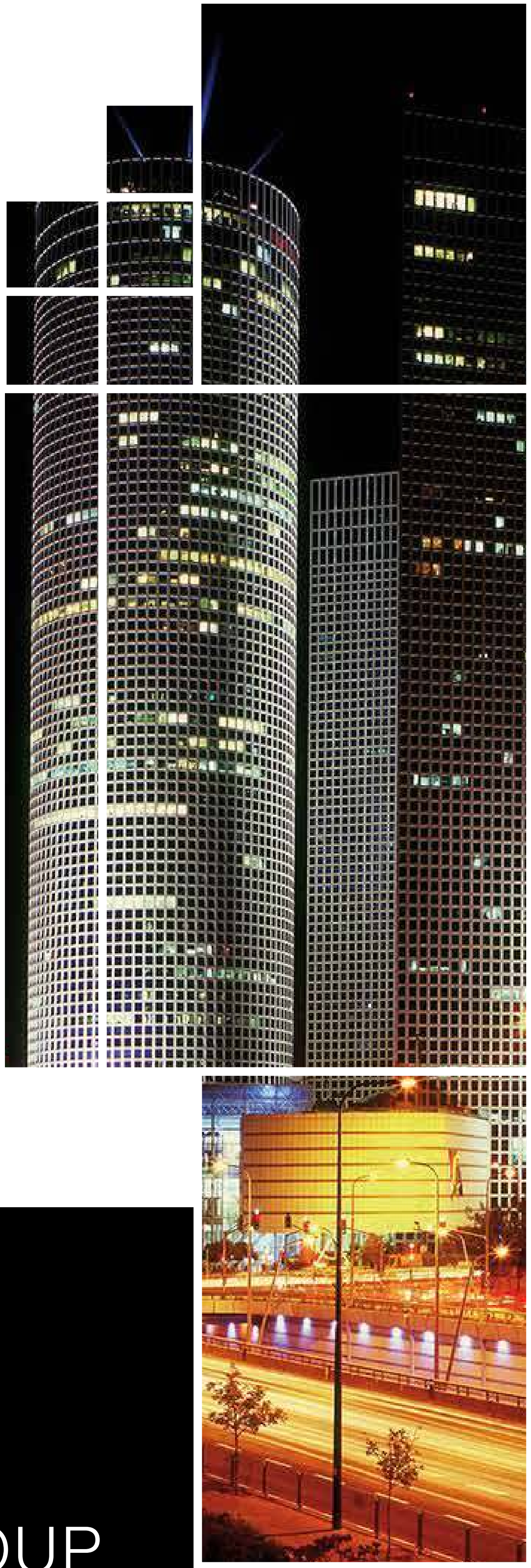
AZRIELIGROUP

Azrieli Group Ltd.

Quarterly Report
Q3/2016

Dated 30 September 2016



Part A Board Report

Part B Update of the Description of the Corporation's Business

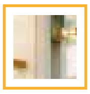
Part C Consolidated Financial Statements Dated 30 September 2016

Part D Effectiveness of Internal Control over the Financial Reporting and Disclosure

AZRIELI GROUP

Part A

Board Report



AZRIELIGROUP

Azrieli Group Ltd.

Board of Directors' Report on the State of the Company's Affairs

for the nine and three months ended September 30, 2016

The board of directors of Azrieli Group Ltd. (the "**Company**"); the Company together with all corporations directly and/or indirectly held thereby shall hereinafter be referred to as: the "**Group**" or "**Azrieli Group**") hereby respectfully submits the Board of Directors' Report for the nine and three months ended September 30, 2016 (the "**Report Period**" and the "**Quarter**" respectively), pursuant to the Securities Regulations (Periodic and Immediate Reports), 5730-1970 (the "**Regulations**").

The review that shall be presented below is limited in scope and refers to events and changes which occurred in the state of the Company's affairs in the Report Period, whose effect is material, and should be inspected together with the Description of the Corporation's Business Chapter in the periodic report for December 31, 2015, the Financial Statements and the Board of Directors' Report on the state of the Company's affairs for the year ended on the same date (the "Periodic Report for 2015") and the update to the Corporation's Business Chapter and the Financial Statements for September 30, 2016.

Extended standalone statement – the income-producing property business

The Company's management acknowledges the importance of transparency to the investors, the shareholders, the bondholders and analysts and deems all of the above as its partners. Therefore, the Company had decided to adopt a policy whereby, in the Company's Board of Directors' Report, disclosure shall be made regarding a summary of extended standalone financial statements of the Company, i.e. a summary of the Company's balance sheets and income statements on a consolidated basis, presented according to the IFRS, except for the Company's investments in Granite Hacarmel Investments Ltd. ("Granite" or "Granite Hacarmel") and in Azrieli eCommerce Ltd.[1] ("Azrieli eCommerce"), which are presented based on the book value instead of the consolidation of their statements with the Company's statements (the other investments are presented with no change from the statement presented according to the IFRS). The Company's management believes that this Report adds considerable information which helps to understand the large contribution of the real estate business to the total profit of the Company, while excluding material items of the Consolidated Financial Statements, deriving from the consolidation of Granite Hacarmel and Azrieli eCommerce, such as trade accounts receivable, inventory, sales etc. The extended standalone statement is attached hereto as Annex B. This Report is not audited or reviewed by the Company's auditors.

[1] Formerly Netex New Media Ltd., a company acquired by the Company in the framework of a transaction for the purchase of business in the eCommerce sector. For details, see Section 1.3 below.

Highlights for the Quarter and for the nine-month period ended September 30, 2016 until the Report Release Date(*)

Net Profit
• Approx. NIS 1,198 million net profit in the nine months, compared with net profit of approx. NIS 539 million in the same period last year. • Approx. NIS 279 million net profit in the Quarter, compared with net profit of approx. NIS 102 million in the same quarter last year.
FFO from the income-producing property operations
• In the nine months – approx. 9% growth in the FFO (NIS 704 million) attributed to the income-producing property operations (see Section 1.3.5 below); • In the Quarter - approx. 8% growth in the FFO (NIS 244 million) attributed to the income-producing property operations (see Section 1.3.5 below);
Improvement in the NOI in the Quarter compared with the same quarter
• Approx. 4% growth in the NOI (approx. NIS 328 million) compared with the same quarter last year (approx. NIS 315 million);
Improvement in the same-property NOI in Israel in the Quarter compared with the same quarter
• Approx. 3% growth in the same-property NOI in Israel compared with the same quarter (see Section 1.3.3 below);
Comprehensive Income
• Approx. NIS 1,211 million comprehensive income in the nine months, compared with comprehensive income of approx. NIS 619 million in the same period last year. • Approx. NIS 292 million comprehensive income in the Quarter, compared with comprehensive income of approx. NIS 83 million in the same quarter last year.
Business Development and Initiation
• In the Report Period, the Company invested approx. NIS 2,277 million in the purchase of properties, development, construction of new properties and the upgrade and betterment of existing properties (see Section 1.3 below).
Disposition of Assets in Granite Hacarmel
• In accordance with the Group's strategy, the Company is examining, on an ongoing basis, the holdings which are not in its core business in the real estate sector. For details regarding the closing of the transaction for the sale of all of Granite's rights in Sonol, see Section 1.3 below.

(*) In the above highlights, the Company included the main issues specified in this Report below. With respect to forward-looking information, including in respect of the progress of the projects under construction, see Section 1.3.1 below.

1. The Board's explanations for the state of the corporation's business

1.1 Key Data from the Description of the Corporation's Business

Summary of the Group's operating segments as of the Report Date

As of the Report Date, the Group's business activity focuses on the various real estate sectors, while the majority of the Group's business activity is in the retail centers and malls in Israel segment and in the office and other space for lease segment both in Israel and overseas. The Group also operates in the senior housing segment, in the Granite segment, which mainly includes activities in the fields of energy, water and sewage, and the Group has other activities of eCommerce and minority holdings in financial corporations. In view of the closing of the transaction for the sale of the Group's holdings in Sonol, commencing from the quarterly report as of June 30, 2016, Sonol's operations became discontinued operations, according to GAAP, and are presented in the Company's income statements separately from the continued operations (see Note 4 to the financial statements). In view of the aforesaid, commencing from this report, the Company has begun reporting on its operations in the Granite segment as a separate business segment, as defined in GAAP. In addition, commencing from this Report, the Company's business in the senior housing segment has begun to be described in the Company's financial statements as a separate business segment in view of the establishment and expansion of the business and investment in development projects in the segment. The senior housing segment and the Granite segment will now be deemed as separate business segments for the Company's quarterly and periodic reports. For details regarding the Granite business segment according to the First Schedule (the "**Barnea Schedule**") of the Securities Regulations (Details of a Prospectus and the Draft Prospectus – Structure and Form), 5729-1969, see Section 9 of Part B of this Report (update of the Description of the Corporation's Business as of September 30, 2016). For details regarding the senior housing segment according to the investment properties disclosure directive and according to the Barnea Schedule pursuant to the draft amendment of the Securities Regulations (Details of a Prospectus and Draft Prospectus – Structure and Form)(Amendment), 5774-2013, as published by the ISA in December 2013 and the Barnea Schedule, see Sections 7 and 13.1 of the Company's periodic report for 2015 which was released on March 23, 2016 (Ref.: 2016-01-012174) and Section 10 of Part B of this Report.

As of the Report Release Date, the Company reports five business segments to the public[2]:

☒ **The Retail Centers and Malls in Israel Segment** – The Company has 16 malls and retail centers in Israel, with a total leasable area of approx. 310 thousand sqm (consolidated and the Company's share) leased to approx. 1,700 tenants;

[2] "On a consolidated basis" – excluding Granite Hacarmel; the "Company's share" – net of minority holdings in certain companies.

- **Office and Other Space for Lease in Israel Segment** – The Company has 11 income-producing properties in this segment in Israel, with a total leasable area of approx. 393 thousand sqm (consolidated and the Company's share) leased to approx. 550 tenants;

- **Income-Producing Properties Segment in the U.S.** – The Company has 7 income-producing properties in this segment, with a total leasable area of approx. 199 thousand sqm (consolidated) and approx. 189 thousand sqm (the Company's share) leased to approx. 250 tenants;

- **Senior Housing Segment** – The Company has 2 active senior homes of a built-up above-ground area of approx. 49 thousand sqm which include approx. 559 senior housing units, and three projects under development and construction for the construction of approx. 840 residential units of a total area of approx. 107 thousand sqm;

- **Granite Segment** – The Company holds through Granite Hacarmel 100% of the rights in Supergas Israeli Gas Distribution Company Ltd. ("**Supergas**") which engages in the marketing of energy substitutes; and 100% (through Granite Hacarmel) of GES Global Environmental Solutions Ltd. ("**GES**") which engages in the treatment of water, wastewater and chemicals.

<u>The average occupancy rates in the income-producing properties as of the Report Release Date</u>:

- The retail centers and malls in Israel segment: approx. 97%;

- The office and other space for lease in Israel segment: approx. 99%[3];

- The income-producing property in the U.S. segment: approx. 85%[4].

- The senior housing segment in Israel: approx. 96%

<u>Additional operations</u>:

- The eCommerce business – see below a specification regarding the eCommerce business;

- Financial investments[5] - an investment in Bank Leumi Le-Israel Ltd. and in Leumi Card Ltd. See below changes in investments in the Report

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[3] Excluding the 2 buildings of Phase B in the Azrieli Holon Center, which were opened in late-2015 and at the end of Q1/2016 and are in lease-up stages.

[4] The occupancy rate presented includes space that was leased-up after the Report Date by a new tenant in part of the space which was vacated by a previous tenant which held approx. 20 thousand sqm (approx. 10% of the space of the operating segment in the U.S.) in one of the office towers in Houston. The Company is continuing to hold negotiations for the lease of the remaining vacant space. The said occupancy rate as of the Report Date (September 30, 2016) in the income-producing property in the U.S. segment was approx. 83%.

[5] In addition, the Company has negligible investments in venture capital companies, startups and investment funds as specified in the 2015 periodic report.

Period (NIS in millions):

	Investment value in the financial statements as of December 31, 2015	Investments during the nine months ended September 30, 2016	Total investment as of September 30, 2016 before adjustment to changes in fair value during the Report Period	Fair value* of the investment as presented in the financial statements as of September 30, 2016	Change in fair value in the Report Period	Dividend received in the Report Period
Investment in Bank Leumi LeIsrael Ltd. (*)	954	-	**954**	**1,007**	**53**	-
Investment in Leumi Card Ltd. (**)	603	-	**603**	**603**	-	10
Total	1,557	-	**1,557**	**1,610**	**53**	10

*Fair value of the investment in Bank Leumi LeIsrael is determined according to the value of the stock on the Stock Exchange as of June 30, 2016.

**Fair value of the investment in Leumi Card is determined by an independent valuator, according to the valuation as of December 31, 2015.

The Group's growth engines: Development of income-producing properties - As the Company has reported in the past, the Company is focusing on its core business of real estate. The Group's main growth engine is the development of income-producing property projects: malls, offices, income-producing properties in the U.S. and senior housing. As of the Report Date, the Company has 9 projects at various stages of development in Israel. The Azrieli Sarona project in Tel Aviv, whose construction is expected to be completed in 2017, expected to include approx. 115,000 sqm of offices and a boutique mall of an area of approx. 11,500 sqm. As of the Report Release Date, several agreements have been signed with tenants for approx. 50% of the leasable office space in this project. In addition, the Company is currently completing the construction of the office tower and mall in Azrieli Rishonim in Rishon Lezion which are expected to open in early 2017. Azrieli Rishonim is situated near to Route 431 and to the Rishonim train station, which allows considerable accessibility.

An additional project to be constructed on the artery of Menachem Begin North, close to the Azrieli towers, is the Azrieli Town project, while on August 31, 2016, the Company received the holding in the lot and it is expected to be completed in 2020. As of the Report Release Date, the Company has signed lease agreements with respect to space constituting more than one half of the leasable office space. In addition, the Company has several additional projects at development and construction stages, for which no completion date has yet been scheduled: expansion of the Azrieli Tel Aviv Mall and construction of a fourth tower for the Azrieli Tel Aviv Center on the land which the Company purchased from Yedioth Ahronoth and which was handed over to the Company's possession in March 2016. In addition, in Holon the Company purchased a number of plots of land for the development of the industrial and commercial area, close to the Azrieli Holon Center. In the senior housing sector, the Company has three plots of land at various development stages (see further details below).

For details with respect to projects under construction, see Section 1.3.1 below.

