	**-**	-
Unrealized gain	**-**	(5)
Total	**11**	**82**

NOTE 5:- INVESTMENTS IN INVESTEES (Cont.)

d. Movement in investments:

	Subsidiaries	Associates	Total
	U.S. dollars in millions		
Balance at January 1, 2012	384	92	476
Investment in shares	(2)	-	(2)
Company's share of earnings of investees	37	-	37
Dividend received	(40)	-	(40)
Loans, net	2	(10)	(8)
Provision for impairment	-	-	-
Capital reserve	4	-	4
Balance at December 31, 2012	385	82	467
Investment in shares	4	-	4
Company's share of earnings of investees	37	(2)	35
Dividend received	(15)	-	(15)
Loans, net	2	(8)	(6)
Provision for impairment	-	(2)	(2)
Capital reserve	3	-	3
Unrealized gain	1	-	1
Business combination (ISI)	72	(59)	13
Balance at December 31, 2013	489	11	500

(a) Loans:

In 2013, the Company granted a subsidiary loans totaling approximately $ 2 million denominated in Euro and bearing annual interest of Libor + 1%.

(b) Investment in debentures:

In 2013, the Company received a total of approximately $ 13 million on account of interest accrued on the debentures of an associate and carried a total of approximately $ 5 million in respect of interest and the increase in value of these debentures. In November 2013, an agreement was signed for the deferral of the maturity date of the debentures to November 2015 and for the lowering of the interest paid on the debentures to 6% a year.

(c) Dividend:

The Company received a dividend from a subsidiary totaling approximately $ 15 million for the earnings for 2012.

NOTE 6:- LINKED BALANCES - SEPARATE FINANCIAL INFORMATION

a. Composition as of December 31, 2013:

	In or linked to dollar	In CPI-linked NIS	In or linked to Euro	In or linked to other currency	In unlinked NIS	Total
	U.S. dollars in millions					
Assets:						
Cash and cash equivalents	528	-	2	8	93	631
Short-term financial assets	557	62	19	-	351	989
Trade receivables	129	-	13	1	218	361
Income receivable from work in progress, net	297	-	-	-	60	357
Other accounts receivable	249	-	3	-	18	270
Taxes receivable	-	98	-	-	-	98
Current accounts with investees	25	-	-	-	12	37
Long-term loans and receivables	30	-	-	-	42	72
Liabilities:						
Current maturities of debentures and other credit providers	235	2	-	-	-	237
Short-term financial liabilities	5	-	-	-	-	5
Trade payables	278	-	14	2	91	385
Other accounts payable	99	84	-	-	240	423
Provisions	80	-	-	-	16	96
Current accounts with investees	-	-	-	-	-	-
Payables in respect of work in progress, net	1,539	-	-	-	93	1,632
Debentures	346	-	-	-	-	346
Employee benefit liabilities, net	-	26	-	-	254	280

NOTE 6:- LINKED BALANCES - SEPARATE FINANCIAL INFORMATION (Cont.)

b. Composition as of December 31, 2012:

	In or linked to dollar	In CPI-linked NIS	In or linked to Euro	In or linked to other currency	In unlinked NIS	Total
	U.S. dollars in millions					
Assets:						
Cash and cash equivalents	52	-	4	6	345	407
Short-term financial assets (*)	304	62	41	-	239	646
Trade receivables	194	-	11	-	129	334
Income receivable from work in progress, net (*)	361	-	-	-	66	427
Other accounts receivable	293	-	5	1	58	357
Taxes receivable	-	83	-	-	-	83
Current accounts with investees	31	-	-	-	12	43
Long-term loans and receivables	5	-	-	-	36	41
Liabilities:						
Current maturities of debentures and other credit providers	307	4	-	-	-	311
Short-term financial liabilities	1	-	-	-	-	1
Trade payables	179	-	10	2	77	268
Other accounts payable	105	89	(1)	-	199	392
Provisions	52	-	-	-	15	67
Current accounts with investees	-	-	-	-	-	-
Payables in respect of work in progress, net	1,473	-	-	-	79	1,552
Debentures	82	-	-	-	-	82
Employee benefit liabilities, net	-	29	-	-	237	266

NOTE 7:- TAXES ON INCOME

a. Composition:

	Year ended December 31,		
	2013	2012	2011
	U.S. dollars in millions		
Current taxes	**(15)**	11	(13)
Taxes in respect of previous years, net	**(1)**	3	(3)
	(16)	14	(16)
Deferred tax expenses (income):			
Creation and reversal of temporary differences	**(10)**	(17)	24
Changes in tax rate	**(7)**	(1)	(7)
Total income tax expenses (income)	**(33)**	(4)	1

b. Taxes on income recognized directly in equity:

	Year ended December 31,		
	2013	2012	2011
	U.S. dollars in millions		
Deferred taxes	**5**	7	-
Total	**5**	7	-

NOTE 7:- TAXES ON INCOME (Cont.)

c. Reconciliation between the theoretical tax on pre-tax income and the amount of tax benefits included:

	Year ended December 31,		
	2013	**2012**	**2011**
	U.S. dollars in millions		
Income before taxes on income	**40**	64	85
Statutory tax rate	**25%**	25%	24%
Tax computed on pre-tax income at the statutory tax rate	**10**	16	20
Nondeductible expenses	**(1)**	1	-
Differences in measurement basis (dollar against CPI) and others	**(30)**	(6)	18
Effect of change in tax rate	**(5)**	(1)	(7)
Taxes in respect of previous years	**(1)**	3	(3)
Effect of benefits for beneficiary enterprise	**(3)**	(5)	-
Utilization of tax losses and timing differences from previous years for which no deferred taxes were previously recognized	**(3)**	(12)	(27)
Total income tax expenses (income)	**(33)**	(4)	1

NOTE 7:- TAXES ON INCOME (Cont.)

d. Movement in deferred taxes:

1. Composition:

	Property, plant and equipment	Employee benefits	Debentures	Available-for-sale financial assets	Other	Total
	U.S. dollars in millions					
Balance at January 1, 2011	(11)	86	(4)	-	(3)	68
Changes in 2011						
Changes carried to profit and loss	(10)	2	4	-	-	(4)
Changes carried to equity	-	-	-	-	-	-
Balance at December 31, 2011	(21)	88	-	-	(3)	64
Changes in 2012						
Changes carried to profit and loss	10	3	3	-	(10)	6
Changes carried to equity	-	-	-	-	(7)	(7)
Balance at December 31, 2012	(11)	91	3	-	(20)	63
Changes in 2013						
Changes carried to profit and loss	**8**	**17**	**-**	**-**	**-**	**25**
Changes carried to equity	**-**	**(2)**	**(4)**	**-**	**1**	**(5)**
Balance at December 31, 2013	**(3)**	**106**	**(1)**	**-**	**(19)**	**83**

2. The deferred taxes are computed at the tax rates that are expected to apply to the Group upon reversal of the temporary differences for which they were created, as detailed in paragraph b above.

NOTE 7:- TAXES ON INCOME (Cont.)

e. The expected realization dates of deferred taxes:

	December 31, 2013	December 31, 2012
	U.S. dollars in millions	
Deferred tax assets that are expected to be settled in 12 months	**35**	21
Deferred tax assets that are expected to be settled after more than 12 months	**93**	83
Deferred tax liabilities that are expected to be settled in 12 months	**(13)**	(17)
Deferred tax liabilities that are expected to be settled after more than 12 months	**(32)**	(24)
Deferred tax balances, net	**83**	63

NOTE 7:- TAXES ON INCOME (Cont.)

f. Disclosure of the tax effects relating to each component of other comprehensive income:

	Year ended December 31,		
	2013	**2012**	**2011**
	U.S. dollars in millions		
Foreign currency translation adjustments of foreign operation:			
Amount before taxes on income	**(1)**	-	-
Tax benefit (expense)	**-**	-	-
Net amount after taxes	**(1)**	-	-
Available-for-sale financial assets:			
Amount before taxes on income	**-**	(1)	1
Tax benefit (expense)	**-**	-	-
Net amount after taxes	**-**	(1)	1
Cash flow hedge:			
Amount before taxes on income	**(2)**	53	(6)
Tax benefit (expense)	**(2)**	(11)	-
Net amount after taxes	**(4)**	42	(6)
Remeasurement of defined benefit plans:			
Amount before taxes on income	**18**	(5)	(5)
Tax benefit (expense)	**(3)**	-	-
Net amount after taxes	**15**	(5)	(5)
Other comprehensive income net of taxes	**10**	36	(10)

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