Betterment of properties – The Company acts for the promotion and betterment of existing properties, including by way of the addition of retail space and leasable office space. For further details, see Section 5 of Chapter B of this Report.

Senior Housing - As the Company has reported in the past, the Company from time to time looks into expanding its business, including entry into related real estate sectors. Thus, in 2014, the Company began to develop the senior housing segment, with the purchase of land for senior housing in Modiin. The Company currently has two active senior homes: Palace Tel Aviv, which was purchased in 2015, and Palace Raanana (formerly Ahuzat Bayit, Raanana), whose purchase was closed in Q2/2016. In addition, the Company has two additional projects at construction stages, one in Modiin and the other in Lehavim, which are expected to open in 2018. Another project of the Company, in Rishon Lezion, is at planning stages.

Expansion of the overseas office sector - As a development company, the Company from time to time examines growth targets for the expansion of its business, and explores opportunities, *inter alia* for the purchase of income-producing property and land for development also overseas. As part of this strategy, in August 2016, the Company purchased a property known as Lake Aspen II in Austin, Texas, in the U.S.

eCommerce Activity – Further to the Company's reports whereby it is continuing to look into business opportunities in connection with expansion of its business to additional segments which are in line with its business strategy, while gaining a foothold in the world of digital commerce which is gaining momentum in Israel and worldwide and creation of an additional growth engine, with the aim of creating a consumer experience, concurrently with the development of its core business in traditional commerce, the Company purchased business in the field of electronic commerce (eCommerce) from Buy2 Networks Ltd.

*The Company's estimates stated in this section, inter alia in connection with the dates for completion of the construction and the scopes of the projects, are forward-looking information, as defined in the Securities Law, 5728-1968 (the "**Securities Law**"), which is based on subjective estimates of the Company as of the Report Date, and there is no certainty that they will materialize, in whole or in part, or they may materialize in a materially different manner, inter alia due to factors beyond its control, including changes in market conditions, changes in the Company's plans, the time that shall be required for approval of the building plan for construction.*

1.2 Business Environment – Income Producing Real Estate Operation

In the estimation of the Company's board of directors, no material change has occurred in the business environment in which the Group operates, as described in the Board of Directors' Report as of December 31, 2015, except as specified below. The business indicators in the first nine months of 2016 show that the Israeli market is continuing to grow at the moderate pace of the last two years. In the income-producing property sector in Israel, stability has been preserved both on the level of demand and on the level of rental prices and the occupancy rate, further to the trend that characterized 2015. The (known) CPI remained unchanged in the first nine months of 2016. The Bank of Israel interest rate remained unchanged in the first nine months at 0.1%. The Prime interest rate is 1.6%.

The Company estimates that in the coming years there may be changes in the competitive balance between the players in the income-producing property sector, *inter alia* due to the opening of new retail centers and the expansion of the supply of retail spaces throughout the country and/or due to the lease-up of office projects, mainly in the Dan Metropolitan Area, which pose challenges to the sector. Recently, there has been an apparent increase in the Company’s exposure to the high-tech industry due to the growth in the lease of offices to companies from within this sector.

The Company's management estimates that the broad dispersion of the portfolio of properties owned thereby, the active current management and maintenance of the properties, their being located mainly in high-demand areas, the high business positioning of the properties and the Company’s investments in the betterment of its properties to maintain such advantage, the high occupancy rates, the broad range of businesses existing in the malls and retail centers of the Group and the suitable mix of businesses and the stable capital structure of the Company contribute to reducing the scope of the exposure of the Group's business to significant crisis and/or instability due to the materialization of any of the Company’s risk factors.

The Company’s above estimations regarding changes in the income-producing property in Israel sector and their effect on the Company’s results are merely subjective estimations and constitute forward-looking information within the definition of the term in the Securities Law. Actual effects and results may materially differ from the aforesaid estimations and what they imply, for various reasons, including the further intensification of competition, a decline in demand and a deterioration of the economic situation in Israel.

1.3 Summary of Developments in and after the Report Period, until the Release Date

Closing of the acquisition of a property in Holon

On April 13, 2016, the Company closed the acquisition of all of the ownership rights in a property of a registered area of approx. 53,000 sqm, situated in the Holon industrial zone, with a built-up area of approx. 14,300 sqm of workshops and commercial buildings thereon, which are leased to various tenants, after it received the Antitrust Commissioner’s approval, in consideration for NIS 280 million plus VAT. The designation of the land, according to a valid zoning plan, is a special industrial area with a retail front, and includes building rights of approx. 193 thousand sqm above-ground and parking basements[6].

Closing of the acquisition of "Yedioth Ahronoth House" (expansion of Azrieli Tel Aviv center)

On March 31, 2016, closing was performed of the acquisition of the full ownership of land of an area of approx. 8,400 sqm near the Azrieli Tel Aviv center, on which is currently built a building which is slated for demolition known as "Yedioth Ahronoth House"[7].

Closing of the acquisition of Azrieli Town

On August 31, 2016, a transaction was closed for the acquisition of the land designated for the Azrieli Town project, the Company paid the remaining consideration and the possession of the lot was handed over thereto.[8]

Closing of the acquisition of a senior home and retail center in Raanana

May 25, 2016 saw the closing of the acquisition of 100% of the shares of Ahuzat Bayit Raanana – Senior Housing Ltd.[9], which holds and manages "Ahuzat Bayit" (currently "**Palace Raanana**"), a senior home, and "Park Mall", a retail center in Ra'anana, in consideration for NIS 55 million, which followed the receipt of approval from the Antitrust Commissioner on April 13, 2016[10].

Winning a tender for the acquisition of lease rights designated for senior housing in Rishon Lezion

On March 13, 2016, a consolidated company won a tender conducted by the ILA for the acquisition of lease rights in a lot of an area of 3,400 sqm designated for senior housing in the Harakafot neighborhood in East Rishon Lezion, designated for the construction of at least 250 senior housing units and approx. 3,000 sqm of retail, in consideration for NIS 26.6 million. According to the terms and conditions of the tender, the consolidated company paid development

[6] For further details, see the Company's immediate reports of March 2, 2016, March 23, 2016 and April 14, 2016 (Ref.: 2016-01-039331, 2016-01-012798 and 2016-01-048550, respectively), included herein by way of reference, and Note 3B to the financial statements as of September 30, 2016.

[7] For further details, see the Company's immediate reports of May 22, 2013 and April 3, 2016 (Ref.: 2013-01-068386 and 2016-01-023433, respectively), included herein by way of reference, and Section 7.8 of the description of the corporation's business, Chapter A of the 2015 periodic report and Note 3G to the financial statements as of September 30, 2016.

[8] For further details, see the Company's immediate report of September 1, 2016 (Ref.: 2016-01-115657), included herein by way of reference.

[9] On the date of the transaction, Ahuzat Bayit was a bond company, within the definition of this term in the Companies Law, 5759-1999 (the "**Companies Law**"). On June 29, 2016, Ahuzat Bayit notified of the full and final repayment of Series A Bonds. Upon payment of the early redemption on June 29, 2016, the Company ceased to be a reporting corporation, within the definition of this term in the Securities Law.

[10] For details, see the Company's immediate reports of March 24, 2016, March 27, 2016, April 13, 2016 and May 25, 2016 (Ref.: 2016-01-013692, 2016-01-014163, 2016-01-048331 and 2016-01-034146, respectively), which are included herein by way of reference, and Note 3E to the financial statements as of September 30, 2016.

expenses of approx. NIS 22 million[11].

Purchase of an office building in Austin, Texas, U.S.A.

In August 2016, a consolidated company purchased an office building (the construction of which was completed in August 2015), located in Austin, Texas, U.S.A., for U.S. $40.5 million. The size of the property is 128,990 sqf (11,984 sqm) and it is occupied by a single tenant with a lease until 2028, with no option for early exit. The property was purchased with an average rate of return for the term of the lease of approx. 8%. For the purpose of the purchase of the property, the consolidated company took a loan in the amount of U.S. $22 million for a period of 7 years, bearing fixed dollar interest of 3.65%.

Closing of the acquisition of eCommerce business

On June 2, 2016 (following the receipt of approval from the Antitrust Commissioner on May 18, 2016), a transaction was closed for the purchase of operations in the eCommerce sector from Buy2 Networks Ltd., a public company whose shares are listed on the Tel Aviv Stock Exchange, in consideration for NIS 70 million, subject to adjustments, such that the net consideration, as of the Report Date, is approx. NIS 62 million. In addition, the Company shall pay approx. NIS 5 million per year for management services in the business sector which will be provided by the seller to the buyer for a period of 24 months[12].

Financing transactions

Date	Type of financing	Total amount raised (NIS in millions)	Annual interest rate	Duration	Collateral	Comments
July 2016	Bond issuance (Series D)	2,194	1.34	7.6	None	According to a shelf offering report published on July 5, 2016 (Ref.: 2016-01-075079), published under the Company's shelf prospectus that was published on May 10, 2016 (Ref.: 2016-01-063049). For further details regarding the Bonds (Series D), see Note 3M to the Financial Statements for September 30, 2016.
May 2016	Private financing from an institutional entity	550	1.5	6.5	Yes	Immediate report dated May 2, 2016 (Ref.: 2016-01-057004) (included by way of reference) and Note 3H to the Financial

[11] For details, see the immediate report of March 13, 2016 (Ref.: 2016-01-005097), included herein by way of reference.

[12] For further details, see the immediate reports of the Company of May 3, 2016 and June 2, 2016 (Ref.: 2016-01-057901 and 2016-01-043209), which are included herein by way of reference.

						Statements for September 30, 2016.
May 2016	Private financing from an institutional entity	300	Prime (-)0.1%	0.3	Yes	Immediate report dated May 2, 2016 (Ref.: 2016-01-057553) (included by way of reference) and Note 3I to the Financial Statements for September 30, 2016.
April 2016	Private financing from an institutional entity	250	1.35%	1.7	No	The Company has an undertaking to meet financial covenants identical to the covenants that were set forth in the indentures for the Company's Series B and Series C Bonds (the "**Indentures**"). The agreement includes standard grounds for acceleration, including grounds listed in the Indentures. In addition, the agreement includes an undertaking to not grant a floating charge on the Company's assets, in whole or in part, to any entity whatsoever, unless a floating charge is made at the same time in favor of the lender, identical in rank and scope (*pari passu*).

It is noted that in July and August 2016, the Group prepaid loans in the sum total of approx. NIS 900 million (of which approx. NIS 300 million were short-term loans and the balance mostly long-term loans which were due in March 2017). Some of the said loans were secured by various collateral which were removed after repayment of the loans.

<u>Shelf prospectus</u>

On May 10, 2016, the Company published a shelf prospectus after receiving a permit from the ISA.

<u>Closing of the sale of Sonol</u>

On July 24, 2016, Granite Hacarmel closed a transaction for the sale of all of its holdings (100%) in Sonol. The transaction was closed without material changes. On and after the closing date, the buyer paid the part of the consideration that was designated for payment on the closing date[13].

[13] For further details, see the Company's reports of June 18, 2015, October 26, 2015, February 2, 2016, April 14, 2016, June 19, 2016 and July 24, 2016 (Ref.: 2015-01-050991, 2015-01-141945, 2016-01-021562, 2016-01-048793, 2016-01-052239 and 2016-01-088873), included herein by way of reference, and Note 4 to the financial statements as of September 30, 2016.

In addition, the Company and Granite sold to other third parties all of their holdings, including through Sonol, in the Pi Glilot land and in the shares of the Pi Glilot company (which holds lease rights in respect of land in the Pi Glilot site), for total consideration of approx. NIS 130 million. These transactions have not yet been closed. Furthermore, after receipt of the consideration, Granite Hacarmel prepaid a long term loan which was secured by a pledge on the shares of Sonol. In view of the aforesaid, Sonol is presented in the Financial Statements as discontinued operations. For further details see Notes 3L and 4 to the Financial Statements as of September 30, 2016.

Senior Officers

On March 23, 2016, the Company reported the appointment of Mr. Menachem Einan as a director of the Company (Ref.: 2016-01-012291), which is included herein by way of reference. On August 9, the Company's general meeting approved the appointment of Mr. Einan and approved renewal of the office of the outside directors, Messrs. Efraim Halevy and Niv Ahituv, for a third three-year term of office (Ref.: 2016-01-100267), included herein by way of reference. During Q2/2016, the service of Mr. Ofer Avram, VP, Head of Offices Segment, and Ms. Michal Kamir, General Counsel, Company Secretary and Internal Enforcement Officer of the Company, came to an end. Messrs. Gideon Avrami (formerly CEO of the management company of Azrieli Jerusalem mall (Malcha)) and Ran Tal were appointed, respectively, in their stead.

Class Actions

On April 14, 2016, a joint motion was filed with the court to enter a judgment approving a settlement agreement in connection with a motion that was filed with the Economic Department at the Tel Aviv District Court (the "**Court**") against the Company and against the subsidiary, Canit Hashalom, for a class action concerning a full tender offer completed by the Company in September 2012, for shares of the public in Granite Hacarmel. In accordance with the Settlement Agreement, and without admitting any of the claims raised by the class plaintiff, and for settlement purposes only, the class of plaintiffs (as defined in the Settlement Agreement) will be paid NIS 1,250,000 (including the legal fees of the class plaintiff's counsel) against a full, absolute and final waiver and discharge of the action.On September 19, 2016, a hearing was held at the Court in which the parties accepted the Court's recommendation, according to which the petitioner would withdraw the motion for class action (according to the provisions of Section 16 of the Class Action Law, 5766-2006) and the respondents (the Company and a subsidiary thereof) would pay the petitioner compensation in the amount of NIS 50,000 and legal fees to the petitioner's attorney in the amount of NIS 250,000 plus VAT, without recognizing any of the petitioner's claims. These agreements were sanctioned as a judgment[14].

As has already been stated in the past, the Company is conducting initial contacts only with several entities in Israel and overseas, further to its reports in the 2015 Periodic Report, concerning business opportunities within the

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[14] For further details, see the Company's immediate reports of August 8, 2013 and April 26, 2016 (Ref.: 2013-01-113148 and 2016-01-055675, respectively), included herein by way of reference.

Company's business areas or the disposition of holdings that are not in its core business, which are not certain to mature into negotiations. The Company shall report in the future, insofar as there shall be developments which shall require reporting pursuant to law. As of the Report Release Date, there are no short-term plans which deviate from the Company's ordinary course of business and which may have material repercussions on the Company's business and results.

1.3.1 **Developments in Enterprise and Development**

As of the date of this Report, the Company is acting for the development of several properties under construction, as specified below.

Set forth below is a summary of the data regarding properties under construction and expansions as of September 30, 2016

Name of property	Location	Date of purchase	Usage	Rate of holding	Area of land (in sqm)	Sqm for marketing	Date of commencement of construction	Estimated date of completion	Value of the project on the Company's books as of September 30, 2016 (NIS in millions)	Cost invested (without discounting and tenant adjustments) as of September 30, 2016 (NIS in millions)	Estimated cost of construction including land (NIS in millions)
Azrieli Rishonim	Rishon Lezion	Aug. 2008	Commerce and Offices	100%	19,000	50,000	December 2011	March 2017	606	586	760-770
Sarona Azrieli	Tel Aviv	May 2011	Commerce and Offices	100%	9,400	11,500 115,000	May 2012	Y2017	1,674	1,375	1,600-1,660
Modi'in Senior Housing	Modi'in	June 2014	Senior Housing	100%	10,500	35,000*	April 2015	Y2018	117	113	350-360
Azrieli Town[(1)]	Tel Aviv	October 2012	Commerce, Offices and Residential	100%	10,000	75,000	September 2016	Y2020	474	291	1,000-1,050

Lehavim senior housing	Lehavim	December 2014	Senior Housing	100%	28,300	*44,000	August 2016	Y2018	28	27	320-340
Expansion of Azrieli Center Tel Aviv(2)	Tel Aviv	May 2013	Commerce, Offices and Residential	100%	8,400	69,000	September 2016 **	Not yet determined	577	407	1,000-1,050
Holon Manor land	Holon	Feb. 2015	Commerce and Offices	100%	6,200	28,000	Q2/2017	Y2020	33	36	210-230
Property in Holon Industrial Zone - Lodzia(3)	Holon	April 2016	Commerce and Offices	100%	59,200	220,000	Not yet determined	Not yet determined	324	343	Not yet determined
Rishon Lezion Senior Housing Land	Rishon Lezion	March 2016	Senior housing	100%	3,400	*28,750	Not yet determined	Not yet determined	50	50	Not yet determined
Total						676,250			3,883	3,228	

(1)On August 31, 2016 the Company received possession of this property, the data presented relate to the existing zoning plan for the land.
(2) On March 31, 2016, the Company received possession of this property, the data presented relate to the existing zoning plan for the land.
(3) Includes another plot of land (approx. 6,200 sqm, and in relation thereto marketing areas of approx. 27,000 sqm) originally purchased in an ILA tender, which constituted part of the Holon Manor land. With respect to the property purchased from Lodzia, it was determined that until April 2017, income in respect thereof belongs to the seller.
(*) The figure constitutes the scope of building rights in sqm.
(**) Work has begun for clearance of the premises for the purpose of demolition of the building.

The Company's estimates stated in this Section 1.3.1, including the above table, inter alia, in respect of the projected investments and costs for properties under construction, manner of financing the projects, dates for completion of construction, receipt of various regulatory approvals required for the progress of the projects under construction are forward-looking information as such term is defined in the Securities Law, based on subjective estimations of the Company as of the Report Date and there is no certainty to their realization, in whole or in part, or they may realize in a materially different manner, inter alia due to causes which are beyond its control, including changes in market conditions, changes in the Company's plans, the duration of time required for approval of the construction plan for performance and in prices of construction inputs.

1.3.2 The NOI (Net Operating Income) index[15]

Below are the NOI figures regarding income-producing property, from the retail centers and malls in Israel segment, from the office and other space for lease in Israel segment, from the income-producing property in the USA segment and the senior housing segment.

NIS in millions	For the three months ended		For the nine months ended		For the year ended
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015	December 31, 2015
Retail centers and malls in Israel	**196**	190	**579**	556	748
Growth rate	**3%**		**4%**		
Office and other space for lease in Israel	**92**	86	**275**	254	347
Growth rate	**7%**		**8%**		
Income-producing property in the USA	**32**	34	**91**	101	132
Growth rate	**(6%)**		**(10%)**		
Senior housing	**8**	5	**20**	5	12
Growth rate	**60%**		**300%**		
Total NOI	**328**	**315**	**965**	**916**	**1,239**
Growth rate	**4%**		**5%**		
For explanations regarding the change in the NOI, see Sections 1.10.1, 1.10.2, 1.10.3 and 1.10.4 below.					

1.3.3 Same property NOI Index[16]

NIS in millions	For the three months ended		For the nine months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Retail centers and malls in Israel segment	**192**	190	**546**	540
Office and other space for lease in Israel segment	**92**	86	**275**	254
Income-producing property in the US segment	**30**	34	**89**	101
Senior housing segment	**6**	5	**-**	-
Total	**320**	**315**	**910**	**895**
Growth rate	**2%**		**2%**	

[15] As stated in the Board of Directors' Report as of December 31, 2015, the NOI figure (which is unaudited) is one of the most important parameters in valuations of income-producing property companies and the measurement of the free cash flow available for service of financial debt that was taken to finance the acquisition of the property (after offsetting current repair and maintenance costs).

[16] Same property NOI – NOI from same properties which were held by the Group throughout all of the reported periods.

Development of actual same property NOI, per quarters (NIS in millions):

	2016			2015	
	Q3	Q2	Q1	Q4	Q3
Same property NOI in all of the periods (*)(**)	**320**	319	319	323	315
NOI from properties acquired/launched	**8**	2	-	-	-
NOI from properties sold during the period	**-**	-	-	-	-
Total NOI for the period	**328**	**321**	**319**	**323**	**315**

(*) In all of the Company's business segments.
(**) Same-property NOI includes the figures of Azrieli Holon Center which is being populated throughout all of the periods and has not been fully leased-up yet.

1.3.4 Weighted cap rate

Following is a calculation of the weighted cap rate derived from the entire income-producing property (excluding senior housing[17]) of the Group as of September 30, 2016**:**

	NIS in millions
Total Investment property in the "Extended Standalone" Statement (See Annex C) (*)	**23,324**
Net of value attributed to investment property under construction	**3,478**
Net of the value attributed to land reserves	**498**
Net of the value attributed to senior housing	**1,045**
Total value of income-producing investment properties (including fair value of the vacant space)	**18,303**
Actual NOI for the quarter ended on June 30, 2016	**320**
Addition to future quarterly NOI (**)	**21**
Total standardized NOI	**341**
Pro-forma annual NOI based on standardized NOI (excluding senior housing)	**1,364**
Weighted cap rate derived from income-producing investment property (including vacant space) (***)	**7.5%**

(*) The data are based on the update of the valuations as of June 30, 2016, (as of

[17] Since the value of senior housing properties derives from the FFO and not from the NOI, these properties were not included in this calculation. The weighted cap rate of the senior housing as of the Report Date is 8.75%.

the Report Date, the Company has not performed new valuations for the income-producing property included in this calculation), and include receivables appearing in the balance sheet item "loans and receivables" in respect of averaging attributed to real estate.

(**) The figure mainly includes estimates for an addition of NOI for vacant spaces not yet leased-up, and space that was and shall be leased-up during 2016 in a full year lease-up for which value was credited in the update of the valuations as of June 30, 2016 or that were purchased thereafter.
This figure does not constitute a forecast of the Company for the NOI of 2016 and all of its purpose is to reflect the NOI under the assumption of full lease-up for a whole year of all of the income-producing property.

(***) Annual standardized NOI rate out of the total income-producing investment property (including vacant space).

The Company's estimates mentioned in this Section 1.3.4 includes forward-looking information, as defined in the Securities Law. This information is uncertain and is based, inter alia, on information regarding a contractual engagement with tenants as of the Report Date, parameters in the calculation of the fair value and the Company's estimates in respect of lease-up of space. The actual results may be materially different to the estimates specified above and the implications thereof for various reasons, including immediate termination of lease agreements or a business crisis of any of the tenants or a change in the parameters for fair value or non-achievement of development or lease-up targets.

1.3.5 The FFO (Funds From Operations) index for the real estate business (Calculated in NIS in millions):

The FFO Index is an indicator commonly used around the world that provides an adequate basis for comparison between income-producing property companies. The index expresses net reported profit net of income and expenses of a capital nature, plus the Company's share in depreciation from real estate and other amortizations.

In this Report the FFO index is presented for the Group's income-producing property.

The Company's management believes that since the FFO index is an index customary in companies of which all of their business focuses on the income-producing property, therefore an adjustment of that index is required in companies of the Company's kind to better reflect the Group's income-producing property business while neutralizing influences which are not from the real estate business, such as in respect of non-operating items which are affected by revaluation of fair value of assets and liabilities, mainly adjustments of fair value of investment property and property under construction, various capital losses and gains, deferred tax expenses and financing expenses in respect of appreciation of financial liabilities, as specified in the basic assumptions underlying the table below. It should be emphasized that the FFO does not represent cash flow from current operations according to GAAP and does not reflect cash held by the Company and its ability to distribute the same and does not substitute the reported net profit. It is further clarified that this index is not a figure which is audited by the Company's auditors.

Remarks and assumptions:

NIS in millions	For the three months ended September 30, 2016	For the three months ended September 30, 2015	For the nine months ended September 30, 2016	For the nine months ended September 30, 2015
Net profit for the period attributed to shareholders	**279**	101	**1,195**	533
Discounting the net loss (profit) from Granite Hacarmel and from Azrieli eCommerce attributed to shareholders (including amortization of surplus costs)	**10**	88	**(14)**	71
Adjustments to profit: (1)				
Depreciation (appreciation) of investment property	**(127)**	5	**(518)**	(35)
Depreciation and amortizations	**2**	2	**5**	4
Net non-cash flow financing and other expenses (revenues)	**1**	1	**(26)**	(43)
Tax expenses	**49**	29	**28**	99
Plus benefit recorded for employee option plan	**-**	-	**-**	3
Net of dividend received from financial assets available for sale	**-**	(10)	**(10)**	(10)
Cash flow due to receipt of deposits from tenants net of return of deposits to tenants(2)	**30**	8	**40**	8
Net of revenues from forfeiture of tenants' deposits	**(5)**	(3)	**(11)**	(3)
Total adjustments to profit	**(50)**	32	**(492)**	23
Plus interest paid for real investments (3)	5	5	15	21
Total FFO attributed to income-producing property operations (4)	**244***	**226**	**704**	**648**

1. The adjustments to the profit below do not include adjustments due to Granite Hacarmel and Azrieli eCommerce since their results were discounted in full.
2. The FFO calculation changed such that deposits of the tenants in the senior housing shall be deemed as received or as repaid on the date of execution or expiration of the agreement, as the case may be.
3. Calculated according to weighted interest of the Group due to the real investments, which include: Granite Hacarmel, Azrieli eCommerce Bank Leumi and Leumi Card, due to 65% of the investments' cost.
4. Which is attributed to the shareholders only.

(*) Including income of approx. NIS 16 million in respect of apartments in Palace Raanana which were leased-up for the first time. In addition, including growth in interest expenses in view of the scope of the financing round that was performed in the Quarter to refinance loans of the Group due in the upcoming period. Insofar as the debt raised will replace the existing loans, the FFO is expected to increase.

1.3.6 The EPRA indices: Net Asset Value (EPRA NAV and EPRA NNNAV)

The Company is included in the EPRA index and is also a member of this association (European Public Real Estate Association) which incorporates the large income-producing property companies. In view of the aforesaid, the Company decided to adopt the position statement which was published by the EPRA, the aim of which is to increase the transparency, uniformity and comparativeness of financial information which is released by the real estate companies.

The EPRA NAV reflects the Company's net asset value under the assumption of continued future activity which assumes the non-disposal of the real estate assets and therefore, various adjustments are required such as presentation by fair value of properties which are not so presented in the financial statements and cancellation of deferred taxes deriving from revaluation of investment property.

The EPRA NNNAV index reflects the Company's net asset value of the Company under an immediate liquidation assumption of the "Spot" real estate segment, and therefore certain adjustments are required, such as presentation at fair value of assets and liabilities which are not so presented in the financial statements and adjustments to deferred taxes.

It should be emphasized that the indices specified above do not include the expected profit component in respect of the projects under construction which has not yet been recorded in the financial statements.

These figures do not constitute a valuation of the Company, are not audited by the Company's auditors and do not replace figures in the Financial Statements.

EPRA NAV (NIS in millions)	**As of**	
	September 30, 2016	**September 30, 2015**
Equity attributed to the Company's shareholders in the financial statements	**14,588**	13,544
Together with a tax reserve due to revaluation of investment property and fixed assets to fair value (net of the minority share)	**2,979**	2,937
EPRA NAV	**17,567**	**16,481**
EPRA NAV per share (NIS)	**145**	**136**
EPRA NNNAV (NIS in millions)	**As of**	
	September 30, 2016	**September 30, 2015**
EPRA NAV	**17,567**	16,481
Adjustment of assets' value to fair value (net of the minority)	**13**	8
Adjustment of the value of financial liabilities to fair value (net of the minority)	**(81)**	(202)

Net of tax reserve due to revaluation of investment property and fixed assets to fair value (net of the minority share)	**(2,979)**	(2,937)
EPRA NNNAV	**14,520**	**13,350**
EPRA NNNAV per share (NIS)	**120**	**110**

1.3.7 Summary of the Company's Results (Consolidated)

a. Analysis of the net profit (consolidated) NIS in millions

	For the three-month period ended		For the nine-month period ended		For the year ended
	Sep. 30, 2016	Sep. 30, 2015	Sep. 30, 2016	Sep. 30, 2015	December 31, 2015
Net profit for the period attributed to the shareholders	**279**	101	**1,195**	533	821
Net profit attributed to the shareholders and non-controlling interests	**279**	102	**1,198**	539	828
Basic profit per share from ongoing operations (in NIS)	**2.35**	1.57	**9.93**	5.07	7.59
Basic profit (loss) per share from discontinued operations (in NIS)	**(0.05)**	(0.74)	**(0.07)**	(0.68)	(0.82)
Comprehensive income for shareholders and non-controlling interests	**292**	83	**1,211**	619	846

In the Report Period, the Company recorded growth in the NOI from the real estate operations, growth in the profit from adjustment of the fair value of investment property, a decrease in the tax expenses and a decrease in the loss from discontinued operations compared with the same period last year.

b. Comprehensive Income

The Company's capital and comprehensive income are also affected by various capital funds, mainly capital funds due to adjustment to the fair value of investments treated as financial assets available for sale and by funds due to translation differences from foreign operations.

The difference between the comprehensive income and the net profit in the nine months ended September 30, 2016 mainly derives from an increase in the fair value of financial assets available for sale, net of tax of approx. NIS 54 million net of a decrease from translation differences from foreign operations of approx. NIS 41 million. The difference between the comprehensive income and the net income during the three months ending on September 30, 2016 derives mainly from the increase in the fair value of financial assets available for sale, net of tax in an amount of approx. NIS 39 million, net of a decrease in the translation differences due to foreign business in the amount of approx. NIS 26 million.

1.4 Business Results and Total Assets

Following is the contribution of the Group's operating segments to the business results: (NIS in millions)

	Segment profit for the 3 months ended:		Segment profit for the nine months ended:		Rate of the segment's profit from the total consolidated net profit in the 3 months ended:		Rate of the segment's profit from the total consolidated net profit in the nine months ended	
	Sep. 30, 2016	**Sep. 30, 2015**	**Sep. 30, 2016**	**Sep. 30, 2015**	**Sep. 30, 2016**	**Sep. 30, 2015**	**Sep. 30, 2016**	**Sep. 30, 2015**
Retail centers and malls in Israel	**196**	190	**579**	556	**70%**	187%	**48%**	103%
Office and other space for lease in Israel	**92**	86	**275**	254	**33%**	84%	**23%**	47%
Income-producing property in the USA	**32**	34	**91**	101	**12%**	33%	**8%**	19%
Senior housing	**8**	5	**20**	5	**3%**	5%	**2%**	1%
Granite	**11**	8	**66**	68	**4%**	8%	**5%**	13%
Others	**(2)**	-	**(2)**	1	**(1%)**	-	-	-
Total attributed profit	**337**	**323**	**1,029**	**985**	**121%**	**317%**	**86%**	**183%**
Changes in fair value	**127**	(5)	**518**	36	**45%**	(5%)	**43%**	7%
Net financing expenses	**(56)**	(38)	**(115)**	(97)	**(20%)**	(37%)	**(9%)**	(18%)
Tax expenses	**(90)**	(78)	**(157)**	(242)	**(32%)**	(77%)	**(13%)**	(45%)
Net administrative and other expenses	**(33)**	(11)	**(69)**	(61)	**(12%)**	(11%)	**(6%)**	(12%)
Income from continuing operations	**285**	**191**	**1,206**	**621**	**102%**	**187%**	**101%**	**115%**
Income (loss) from discontinued operations	**(6)**	(89)	**(8)**	(82)	**(2%)**	(87%)	**(1%)**	(15%)
Net profit for the period	**279**	**102**	**1,198**	**539**	**100%**	**100%**	**100%**	**100%**

The Group's revenues from the operating segments for the nine-month period ended September 30, 2016 amounted to approx. NIS 1,764 million, compared with approx. NIS 1,759 million in the same period last year, an increase of approx. NIS 5 million. The difference is comprised mainly of an increase of approx. NIS 88 million in revenues of the income-producing property segment, net of a decrease of approx. 85 in the Granite segment, mainly in GES's income as a result of the sale of Via Maris in the same quarter last year. As of September 30, 2016, the total assets on the balance sheet was approx. NIS 28.3 billion compared with approx. NIS 26.4 billion as of December 31, 2015, which increase is attributed mainly to investments and revaluations in the income-producing property segments and growth in cash, offset against a decline in assets as a result of the sale of the Sonol segment.

Following is the share of the assets of the operating segments from the total assets of the Group:

	The share of the segment's assets out of the total assets, on a consolidated basis, as of (NIS in millions)		The rate of the segment's assets out of the total assets, on a consolidated basis, as of	
	Sep. 30, 2016	**Dec. 31, 2015**	**Sep. 30, 2016**	**Dec. 31, 2015**
Retail centers and malls in Israel	**11,899**	11,056	**42%**	42%
Office and other space for lease in Israel	**7,990**	6,830	**28%**	26%
Income-producing property in the USA	**2,194**	2,052	**7%**	8%
Senior housing	**1,393**	803	**5%**	3%
Granite	**1,293**	1,175	**5%**	4%
Others and adjustments	**3,566**	4,529	**13%**	17%
Total	**28,335**	**26,445**	**100%**	**100%**

1.5 Summary of Balance Sheet Data from the Consolidated Statement: (NIS in millions)

	As of Sep. 30, 2016	As of Sep. 30, 2015	As of Dec. 31, 2015
Current assets	**2,117**	2,607	2,438
Non-current assets	**26,217**	23,722	24,007
Current liabilities	**3,584**	3,623	3,523
Non-current liabilities	**10,117**	9,063	9,052
Capital attributed to the Company's shareholders	**14,588**	13,544	13,771
Capital attributed to the Company's shareholders from the total balance sheet (in percent)	**51%**	**51%**	**52%**

The Group finances its business activity mostly by its equity, cash and cash equivalents and by using non-bank credit (mostly bonds and loans from institutional bodies), bank credit (short- and long-term) and commercial paper. The Group's financial solidity, which is characterised by low leverage and significant non-mortgaged properties, provides the Group with available sources for obtaining finance under convenient terms.

1.6 Financial Condition, Liquidity and Financing Sources (in NIS in Millions)

The Item	**Sep. 30, 2016**	**December 31, 2015**	**Explanations and Comments**
Total balance sheet	**28,335**	26,445	The increase derives mainly from an increase in investment property, growth in cash, net of a decline in assets as a result of the sale of Sonol's operations.

Current assets	**2,117**	2,438	The decrease derives from the write-off of the balances in respect of Sonol's business that was sold, offset against growth in cash.
Investment property	**23,237**	20,529	The increase derives from progress of the investments in the projects under construction and in the income-producing properties, from the purchase of land, an office building and a senior home and from revaluations.
Short-term credit	**2,396**	2,030	The increase derives from taking short term loans and an increase in the maturities of long term loans and bonds.
Loans from banks and from other credit providers	**2,489**	2,989	The decrease derives from payments and classification as current maturity, net of new loans taken.
Bonds, net	**4,514**	2,963	The increase derives from the issue of bonds, offset against current payments and classification as current maturity.
Capital	**14,634**	13,870	The increase derives from the comprehensive income for the period, net of the distribution of dividend.

(a) Liquid Means in the Group

As of September 30, 2016, the cumulative scope of liquid means (cash and cash equivalents and short-term deposits and investments) held by the Group amounted to approx. NIS 1,616 million. The Company deems its liquid means, the considerable cash flow from current operations and its non-pledged assets (at a total value of approx. NIS 19.3 billion in addition to approx. NIS 1.6 billion specified above) as significant for its financial strength, for its high financial flexibility due to its non-dependency on the availability of external sources also for the purpose of returning debts and for the ability to use investment opportunities in different periods In Section 18 of the Description of the Corporation's Business Chapter in Chapter A of the 2015 Periodic Report, the Company specified additional issues in connection with the financing activity at the Group[18]. Regarding additional possible liquid sources, the Company estimates that the Group is able to raise financing under favorable terms, even under the currently prevailing financial conditions.

Following is a table of non-pledged assets that are available to serve as collateral against the receipt of credit[19]:

Assets	Value of assets as of Sep. 30, 2016 (NIS in millions) as presented in the financial statements
Properties in retail centers and malls in Israel segment	**10,072**
Properties in the office and other space for	**6,607**

[18] In Section 18 of the Description of the Corporation's Business Chapter in Chapter A of the 2015 Periodic Report, the Company specified additional issues in connection with the financing activity at the Group.

[19] The real properties in the table do not include real properties held by Granite.

lease in Israel segment	
Other Properties	**236**
The Company's holdings in Azrieli eCommerce	**66**
Company's holdings in Leumi Card	**603**
Company's holdings in Granite Hacarmel	**753**
Company's holdings in Bank Leumi	**1,007**
Total	**19,344**

In addition, the Company holds pledged income-producing properties, the loan rate for which is lower than their fair value.

(b) Dividends

	Date of Approval	**Date of Payment**	**Sum**
Azrieli Group	March 22, 2016	May 4, 2016	NIS 400 million[20]
Leumi Card	February 23, 2016	March 1, 2016	NIS 50 million[21]
Bank Leumi	---	---	---

(c) Cash flows

	For the nine months ended on Sep. 30, 2016 NIS in millions	**For the nine months ended on Sep. 30, 2015 NIS in millions**	**Explanations and comments**
Net cash flows derived by the Group from current operations	**1,003**	907	During the period and the same period, resulted mainly from the operating profit of the income-producing property in the sum of approx. NIS 965 million (approx. NIS 916 million in the same period), and a current cash flow from Sonol until the sale thereof which was offset against income taxes paid.
Net cash flows used by the Group for investment activities	**1,827**	622	The cash flow in the Report Period was mainly used for the acquisition of and investment in investment property and investment property under construction in the sum of approx. NIS 1,807 million and for the purchase of companies consolidated for the first time. This amount was offset by the proceeds from the sale of Sonol in the sum of approx. NIS 116 million. The cash flow in the same period last year was mainly used for the acquisition of and investment in investment property and investment property under construction in the sum of approx. NIS 838 million and for the acquisition of the Palace senior housing company, offset against net proceeds received from

[20] As of September 30, 2016, the Company has retained earnings in the sum of approx. NIS 12.1 billion (including a revaluation fund for financial assets available for sale).
[21] The Company's share in the sum of the said dividend is NIS 10 million.

	For the nine months ended on Sep. 30, 2016 NIS in millions	For the nine months ended on Sep. 30, 2015 NIS in millions	Explanations and comments
			the sale of Via Maris and the solar business in the sum of approx. NIS 509 million
Net cash flows derived by the Group from financing activities	**1,453**	566	The increase versus the same period last year mainly derived from an increase in the receipt of long-term loans in the sum of approx. NIS 1,028 million in the period versus last year, net of an increase of NIS 80 million in the sum distributed as dividend, net of the purchase of non-controlling interests in the sum of approx. NIS 51 million in the current period.
Net cash flows derived by the Group from current operations	**292**	304	During the quarter and the same quarter, resulted mainly from the operating profit of the income-producing property in the sum of approx. NIS 328 million (approx. NIS 315 million in the same quarter), which was offset against income taxes paid, plus current cash flow from Sonol's operations in the corresponding quarter only.
Net cash flows used for investment activities	**474**	470	The cash flow in the Report Period was mainly used for the acquisition of and investment in investment property and investment property under construction in the sum of approx. NIS 582 million, offset against the proceeds from the sale of Sonol in the sum of approx. NIS 116 million. The cash flow in the same period last year was mainly used for the acquisition of and investment in investment property and investment property under construction in the sum of approx. NIS 233 million and for the acquisition of the Palace senior housing company.
Net cash flows derived from financing activities	**1,197**	401	The increase versus the same period last year mainly derived from an increase in the issue of bonds in the sum of approx. NIS 1,180 million in the Quarter versus last year, net of an increase of approx. NIS 460 million in the repayment of long-term loans and short-term credit in the Quarter versus the corresponding quarter.

<u>Following is the composition of the Group’s financing sources</u>

	September 30, 2016		**December 31, 2015**	
	NIS in millions	**% of total balance sheet**	**NIS in millions**	**% of total balance sheet**
Short-term credit and current maturities of loans from banks and other credit providers	**2,396**	**8%**	2,030	8%
Long-term credit from banks and other credit providers	**2,489**	**9%**	2,989	11%
Long-term bonds	**4,514**	**16%**	2,963	11%
Total	**9,399**	**33%**	**7,982**	**30%**

The increase in the sum of approx. NIS 1,417 million in the Report Period mainly derives from the issue of bonds, receipt of long-term loans and growth in short-term credit offset against current loan and bond repayments and offset against prepayment of loans. As of the Report Date, the Company has a deficit in the working capital in the sum of approx. NIS 1.5 billion on a consolidated basis and in the sum of approx. NIS 0.7 billion in the standalone statement, resulting, *inter alia*, from the decision of the Group's management, at this stage, to finance its business also through short-term credit in view of the business opportunity, due to the low interests for such credit. The Company estimates that if it decides to exchange such credit with long-term credit at any time, it will be able to do so in light of its financial strength and/or the scope of its non-pledged assets, and therefore, the Company’s board of directors determined, at its meeting of November 22, 2016, after having examined the cash flow sources and the financing of the Company, that the said deficit in the working capital does not affect its ability to repay its liabilities on time.

The Company's estimations mentioned in this Section 1.6 of the board of directors' report in relation to its liquidity and the availability of its financing resources, particularly with respect to the eventuality of converting the short-term debt into long-term debt, is forward-looking information, as defined in the Securities Law, which is based on the Company's estimations with regards to developments in markets, inflation levels and projected cash flows, its financial strength and on the conditions and possibilities for credit raising on the Report Date. Such estimations may not materialize, in whole or in part, or may materialize in a manner that materially differs from the Company's estimations. The principal factors which may affect this are: changes in the capital market which will impact the conditions and possibilities for raising credit, changes in the Company's plans, including use of liquid balances that shall exist for the purpose of utilizing business opportunities, changes in the advantageousness of holding of the various investment avenues or the advantageousness of use of various financing avenues, exacerbation of the economic situation in Israel or in the U.S. and entry into severe recession, and the Company's or any of the Group's companies’ encountering financing or other difficulties, in a manner affecting the Company's cash flow.

(d) Rating

As of the Report Date, the Company is rated AA+ by Maalot and Aa1 by Midroog. For details regarding the rating of the bonds, the commercial paper and private loans of the Company, see the Periodic Report for 2015. From the date of release of the Periodic Report for 2015 until the date of release of this report, the following updates occurred: to review Maalot's report for a private loan, see the Company's immediate report of March 29, 2016 (Ref.: 2016-01-017358), included herein by way of reference; to inspect Midroog's report for the Series D bonds of the Company, see the Company's immediate report of July 5, 2016 (Ref.: 2016-01-074611), included herein by way of reference; to review Midroog's report for the Series A and Series D bonds, see the Company's immediate report of July 20, 2016 (Ref.: 2016-01-086899), included herein by way of reference.

(e) Liabilities and Financing

Financial liabilities of the Group (except for Granite Hacarmel and Azrieli eCommerce) as of September 30, 2016, in millions of NIS:

	Fixed Interest			Variable Interest		Total		Total
	Index linked	USA Dollar Linked	Not Linked	Sterling Linked	Not Linked	Fixed Interest	Variable Interest	
Short Term Loans	-	-	-	21	961	-	982	982
Long Term Loans	6,522	1,145	252	-	42	7,919	42	7,961
Total	6,522	1,145	252	21	1,003	7,919	1,024	8,943

The date of payment of the Group's financial liabilities (with the exception of Granite Hacarmel) as of September 30, 2016, in NIS in millions:

Year	Principal	Interest	Total
1	2,317	154	2,471
2	741	121	862
3	623	110	733
4	900	94	994
5 forth	4,362	249	4,611
Total	8,943	728	9,671

The Company's policy is to finance its operations, beyond the positive and stable cash flow from current operations and current assets, mainly by long-term loans, index-linked with a fixed interest, in order to minimize market risks resulting from changes in the interest rates in the economy and neutralize the market risk resulting from changes in the CPI, while using the fact that most of the Company's revenues are index-linked.

Nonetheless, in light of the low interest rates for short-term loans with variable interest, the Company decided to finance its activity also by using short-term loans as specified above.

As of September 30, 2016, short-term loans accounted for approx. 11% of the Group's total financial liabilities (except for Granite Hacarmel and Azrieli eCommerce). In the Company's estimation, this rate is low and conservative in light of the low leverage ratio and the sum of the non-pledged assets as specified above.

According to the Company's policy, from time to time, it considers the opportunities for converting the short-term debt to a long-term debt with fixed interest. The Company's management considers on an on-going basis the payment sources for financing the existing and expected liabilities as they become due, including with respect to the cash flow and the sum of the non-pledged assets. For details regarding the offering of the Company's Series D bonds and prepayment of long-term loans and short-term credit which occurred during the quarter, see Section 1.3 of Part A of the report.

In the Report Period, the sources for financing the financial liabilities are mainly the following:

- The Group has a positive cash flow from current operations for many years. This cash flow amounted to the sum of approx. NIS 1,003 million in the nine months ended September 30, 2016, compared with the sum of approx. NIS 907 million in the same period last year.
- The liquid means and the non-pledged assets as specified in Section 1.6(a) above.
- In addition, the Group has income-producing pledged properties, the amount of the loan for which is significantly lower than their fair value.

1.7 General Administrative and Marketing Expenses (Extended Standalone)

The Company's consolidated administrative and marketing expenses (without Granite Hacarmel and Azrieli eCommerce) in the Report Period amounted to approx. NIS 69 million in the Report Period, compared with approx. NIS 64 million in the same period last year. The Company's consolidated administrative and marketing expenses (without Granite Hacarmel and Azrieli eCommerce) in the Quarter amounted to approx. NIS 26 million in the Report Period, compared with approx. NIS 22 million in the same period last year. The increase in the Report Period and in the Quarter mainly derives from an increase in marketing expenses.

1.8 The Net Financing Expenses

The Group's net financing expenses in the Report Period amounted to the sum of approx. NIS 115 million, compared with approx. NIS 97 million in the same period last year. The increase in the financing expenses mainly derives from the effect of the change in the rate of the rise in the index on loans and bonds in the Report Period, compared with the same period last year, and from an increase in the amount of the debt. The Group's net financing expenses in Q3/2016 amounted to approx. NIS 56 million, compared with approx. NIS 37 million in the same period last year. The increase in the net financing expenses mainly derives from the effect of the change in the rate of the rise in the index on loans and bonds in the Report Period, compared with the same period last year, and from an increase in the amount of the debt.

1.9 Taxes on Income

The Group's income tax expenses in the Report Period, amounted to the sum of approx. NIS 157 million, compared with tax expenses in the sum of approx. NIS 242 million in the same period last year. The decline in tax expenses in the Report Period mainly derives from reduction of the corporate tax rate to 25% (which created tax income of approx. NIS 162 million) and reduced the current tax expenses in the Report Period, offset against an increase in the tax expenses in the present period which mainly derives from an increase in the gain from fair value adjustment of investment property.

1.10 Contribution to the Company's Results According to Operating Segments

The Company implemented in its Financial Statements the International Financial Reporting Standard 8 concerning Operating Segments (IFRS8). The Company's division into segments is based on the managerial and internal reports of the Company. For details regarding the Granite business segment and the senior housing segment becoming reportable segments see Section 1.1. above, and this Section below. With respect to the income-producing property segments, the NOI figure is one of the most important parameters in valuations of income-producing property companies (for the manner of calculation of the figure, see Section 1.1.7 of the Board of Directors' Report for December 31, 2015). In addition, the contribution to the results takes into account the Company's share in the results of Granitewhich constitutes an operating segment.

1.10.1 Retail Centers and Malls in Israel Segment

Summary of the segment's business results:

	For the three-month period ended		For the nine-month period ended		For the year ended
	Sep. 30, 2016	**Sep. 30, 2015**	**Sep. 30, 2016**	**Sep. 30, 2015**	**Dec. 31, 2015**
	NIS in Millions				
Revenues	**250**	243	**723**	695	931

% change	**3%**		**4%**		
NOI	**196**	190	**579**	556	748
% change	**3%**		**4%**		

The NOI figure is one of the important parameters in valuations of income-producing property companies. For details concerning the manner of calculation of this figure, see Section 1.3.2 above.

The growth in the NOI in the nine months mainly derives from lease-up of the second floor in the Ayalon mall and the opening of the Ramla mall in March 2015.

Following is the development of the segment's NOI (NIS in millions):

	For the three-month period ended		**For the nine-month period ended**	
	Sep. 30, 2016	**Sep. 30, 2015**	**Sep. 30, 2016**	**Sep. 30, 2015**
For the segment's properties owned by the Company as of the beginning of the period[22]	**192**	190	**546**	540
For properties whose construction was completed in 2015	**-**	-	**27**	16
For properties that were purchased or whose construction was completed in 2016	**4**	-	**6**	-
Total	**196**	190	**579**	556

The same property NOI in the malls and retail centers in Israel segment was favorably affected primarily by a real increase in the rent at the time of renewal of contracts in the various properties (pursuant to option exercise by the tenants and/or execution of new agreements) and lease-up of the second floor of the Ayalon mall, offset against space left vacant in periods of tenant turnover in some of the malls.

The balance of the assets of the retail centers and malls in Israel segment – amounted, on September 30, 2016, to the sum of approx. NIS 11.9 billion, compared with approx. NIS 11.1 billion on December 31, 2015. The change mainly derives from investments in the segment's properties, the purchase of land and the revaluation profits as aforesaid.

Change due to the adjustment of fair value of investment property and investment property under construction of the segment

The gain from fair value adjustment of investment property and investment property under construction of the segment amounted, in the Report Period, to approx. NIS 119 million compared with a gain of approx. NIS 56 million in the same period last year. The assets are presented according to an update to the valuations performed by an

[22] Same property NOI – NOI from similar properties that were held by the Group throughout all of the reported periods.

independent appraiser as of June 30, 2016, with the exception of the valuations for the land to be used for expansion of Azrieli Tel Aviv center and for the property under construction Azrieli Sarona center which were performed in the first quarter and valuations for the land that will be used for the construction of Azrieli Town and for the property under construction Azrieli Rishonim that was performed in the third quarter.

1.10.2 Office and other space for lease in Israel segment:

Summary of the segment's business results:

	For the three-month period ended		For the nine-month period ended		For the year ended
	Sep. 30, 2016	**Sep. 30, 2015**	**Sep. 30, 2016**	**Sep. 30, 2015**	**Dec. 31, 2015**
	NIS in Millions				
Revenues	114	104	334	308	420
% change	**10%**		**8%**		
NOI	92	86	275	254	347
% change	**7%**		**8%**		

The increase in revenues and in the NOI derives mainly from growth in revenues from existing office space for lease and from continued lease-up of the offices in the Azrieli Holon Center.

Following is the development of the segment's NOI (NIS in millions):

	For the three-month period ended		For the nine-month period ended	
	Sep. 30, 2016	**Sep. 30, 2015**	**Sep. 30, 2016**	**Sep. 30, 2015**
Due to the segment's properties owned by the Company as of the beginning of the period[23]	**92**	86	**275**	254
Due to properties which were purchased or whose construction was completed in 2015	-	-	-	-
Due to properties which were purchased or whose construction was completed in 2016	-	-	-	-
Total	**92**	86	**275**	254

The same property NOI in the office and others in Israel segment was favorably affected primarily by a real increase in the rent at the time of renewal of contracts in the various properties (pursuant to the exercise of options by the tenants and/or execution of new contracts) and continued lease-up of Azrieli Holon Center.

[23] Same property NOI – NOI from similar properties that were held by the Group throughout the reported periods.

<u>The balance of the Group's investment property in the office and other space for lease in Israel segment</u> – amounted on September 30, 2016 to the sum of approx. NIS 8 billion compared with approx. NIS 6.8 billion on December 31, 2015. The change mainly derives from investments in the segment's properties, the purchase of land and revaluation profits as stated below.

<u>Change from adjustment of fair value of investment property and investment property under construction, of the segment</u>

The gain from the fair value adjustment of investment property and investment property under construction of the segment amounted, in the Report Period, to the sum of approx. NIS 391 million, compared with a loss of approx. NIS 17 million in the same period last year. The assets are presented according to an update to the valuations carried out by an independent appraiser as of June 30, 2016, with the exception of the valuations for the land to be used for expansion of Azrieli Tel Aviv center and for the property under construction Azrieli Sarona center which were performed in the first quarter and valuations for the land that will be used for the construction of Azrieli Town and for the property under construction Azrieli Rishonim that was performed in the third quarter.

1.10.3 <u>Income-producing property in the USA segment:</u>

Summary of the business results of the segment:

	For the three-month period ended		**For the nine-month period ended**		**For the year ended**
	Sep. 30, 2016	**Sep. 30, 2015**	**Sep. 30, 2016**	**Sep. 30, 2015**	**December 31, 2015**
NIS in millions					
Revenues	**57**	59	**167**	179	236
% change	**(3%)**		**(7%)**		
NOI	**32**	34	**91**	101	132
% change	**(6%)**		**(10%)**		

<u>Following is the development of the segment's NOI (NIS in millions):</u>

	For the three-month period ended		**For the nine-month period ended**	
	Sep. 30, 2016	**Sep. 30, 2015**	**Sep. 30, 2016**	**Sep. 30, 2015**
Due to the segment's properties owned by the Company as of the beginning of the period[24]	**30**	34	**89**	101
Due to properties	-	-	-	-

[24] Same property NOI – NOI from similar properties that were held by the Group throughout the reported periods.

purchased or whose construction was completed in 2015				
Due to properties purchased or whose construction was completed in 2016	2	-	2	-
Total	**32**	34	**91**	101

The same property NOI in the income-producing property in the USA segment was negatively affected mainly by the expiration of a contract with a tenant that held an area of approx. 20 thousand sqm in one of the office towers in Houston (which was already leased in part after the Report Date) and the effect of the average exchange rate of the U.S. dollar in the Report Period which was approx. 1% lower than the exchange rate in the same period last year.

The investment property balance of the Group in the segment – amounted, on September 30, 2016, to the sum of approx. NIS 2.2 billion, compared with approx. NIS 2.1 billion on December 31, 2015. The change mainly derives from the purchase of the office building in Austin, Texas, U.S., offset against a decrease as a result of a decline in the rate of the dollar.

Change from fair value adjustment of investment property of the segment -

The loss from fair value adjustment of investment property of the segment amounted, in the Report Period, to the sum of approx. NIS 8 million, and derived from the decline in the exchange rate of the Pound Sterling in the period.

1.10.4 Senior housing segment:

Summary of the segment's business results:

	For the three-month period ended		For the nine-month period ended		For the year ended
	Sep. 30, 2016	**Sep. 30, 2015**	**Sep. 30, 2016**	**Sep. 30, 2015**	**Dec. 31, 2015**
	NIS in Millions				
Revenues	30	18	64	18	36
% change	**67%**		**256%**		
NOI	8	5	20	5	12
% change	**60%**		**300%**		

The increase in revenues and in the NOI derives mainly from the purchase of Palace Raanana in 2016 and from the fact that Palace Tel Aviv was acquired in July 2015 and was not fully included in the corresponding period.

Set forth below is the development of the segment's NOI (NIS in millions):

	For the three-month period ended		For the nine-month period ended	
	Sep. 30, 2016	**Sep. 30, 2015**	**Sep. 30, 2016**	**Sep. 30, 2015**
Due to the segment's properties owned by the Company as of the beginning of the period[25]	6	5	-	-
Due to properties which were purchased or whose construction was completed in 2015	-	-	18	5
Due to properties which were purchased or whose construction was completed in 2016	2	-	2	-
Total	**8**	5	**20**	5

The balance of the Group's investment property in the senior housing segment – amounted, on September 30, 2016, to approx. NIS 1.4 billion, compared with approx. NIS 0.8 billion on December 31, 2015. The change mainly derives from the purchase of Palace Raanana.

Change from fair value adjustment of investment property and investment property under construction of the segment

The gain from fair value adjustment of investment property and investment property under construction of the segment amounted, in the Report Period, to approx. NIS 16 million (in the same period last year no loss or profit was recorded). The properties are presented according to an update to the valuations that were carried out by an independent appraiser as of June 30, 2016.

1.10.5 Granite segment:

Following is a summary of data from Granite's consolidated statement: (NIS in millions)

	For the three-month period ended		For the nine-month period ended		For the year ended	Comments and explanations
	Sep. 30, 2016	**Sep. 30, 2015**	**Sep. 30, 2016**	**Sep. 30, 2015**	**Dec. 31, 2015**	
	NIS in millions					
Revenues	**136**	134	**473**	558	731	The decrease in revenues in the Report Period mainly derives from the sale of Via Maris in 2015.
Segment profit	**11**	8	**66**	68	87	

[25] Same property NOI – NOI from similar properties that were held by the Group throughout the reported periods.

1.11 Comment regarding forward-looking information

The Company's intentions mentioned in the introduction to the Board of Directors' Report, the main emphases for the report and Sections 1.1 to 1.10 of the Board of Directors' Report, inter alia*, in connection with taking advantage of business opportunities and expanding the business, liquidity, financing sources and net financing expenses, the pace of the progress of the projects under construction, the projected costs for their construction, the effects of the economic situation on the Company's operating segments and with respect to the possibility of converting the short-term debt into long-term debt and/or raising debt, are forward-looking information, as defined in the Securities Law, based on the Company's plans as of the Report Date, the Company's estimates with respect to developments in the markets, inflation levels, expected cash flows, and on the conditions and the possibilities for raising credit on the Report Date.*

These estimates may not materialize, in whole or in part, or may materialize in a materially different manner than the Company estimated. The main factors which may have an effect thereon are: changes in the capital market which affect the conditions and the possibilities for raising credit, changes in the Company's plans, including use of liquid balances that shall exist for the purpose of taking advantage of business opportunities, changes in the advisability of the holding in various investment channels or the advisability of using various financing channels, delays in the granting of permits or approvals required for progress in the projects under construction, changes in the regulation relating to the Company's business, including in the field of zoning, raw materials used for construction becoming more expensive, changes in the CPI, worsening of the economic situation in Israel or in the U.S. and entering a harsh recession and the Company's or any of the Group's companies' facing financing or other difficulties, in a manner that affects the Company's cash flow.

2. Qualitative Report on the Exposure to and Management of Market risks

2.1 General

The specification below pertains to the Company and subsidiaries wholly owned thereby as well as material held companies of the Company, whose exposure to market risks may materially affect the Company. The risk management at the Company and at the Group's investee companies is determined and performed directly by their managements. The person in charge of market risk management in the Company is the CFO, Ms. Irit Sekler-Pilosof. Upon the sale of Sonol during the Quarter, the Group stopped buying and selling derivatives and assuming liabilities for the purpose of management of market risks. In addition, the Group stopped performing forward transactions in foreign currency that were intended to hedge cash flow exposure, and the exposure to changes in the price of oil distillates on the inventory value, was reduced. With the exception of the aforesaid, in the quarter ended September 30, 2016, no material changes occurred in the risk factors, in the Company's policy on the management of market risks, in the means of supervision or in the implementation of policy, compared with the description in the Board of Directors' Report regarding the state of the corporation's affairs for the year ended December 31, 2015 and in the notes to the Financial Statements for such year.

2.2 Positions in derivatives

The Company has no positions in derivatives as of the date of the report.

2.3 Analysis of sensitivity tests and fair value effects of protection transactions, exchange rates, interest and financial instruments

In the quarter ended September 30, 2016, in view of the sale of Sonol's business, changes in the prices of the oil distillates no longer affect the value of the inventory. In addition, dollar / shekel forward transactions no longer affect the sensitivity to the exchange rate of the dollar versus the shekel. With the exception of the aforesaid, no material changes occurred in the analysis of sensitivity tests and the effects on the fair value compared with the description in the Board of Directors' Report regarding the state of the corporation's affairs for the year ended December 31, 2015.

2.4 Linkage bases table

See **Annex A** to the Board of Directors' Report.

2.5 Designated Disclosure to Holders of Series B, Series C, Series D Bonds

See **Annex C** to the Board of Directors' Report.

The data in the Board of Directors' Report are based on the consolidated financial statements as of September 30, 2016. The financial data and business results of the Company are affected by the financial data and business results of the companies held thereby. In certain cases, details are presented which review events that occurred after the date of the Financial Statements and in proximity to the date of release of the Report, with such fact being stated alongside them (the "**Report Release Date**") or additional details and data on the Company level only. The materiality of the information included herein was examined from the Company's viewpoint. In some cases, an additional detailed description was provided in order to give a comprehensive picture of the described topic, which is, in the Company's opinion, material for purposes of this Report.

3. Corporate Governance Aspects

3.1 The Financial Statement Approval Procedure at the Corporation

The members of the Financial Statements Review Committee (the "**Committee**") are Prof. Niv Ahituv (Chairman of the Committee and an outside director, with accounting and financial expertise), Mr. Menachem Einan, (regular director with professional qualifications), Mr. Efraim Halevy (an outside director with professional qualifications), Mr. Joseph Ciechanover (an independent director with accounting and financial expertise), Mr. Oran Dror (independent director with accounting and financial expertise), and Ms. Tzipa Carmon (an independent director with accounting and financial expertise). For further details regarding the Financial Statements Review Committee, see the Corporate Governance Report which is attached to the Company's Periodic Report for 2015.

Financial Statement Approval Procedure

The Committee convened on November 20, 2016 to review the Financial Statements for September 30, 2016 and all of its members participated in order to formulate its recommendations to the board of directors regarding approval of the statements. After an advanced draft of the quarterly report, including all parts thereof, and the Company's presentation regarding the main financial results and material issues for discussion were forwarded to the Committee members several days before the date scheduled for the Committee's meeting.

After a discussion was held at the Committee as aforesaid, the participants who are not members of the Committee left the meeting (with the exception of the Company’s CEO, CFO and general counsel), at which point the Committee's chairman put the Committee's recommendation to the Board of Directors to the vote and asked whether any of the Committee members still had any unanswered questions or issues. At the same meeting, the Committee decided to recommend to the Board of Directors to approve the Company's Financial Statements for September 30, 2016. The Committee's recommendations were forwarded to the Board members, at the end of the Committee’s meeting, in preparation for the Board meeting which was held on November 22, 2016.

On November 22, 2016, the Company's board of directors, the corporate organ in charge of governance, approved the Company's Financial Statements for September 30, 2016. For details regarding the members of the Board of Directors, see Section 26 of Chapter D of the Company's Periodic Report for 2015. Advanced drafts of the Financial Statements, the notes thereto, the Board of Directors' Report and the annexes thereto and any report and presentation accompanying the same were sent to the Board members several days before the date scheduled for the Board meeting.

Representatives of the Company's auditor gave their comments and responded, as required, to questions directed to them by the Board members pertaining to material issues deriving from the data presented in the Financial Statements contemplated in the discussion. In the framework of presentation of the statements to the Board of Directors, the material developments in the period and the financial results were reviewed, while comparing to previous periods, during which review questions were answered. In addition, a discussion was held on the working capital deficit and the reasons why it does not indicate a liquidity problem at the Company and therefore does not constitute a warning sign. At the end of the discussion at the Board of Directors, a vote was held during which the Company's Financial Statements for September 30, 2016 were approved and the persons authorized to sign them were empowered. .

3.2 Acquisition of Canit Hashalom share

On March 6, 2016, the Company's general meeting approved (after the approval of the Audit Committee and the Company's Board) the Company's engagement with Azrieli Foundation (Israel) R.A. ("**AFI**") in an agreement for the acquisition of Canit Hashalom's share from AFI in consideration for NIS 51 million. The transaction was closed on March 14, 2016. For details, see Part B of the Invitation Report, as released by the Company on January 27, 2016 (Ref.: 2016-01-018823), included herein by way of reference, and Note 3C to the Financial Statements as of September 30, 2016.

3.3 Approval of compensation for controlling shareholder directors of the Company

On May 24, 2016, the Company's Board, after receiving the approval of the Company's Compensation Committee of May 22, 2016, approved the continued payment of the annual compensation and the said participation compensation to Messrs. Naomi Azrieli and Sharon Azrieli, who have served as directors of the Company since June 2010, under the same conditions as were approved in the past, with the exception of linkage (to date, the linked sums amount to NIS 75,175 for annual compensation and NIS 2,660 for participation compensation). In addition, the provisions of Sections 6(a) and 5(b) of the Compensation Regulations will also apply with respect to Naomi and Sharon, and they will be entitled to reimbursement of expenses pursuant to the provisions of Section 6(a) of the Compensation Regulations (including reimbursement for flights, *per diems* and hospitality) and in accordance with the criteria that were approved by the Audit Committee (as being from time to time) in relation to all of the Company's directors and subject to any law. Approval of the compensation as aforesaid is for a period of three years from June 3, 2016. It is further noted that Naomi and Sharon are entitled to letters of indemnification and to D&O insurance under the same conditions to which the Company's other directors are entitled, in accordance with the Company's compensation policy. For further details, see the immediate report that the Company released pursuant to the Companies Regulations (Relief in Transactions with Interested Parties), 5760-2000 (the "**Relief Regulations**") on May 25, 2016 (Ref. no.: 2016-01-033138), included herein by way of reference.

3.4 Renewal of liability insurance policy for directors & officers (including controlling shareholders)

On May 24, 2016 the Company's board of directors (following the approval of the compensation committee) approved an engagement for renewal of an insurance policy for directors and officers (including from among the

Company's controlling shareholders) of the Company and the Company's subsidiaries, apart from Granite Hacarmel which holds an independent D&O insurance policy, from June 3, 2016 until June 2, 2017. The engagement shall be based on the main engagement principles set forth in the Company's approved compensation policy. For further details see the Company's immediate report in accordance with the Relief Regulations of May 25, 2016 (Ref. no.: 2016-01-033144), included herein by way of reference.

3.5 Definition of business

On May 24, 2016, the Company's Board, after the approval of the Audit Committee of May 22, 2016, approved the Company's Definition of Business Procedure (the "**Procedure**"), which will apply to the Company's directors and to the Company's controlling shareholders. The Procedure determines the types of business in which they will not be able to enter into transactions in Israel and overseas and the manner of disclosure to the Company prior to the engagement in such transactions and the manner of making of the decision by the Company as to whether such transactions are relevant to the Company. The procedure will apply to controlling shareholders and members of the Board at the Company, and will be in effect throughout their term of office as controlling shareholders of the Company and/or members of the Company's Board, whichever is later, and in respect of directors for an additional six-month period thereafter, so long as no other resolution shall have been adopted by the Company's Board, after receiving the decision of the Company's Audit Committee. The Procedure determines that a controlling shareholder and/or director of the Company is prohibited from being either directly or indirectly involved in business activity which may, according to the Companies Law, fall under the definition of a business opportunity of the Company, and in any case which falls under one or more of the activities to which the Procedure applies.

The Procedure regulates the process of approval of performance of the transaction by a controlling shareholder and/or a director, if the Company chooses not to perform such transaction itself. According to the Procedure, a controlling shareholder and/or director is required to present, in writing, to the Company's management and subsequently to the Audit Committee, a transaction outline in connection with a property and/or business which falls under any of the activities according to the Procedure that he is interested in performing, and to forward all of the material relevant to the transaction for their inspection. Only if the Company's management, and subsequently the Audit Committee, shall decide that the proposed business does not interest the Company, will the controlling shareholder and/or director of the Company be free to engage in such transaction.

Due to the complexity of the issues covered by the Procedure, the timetables for performance of transactions and the concern that other bodies may thwart the transaction, decisions according to the Procedure need to be made on short notice and even immediately, all as specified in the Procedure. Therefore, the Audit Committee's decision as to whether to approve the proposed business, or alternatively to return the discussion to the Company's management for the purpose of supplementation of details, will be issued no later than up to 10 business days after the date of presentation of the proposal by such person and receipt of the material and information required, which decision will be made by a majority of members who do not have a personal interest in the decision.

It is clarified that the provisions of the Companies Law and the provisions of supplementary laws such as securities law prevail over the provisions of the Procedure, and therefore the Company is required to seek counsel in each case according to the special circumstances thereof, from the legal aspect, as applicable at such time.

3.6 Extension of the term of office of the Company's outside directors

On August 9, 2016, the general meeting of the Company's shareholders approved the appointment of the outside directors serving at the Company, Prof. Niv Ahituv and Mr. Efraim Halevy for an additional term of office, third in number. For further details, see an immediate report on the outcome of the meeting of August 9, 2016 (ref: 2016-01-100267), included herein by way of reference.

3.7 Amendment of the Company's Articles of Association

On August 9, 2016, amendments to the Company's Articles of Association were approved at the Company's shareholders meeting, mainly pertaining to the adaptation of the provisions of the Company's articles of association to the provisions of the law, including the amendment of the provisions of the Articles of Association pertaining to indemnification, insurance and grant of an exemption to officers, as well as the definition of the term a "Party Injured by a Breach" such that this definition shall apply to any act of legislation under which an administrative proceeding may be held. For details see immediate report regarding change of the Company's Articles of Association from August 9, 2016 (Ref.: 2016-01-100270) included herein by way of reference.

3.8 Approval of new compensation policy, amendment of the Company's Articles of Association, approval of extension of the chairman's agreement and update of the CEO's salary

On October 6, 2016, the general meeting of the Company's shareholders approved a new compensation policy for the Company for a period of three years. The same meeting also approved an amendment to the Company's Articles of Association and the extension of the agreement with the chairman of the Company's board of directors, Ms. Danna Azrieli (with no modification of the effective chairman's agreement). In addition, an update of the management agreement with the Company's CEO was approved. For further details, see immediate report on the summoning of the meeting dated August 28, 2016 (Ref.: 2016-01-111643) and immediate report on the results of the meeting dated October 6, 2016 (Ref.: 2016-01-060735), included herein by way of reference.

4. Provisions on Disclosure in connection with the Company's Financial Report

4.1 Description of the Company's business in the Report Period and update of the description of the corporation's business for the Report Period pursuant to Section 39A of the Securities Regulations (Periodic and Immediate Reports), 5730-1970

For events and developments in the Report Period, see Chapter B of this Report – updates to the Description of the Corporation's Business Chapter as of December 31, 2015 and Note 3 to the Financial Statements as of September 30, 2016.

4.2 Report on the Group's liabilities

A report on the Group's liabilities pursuant to Sections 38E and 9D of the regulations is attached on a separate reporting form concurrently with the release hereof.

4.3 Lawsuits

For details see Note 3R to the consolidated financial statement for September 30, 2016.

4.4 Disclosure pertaining to Very Material Valuations

As of the Report Date, no change has occurred in the parameters for the disclosure and attachment of valuations, as published in the Periodic Report for 2015. The Company updated the valuations of its assets in Israel as of June 30, 2016, performed valuations for the first time as of March 31, 2016 for the land that will be used for expansion of Azrieli Tel Aviv Center and for the property under construction Azrieli Sarona and as of September 30, 2016 for land that will be used for the construction of Azrieli Town and for the property under construction Azrieli Sharonim. (For details regarding the parameters for the update of the valuations in the quarterly statements, see Note 3C1 to the Financial Statements as of December 31, 2015).

As of the Report Date, and after the above determination was checked, it transpires that the very material valuation is in respect of the Azrieli Towers in Tel Aviv (which is included in the valuation of the entire Azrieli Center, along with its components – namely – including the Azrieli Mall) only. This valuation as of June 30, 2016 was attached to the Company's Financial Statements as of June 30, 2016, as released on August 25, 2016 (Ref.: 2016-01-109996) and the appraiser's valuation according to which no material changes had occurred to the valuation, is attached hereto. Details regarding this valuation according to the provisions of Regulation 8B of the Regulations, is attached hereto as Annex D.

As of September 30, 2016, the value of the Company's assets whose fair value was determined through a very material valuation (made as of June 30, 2016) was in the sum of approx. NIS 5 billion (which is attributed both to Azrieli Center's towers and Azrieli mall), out of a fair value of investment properties in the sum of approx. NIS 23 billion (approx. 22% of the Company's total investment properties).

4.5 Subsequent events

See Note 7 to the Financial Statements.

4.6 Financial figures attributed to the Company as a parent company

Pursuant to Regulation 9C of the Periodic Reports Regulations, financial figures from the Consolidated Financial Statements attributed to the Company as a parent company are hereby attached in Chapter C, together with an auditor's opinion.

The Company's Board of Directors and management express their great appreciation for the Company's officers, the managements of the Group's various companies and their employees, for their blessed contribution to the Group's achievements in the quarter ended September 30, 2016.

Danna Azrieli	**Yuval Bronstein**
Chairman of the Board	**CEO**

Date: November 22, 2016

<u>Annex A</u>

Reporting According to Linkage Bases

As of September 30, 2016

(IFRS 7)

Annex A
Reporting According to Linkage Bases
As of September 30, 2016 pursuant to IFRS 7
(NIS thousands)

	As of September 30, 2016					
	Israeli Currency		Foreign Currency		Others	Total
	Non-linked	Index linked	Dollar	Other (1)		
Current Assets						
Cash and cash equivalents	1,493,121	3,579	64,288	1,500	-	1,562,488
Short-term deposits and investments	52,918	154	-	-	-	53,072
Trade accounts receivable	275,569	-	8,213	-	-	283,782
Other receivables	41,457	8,132	17,317	-	72,287	139,193
Inventory	-	-	-	-	59,776	59,776
Current tax assets	-	-	-	-	18,139	18,139
Assets of disposal group that is held for sale	-	-	958	-	-	958
Total Current Assets	1,863,065	11,865	90,776	1,500	150,202	2,117,408
Non-Current Assets						
Investments and loans of associates	79,138	-	-	-	578	79,716
Investments, loans and receivables	135,293	41,819	-	-	158,693	335,805
Financial assets	1,609,393	-	23,775	-	87,923	1,721,091
Long-term receivables in respect of a franchise arrangement	-	43,861	3,251	-	3,251	50,363
Investment property and investment property under construction	-	-	-	-	23,236,558	23,236,558
Fixed assets	-	-	-	-	425,655	425,655
Intangible assets	-	-	-	-	346,324	346,324
Deferred tax assets	-	-	-	-	21,976	21,976
Total Non-Current Assets	1,823,824	85,680	27,026	-	24,280,958	26,217,488
Total Assets	3,686,889	97,545	117,802	1,500	24,431,160	28,334,896

(1) Mainly Pound Sterling.

Annex A
Reporting According to Linkage Bases
As of September 30, 2016 pursuant to IFRS 7
(NIS thousands)

(Contd.)

	As of September 30, 2016					
	Israeli Currency		Foreign Currency		Others	Total
	Non-linked	Index linked	Dollar	Other (1)		
Current liabilities						
Current maturities and credit from banks and other credit providers	996,607	1,120,453	258,513	20,565	-	2,396,138
Trade payables	178,790	-	12,236	1,085	-	192,111
Payables and other current liabilities	59,594	22,722	5,276	86	97,985	185,663
Deposits from customers	42,395	717,921	-	-	-	760,316
Provisions	-	-	-	-	12,273	12,273
Current tax liabilities	-	-	-	-	37,635	37,635
Liabilities of disposal group that is held for sale	-	-	90	-	-	90
Total Current Liabilities	1,277,386	1,861,096	276,115	21,736	147,893	3,584,226
Non-Current Liabilities						
Loans from banks and other credit providers	286,055	1,316,378	886,756	-	-	2,489,189
Bonds	-	4,514,338	-	-	-	4,514,338
Employee benefits	-	-	-	-	7,590	7,590
Other liabilities	5,448	39,459	4,057	-	44	49,008
Deferred tax liabilities	-	-	-	-	3,056,721	3,056,721
Total Non-Current Liabilities	291,503	5,870,175	890,813	-	3,064,355	10,116,846
Total Liabilities	1,568,889	7,731,271	1,166,928	21,736	3,212,248	13,701,072
Total Exposure in the Statement of Financial Position	2,118,000	(7,633,726)	(1,049,126)	(20,236)	21,218,912	14,633,824

(1) Mainly Pound Sterling.

Annex B

Financial Statements

(Extended Standalone)

As of September 30, 2016

(Unaudited and unreviewed)

Annex B

Extended Standalone Financial Statements

The Company's extended standalone financial statements are the condensed Company's reports presented according to the IFRS, except for the investments in Granite and in Azrieli eCommerce which are presented on the basis of the equity method *in lieu* of consolidation of their reports with the Company's reports (all other investments are presented with no change to the report presented pursuant to the IFRS). These statements do not constitute separate financial statements within the meaning thereof in the IAS 27, nor separate financial statements pursuant to Regulation 9C of the Securities Regulations (Periodic and Immediate Reports), 5730-1970. The statements are not part of the information that is required to be published according to securities laws. However, the Company's management believes that analysts, investors, shareholders and bond holders may obtain valuable information from the presentation of such figures.

The figures in this annex have not been audited nor reviewed by the Company's auditors.

Balance sheet:

	As of September 30		As of December 31
	2016	2015	2015
	NIS in thousands	NIS in thousands	NIS in thousands
<u>Assets</u>			
Current Assets			
Cash and cash equivalents	1,506,626	1,014,363	860,618
Short-term deposits and investments	4,155	541	506
Trade accounts receivable	93,993	50,356	44,478
Other receivables	105,277	65,538	69,023
Current tax assets	8,369	5,134	5,505
Total Current Assets	1,718,420	1,135,932	980,130
Non-Current Assets			
Investment in investee companies	778,288	1,056,267	952,919
Loans and receivables	209,803	81,221	93,190
Financial assets	1,633,168	1,657,128	1,581,575
Investment property and investment property under construction	23,236,558	20,140,632	20,516,134
Fixed assets	110,294	111,664	111,491
Intangible assets	86,544	74,192	73,952
Deferred tax assets	833	1,087	835
Total Non-Current Assets	26,055,488	23,122,191	23,330,096
Total Assets	27,773,908	24,258,123	24,310,226

Annex B

Extended Standalone Financial Statements

Balance Sheet: (Cont.)

	As of September 30		As of December 31
	2016	**2015**	**2015**
	NIS in thousands	**NIS in thousands**	**NIS in thousands**
Liabilities and Capital			
Current Liabilities			
Current maturities and credit from banks and other credit providers	2,334,916	1,229,644	1,068,409
Trade payables	143,088	114,590	125,455
Payables and other current liabilities	288,179	419,058	362,630
Deposits from senior housing customers	654,501	288,554	295,241
Current tax liabilities	23,500	75,139	91,778
Total Current Liabilities	3,444,184	2,126,985	1,943,513
Non-Current Liabilities			
Loans from banks and other credit providers	2,451,944	2,915,646	2,872,842
Bonds	4,155,700	2,582,101	2,579,151
Other liabilities	45,172	41,806	42,421
Employee benefits	5,203	3,287	3,420
Deferred tax liabilities	3,039,853	2,948,153	3,001,313
Total Non-Current Liabilities	9,697,872	8,490,993	8,499,147
Capital			
Ordinary share capital	18,223	18,223	18,223
Share premium	2,518,015	2,518,015	2,518,015
Capital reserves	428,539	467,290	407,396
Retained earnings	11,622,768	10,540,448	10,827,591
Total equity attributable to shareholders of the Parent Company	14,587,545	13,543,976	13,771,225
Not-controlling interests	44,307	96,169	96,341
Total Capital	14,631,852	13,640,145	13,867,566
Total Liabilities and Capital	27,773,908	24,258,123	24,310,226

Annex B

Extended Standalone Financial Statements

Income Statement:

	For the nine-month period ended Sep. 30		For the three-month period ended Sep. 30		For the year ended Dec. 31
	2016	2015	2016	2015	2015
	NIS in thousands	NIS in Thousands	NIS in thousands	NIS in thousands	NIS in Thousands
Revenues:					
From rent, management and maintenance fees	1,296,101	1,206,914	453,547	426,801	1,631,581
Net gain (loss) from fair value adjustment of investment property and investment property under construction	517,727	36,013	127,261	(5,038)	179,071
Financing	9,563	12,120	584	4,317	8,640
Share in results of held companies, net of tax (*)	25,903	11,413	(4,714)	246	21,447
Other	9,973	9,945	30	9,994	9,983
Total Revenues	1,859,267	1,276,405	576,708	436,320	1,850,722
Costs and Expenses:					
Cost of revenues from rent, management and maintenance fees	324,836	283,879	124,535	110,384	385,222
Sales and Marketing	23,505	19,848	10,463	7,965	34,068
General and Administrative	45,178	43,834	15,666	14,456	60,030
Financing	111,863	85,145	50,665	35,548	110,239
Total Costs and Expenses	505,382	432,706	201,329	168,353	589,559
Income before income taxes	1,353,885	843,699	375,379	267,967	1,261,163
Expenses for taxes on income	(147,520)	(222,757)	(90,736)	(76,925)	(334,571)
Income from continued operations for the period, including minority	1,206,365	620,942	284,643	191,042	926,592
Loss from discontinued operations for the period, including the minority(*)	(8,501)	(81,718)	(5,634)	(88,800)	(98,927)
Net Profit for the period, including the minority	1,197,864	539,224	279,009	102,242	827,665

(*) The comparison figures were restated due to discontinued operations, see Note 4 to the Consolidated Financial Statements.

Annex C

Designated Disclosure to the Bondholders

Annex C - Designated Disclosure to the Bondholders

Set forth below are details regarding the bonds of the Company that are held by the public:

Series	Date of the Issue	Par Value on the Date of the Issue	Par Value on the Report Date	Par Value on the Report Date, including Linkage	Amount of Interest Accrued by the Report Date	Value in the Financial Statements	Market Cap	Type of Interest	Interest Rate	Principal Payment Dates	Interest Payment Dates	Linkage Terms	Details regarding the Trustee
	NIS in millions												
Series B	February 10, 2015 June 23, 2015	623.3 600.3	1,101.2	1,101.2	3.6	1,091.7	1,084.3	Fixed	0.65	April 1 in the years 2016 to 2025 (inclusive)	From October 1, 2015 and subsequently April 1st and October 1st in the years 2016 to 2025 (inclusive).	Linkage (principal and interest) to the rise in the CPI for December 2014*.	Name of the trust company: Hermetic Trust (1975) Ltd.; Address: 113 Hayarkon St., Tel Aviv; Tel: 03-5544553; Fax: 03-5271039; E-mail address: hermetic@hermetic.co.il Contact person at the trustee: Dan Avnon or Idan Knobel.
Series C	Sept. 6, 2015	1,005.1	1,005.1	1,005.1	4.1	997.6	1,025.6	Fixed	1.64	July 1 in the years 2018 to 2027 (inclusive)	From July 1, 2016, twice a year, on January 1st and July 1st in each of the years 2016 to 2027 (inclusive).	Linkage (principal and interest) to the rise in the CPI for July 2015*.	
Series D	July 7, 2016	2,194.1	2,194.1	2,203.0	6.9	2,185.7	2,153.8	Fixed	1.34	From July 5, 2018 twice a year on January 5 and July 5 of each of the years 2018 through 2030	From January 2017 twice a year on January 5 and July 5 of each of the years 2017 through 2030	Linkage (principal and interest) to the rise in the CPI for May 2016*.	
Total		4,422.8	4,300.4	4,309.3	14.6	4,275.0	4,263.7						

* The Series B, Series C and Series D bonds are protected, such that if the known index on the relevant payment due date is lower than the base index (stated in the table), the payment index will be the base index.

Further details regarding the bonds of the Company held by the public:

1. The Series B bond series, the Series C bond series and the Series D bond series of the Company are material to the Company and are not secured by any collateral.

2. The Company will be entitled, at its sole discretion, to perform (partial or full) early redemption of the Series B bonds, the Series C bonds and the Series D bonds. For details, see Section 9.2 of the terms and conditions overleaf in the indenture for the Series B bonds (the "**Indenture for the Series B Bonds**"), which was attached to the shelf offering report that was published by the Company on February 8, 2015 (ref.: 2015-01-027136) and Section 9.2 of the terms and conditions overleaf in the indenture for the Series C bonds (the "**Indenture for the Series C Bonds**"), which was attached to the shelf offering report that was published by the Company on September 3, 2015 (ref.: 2015-01-112788), and Section 9.2 of the Terms and Conditions Overleaf of the indenture for the Series D bonds (the "**Indenture for the Series D Bonds**"), which was attached to the shelf offering report released by the Company on July 5, 2016 (ref.: 2016-01-075079), which are included herein by way of reference.

3. At the end of the Reporting Period and as of the Report Release Date, the Company has fulfilled all of the terms and conditions and undertakings according to the Indenture for the Series B Bonds, the Indenture for the Series C Bonds and the Indenture for the Series D Bonds, and no conditions establishing grounds for acceleration of the Series B, Series C bonds and Series D bonds have been fulfilled.

4. For details regarding an undertaking that the Company assumed in the framework of the Series B bonds, the Series C bonds and the Series D bonds of the Company, see Sections 5.2-5.6 of the Indenture for the Series B Bonds, the Indenture for the Series C Bonds and the Indenture for the Series D Bonds.

Rating of the bonds of the Company held by the public:

Series	Name of Rating Company	Rating Set on the Date of the Issue	Rating Set as of the Report Release Date	Date of Issuance of the Current Rating	Additional Ratings Set between the Date of the Issue and the Report Date	
					Rating	Date of Rating
Series B	Maalot	AA+ stable	AA+ stable	June 21, 2015[1]	-	-
Series C	Maalot	AA+ stable	AA+ stable	September 3, 2015[2]		
Series D	Midroog	Aa1/stable outlook	Aa1/stable outlook	July 20, 2016[3]		

[1] For Ma'alot's rating report on the Company's Series B Bonds, see the Company's immediate report of June 21, 2015 (Ref.: 2015-01-052239), which is included herein by way of reference.
[2] For Ma'alot's rating report on the Company's Series C Bonds, see the Company's immediate report of September 3, 2015 (Ref.: 2015-01-112698), which is included herein by way of reference.
[3] For Ma'alot's rating report on the Company's Series D Bonds, see the Company's immediate report of July 20, 2016 (Ref.: 2016-01-086899), which is included herein by way of reference.

<u>Annex D</u>

Details of Very Material Valuation

Annex D – Disclosure of Valuation in accordance with Regulation 8B of the Securities Regulations (Periodic and Immediate Reports), 5730-1970

Identification of the object of valuation	Azrieli Tel Aviv Center
Timing of the valuation	September 30, 2016
Value of the object of valuation in the Company's books	NIS 5,020,265 thousands
Identification and characterization of valuator	Ronen Katz of Greenberg Olpiner & Co.
Valuation model used by the valuator	DCF method
Assumptions on which the valuator based the valuation	See Section 9.2.9 of the periodic report as of December 31, 2015

Part B

Update of the Description of the Corporation's Business

AZRIELIGROUP

Azrieli Group Ltd.

Update of the Description of the Corporation's Business Chapter in the Company's Periodic Report as of December 31, 2015 (the "Periodic Report")[1]

In accordance with Regulation 39A of the Securities Regulations (Periodic and Immediate Reports) 5730-1970, following is a description of material developments that have occurred in the Company's business during the nine months ended September 30, 2016 and until the Report Release Date, with respect to which disclosure has not yet been made in the Periodic Report, according to the order of the sections in the Description of the Corporation's Business chapter in the Periodic Report. It shall be noted that the terms in this chapter shall have the meaning ascribed thereto in the Periodic Report, unless otherwise expressly provided.

In this chapter: the "**Report Release Date**" - November 23, 2016; the "**Date of the Statement of Financial Position**" and the "**Report Date**" - September 30, 2016; "**Board of Directors' Report**" – the Board of Directors' Report on the State of the Company's Affairs for the nine and three months ended September 30, 2016**.**

1. Developments that occurred in the Group's structure and business until the Report Release Date

Update to Section 1.3 of the Description of the Corporation's Business chapter:

For details with respect to (1) closing the purchase of property in Holon; (2) closing a transaction for the purchase of the "Yediot Aharonot House" (the expansion of the Tel Aviv Azrieli Center); (3) closing the purchase of Azrieli Town; (4) closing the purchase of a senior home and a retail center in Ra'anana; (5) a winning bid in a tender for the purchase of leasehold rights designated for senior housing in Rishon LeZion; (6) purchase of an office building in Austin, Texas, United States; (7) closing the purchase of digital commerce business; (8) financing transactions, debt raising and shelf prospectus; (9) closing the sale of Sonol; (10) changes in the office of executive officers; and (11) class actions; see Section 1.3 of Chapter A of this Report.

[1] As was reported by the Company on March 23, 2016 (Ref. No. 2016-01-012174), included herein by way of reference.

2. The Group’s main operating segments

Update to Section 2 of the Description of the Corporation’s Business Chapter:

Commencing from this report period, the activity of Granite Hacarmel Investments Ltd. (“**Granite**” or “**Granite Hacarmel**”) and the Company’s activity in the senior housing segment, began being described in the Company’s financial statements as separate operating segments (the Granite segment and the senior housing segment, respectively), as defined in GAAP, after the closing of the transaction for the sale of the Group’s holdings in Sonol and Granite’s remaining operations becoming a reportable segment in accordance with the quantitative thresholds required in IFRS 8 and in view of the Company’s desire to expand its activity in the senior housing segment and to become a significant player in the sector. From the quarterly report as of June 30, 2016, Sonol was made, in accordance with GAAP, discontinued operations of the Company which is presented in the Company’s income statements separately from the continued operations (see Note 4 to the financial statements as of September 30, 2016) and is no longer deemed as one of the Company’s operating segments. The Granite segment and the senior housing segment shall be deemed, from this point forth, as separate operating segments for the purpose of the quarterly and periodic reports of the Company. For details regarding Granite in accordance with the Barnea Schedule to the Securities Regulations (Details of the Prospectus and Draft Prospectus – Structure and Form), 5729-1969, see Section 9 below.

For details regarding the senior housing segment according to the Investment Property Disclosure Directive and pursuant to the Barnea Schedule in accordance with the draft amendment to the Securities Regulations (Details of the Prospectus and Draft Prospectus – Structure and Form) (Amendment), 5774-2013, as published by the ISA in December 2013 and the Barnea Schedule, see Sections 7 and 13.1 of the Company’s 2015 periodic report which was published on March 23, 2016 (ref.: 2016-01-012174) and Section 10 below.

3. Investments in the Company's Capital and Transactions in its Shares

Update to Section 3 of the Description of the Corporation’s Business chapter:

For details regarding the holdings of interested parties in the Company, see immediate report dated October 13, 2016 (Ref.: 2016-01-063066), which is incorporated herein by way of reference.

For details with respect to changes that occurred in the holdings of The Azrieli Foundation, an interested party in the Company, see the Company's immediate reports dated March 29, 2016, March 30, 2016 and April 3, 2016 (Ref.: 2016-01-016773, 2016-01-018678 and 2016-01-023424, respectively), which are incorporated herein by way of reference.

For details with respect to changes that occurred in the holdings of Mr. Menachem Einan, a Director in the Company, see the Company's immediate report of April 3, 2016 (Ref.: 2016-01-024156), included herein by way of reference.

4. Dividends

Update to Section 4 of the Description of the Corporation's Business chapter:

On May 4, 2016, the Company paid a dividend to its shareholders in the total amount of approx. NIS 400 million. For details, see Section 1.6(b) of Chapter A of this Report.

5. Properties under Development

Update to Section 7.7 of the Description of the Corporation's Business chapter:

During the Report Period, the Group continued to invest in the development and construction of new properties and in the expansion and renovation of existing properties, *inter alia*, lease-out of additional areas in Azrieli Sarona and receipt of a Form 4 for the parking lots (not for population), completion of the Azrieli Holon Center project and receipt of an occupancy permit for the entire project. With respect to the senior housing project in Modi'in, a permit was received for construction of the basement level of the project, and an above-ground building permit was received for most of the residential units. At Azrieli Tel Aviv mall, the Urbanica store has been opened, and renovation of Azrieli Jerusalem (Malcha) mall was commenced. Renovation of the Azrieli Beer Sheva mall has been completed. In addition, the construction of the "Zappa" club in Azrieli Haifa mall has been completed and the club has been opened to the general public. At the Raanana Palace senior home, the Company is acting for promotion of a zoning plan for the addition of building rights and the Company has begun renovating the buildings.

With respect to the senior housing in Lehavim, applications for building permits for the project have been submitted and a permit was received for foundation and excavation work. In October 2016, an appeal was filed by the residents of Lehavim against the decision of the Licensing Authority to approve the above-ground permit in the project. The Company is acting for summary dismissal of the appeal and a hearing has been scheduled for December 6, 2016.

Azrieli Town – On August 31, 2016, the transaction in relation to the land was closed, the Company paid the balance of the consideration and possession of the lot was handed over thereto. In addition, the Company filed an application for an above-ground building permit in May 2016, which is in the process of approval by the local committee. In September 2016, the local committee approved the Company's application for a shoring, excavation and foundation permit for the project and the Company is acting for fulfillment of the conditions determined therein for receipt of the permit. As of the Report Date, the Company has completed the work of demolition of the building in the property and is continuing to carry out the work. As of the Report Release Date, the Company has signed agreements for the lease of 26 thousand sqm of office space in the project, constituting more than one half of the leasable office space in the project.

6. Land Reserves (Additional Details)

Update to Section 7.8 of the Description of the Corporation's Business chapter:

As of the Report Date, the transaction for the purchase of land for expansion of Azrieli Tel Aviv Center (Yediot Aharonot) was closed and possession of the lot was handed over to the Company. As of the Report Release Date, the Company began the work of evacuation of the building for the purpose of its demolition. In April 2016, the deposit of the zoning plan was approved, subject to the conditions of the District Committee.

With respect to lots purchased by the Company in Holon (including a lot purchased from Lodzia), whose designation is commerce and offices, applications have been filed for building permits for shoring, excavation and basements.

Pi-Glilot Land

In the Report Period, the Company and Granite engaged in an agreement for the sale of all of their holdings in the Pi-Glilot land. For further details, see Section 1.3 of Chapter A of this Report.

For further details regarding the above projects and in respect of the total investments during the Report Period, which the Group continued to invest in the development and construction of new properties and in the expansion of existing properties, see Section 1.3.1 of Chapter A of this Report.

7. Developments Pertaining to Azrieli Tel Aviv Center

Update to Section 9.2 of the Description of the Corporation's Business chapter:

Azrieli Towers in Tel Aviv

(Data according to 100%) (*)	For the Quarter Ended Sept. 30, 2016	For the Quarter Ended June 30, 2016	For the Quarter Ended March 31, 2016	For the Year Ended December 31, 2015
Value of property (NIS in thousands)	2,849,006	2,845,593	2,826,199	2,821,819
NOI in the period (NIS in thousands)	51,235	51,221	52,030	206,354
Revaluation profits (losses) in the period (NIS in thousands)	(1,873)	14,953	(1,031)	24,643
Average occupancy rate in the period (%)	~100%	~100%	~100%	100%
Rate of return (%)	7.2%	7.2%	7.4%	7.3%
Average rent per sqm per month (NIS) (**)	104	102	102	101

(*) As of March 2016, the Corporation's share in the property is 100%.
(**) The figure does not include the rent of the hotel which is located in the Square Tower in Azrieli Center in Tel Aviv. Had the hotel's rent been included, the average rent per sqm per month in Q3/2016 would have been approx. NIS 99 per sqm, in Q2/2016 would have been approx. NIS 98 per sqm, in Q1/2016 would have been approx. NIS 97 per sqm and in 2015 approx. NIS 97 per sqm.

An update of the valuation for this property was published in the Company's financial statements as of June 30, 2016 and the appraiser estimates that no material changes have occurred in the valuation, attached hereto in a separate file.

8. Sonol

With respect to the closing of the sale of Sonol on July 24, 2016, see Section 1.3 of Chapter A of this Report.

9. Granite Segment

For details about Granite segment, see **Annex A** to this Chapter B.

10. The Senior Housing Segment

For details about the senior housing sector, see **Annex B** to this Chapter B.

11. Additional Operations

Update to Section 13.3.1 of the Description of the Corporation's Business Chapter – Investment in Leumi Card:

Final report of the Committee for Increasing Competition in Common Banking and Financial Services (the "**Strum Committee**")

Further to the disclosure made in the 2015 Periodic Report regarding the interim report of the Strum Committee, on July 7, 2016, the Strum Committee released its final report. Based on the report, the Legislative Memorandum for Increasing Competition and Reducing Concentration and Conflicts of Interest in the Banking Market in Israel, 5776-2016 (the "**Legislative Memorandum**") was published, approved by the Government on August 2, 2016, and passed first reading in the Knesset on August 3, 2016. The Legislative Memorandum requires Bank Leumi and Bank Hapoalim, within 3 years, to sell their holdings in the credit card companies held thereby and also prohibits them from operating the issuance of charge cards, clearing charge cards and holding a corporation that operates such issuance or clearing. The Legislative Memorandum imposes additional restrictions on the activity of Bank Hapoalim and Bank Leumi in the credit card sector, upon completion of the sale, and for a 5-year period.

The Legislative Memorandum on the Control of Financial Services Law (Extra-Institutional Financial Services) (Amendment), 5776-2016 (the "**Control Law Legislative Memorandum**")

On July 13, 2016, the Legislative Memorandum on the Control of Financial Services Law (Extra-Institutional Financial Services) (Amendment), 5776-2016 was published, which concerns allowing certain financial service providers to operate, subject to receipt of the appropriate license, also in the field of issuing charge cards as issuers.

Credit Data Law, 5776-2016

Q2/2016 saw the completion of the process of legislation of the Credit Data Law, 5776-2016, addressing the saving of information for the purpose of delivery thereof to the credit database, and the publication of draft regulations by virtue thereof.

Draft outline for the establishment of a new bank

On June 14, 2016, the Banking Supervision Department released a draft outline for the establishment of a new bank in Israel, with the first part of the document focusing on the outline for the grant of a banking license to credit card companies and the second part of the document focusing on the required conditions and the relaxations for the establishment of a new bank from the ground up. The relaxations pertain, *inter alia*, to automation and operation requirements, capital requirements, the license receipt process and digital banking. The outline also includes the devising of a supervisory model and regulation that are compatible with new and small banks.

Paper of Principles for Regulation of Payment Services in Israel

On October 5, 2016, the Bank of Israel published a paper of principles for regulation of payment services in Israel. The principles in the paper are based on the European Payment Services Directive (PSD). Among the issues addressed in the paper of principles are included, *inter alia*, regulation of and licensing entities that provide various services, including payment services that include transfer to third party or payment due to product or service; the issuance of means of payment and the clearing of payment transactions; the principles include also the arrangement of access to the payment systems and the repeal of the Debit Cards Law, 5746-1986. These principles are expected to be integrated in legislation through various stages. At this stage a legislation is promoted which will regulate the operations of nonbank entities in the financial services sector, and which are also expected to provide payment services (see: the Bill for Control of Financial Services (Deposit and Credit Services), 5776-2016, and the Control of Financial Services (Regulated Financial Services) Law, 5776-2016).

12. Financing

Update of Section 18.3 of the Description of the Corporation's Business Chapter:

Engagement in Loan Agreements

For details regarding loan agreements into which the Company entered with institutional bodies, see Section 1.3 of Chapter A of the Report.

For details regarding the prepayment of loans in July and August 2016, see Section 1.3 of Chapter A of the Report.

13. Non-Bank Financing for the Company

Update of Section 18.5 of the Description of the Corporation's Business Chapter:

Series A Bonds of the Company

During the Report Period, principal and interest payments were made in accordance with their payment schedules. As of the Report Date, the balance of nominal value of the Company's Series A Bonds is NIS 407 million.

Series D Bonds of the Company

On July 5, 2016, the Company published a shelf offering report for the issue and listing on TASE of up to NIS 2.2 billion par value of a new bond series (Series D) under a shelf prospectus of the Company. On July 7, 2016, the Company announced that according to the results of the issue, NIS 2.194 billion par value of Series D Bonds had been allotted in consideration for NIS 2.194 billion (NIS 2.177 billion after attribution of the issue expenses). For details regarding Series D Bonds, see Note 3N to the Financial Statements (Part C of the Report).

Commercial Paper

In March 2016, the Company expanded an unrated CP series in the amount of NIS 40 million par value to a total amount of NIS 190 million, in addition to the existing rated series in the total amount of NIS 480 million par value. During Q3/2016, the Company reduced the rated series from NIS 480 million par value to approx. NIS 471 million par value. Subsequently to the date of the balance sheet as of September 30, 2016, NIS 5 million of this series were repaid, and as of the Report Release Date, the Company has two CP series, a rated series in the sum of approx. NIS 466 million and an unrated series in the sum of NIS 190 million.

14. Credit Rating

Update of Section 18.11 of the Description of the Corporation's Business Chapter:

On March 29, 2016, Ma'alot set an AA+ rating for a private loan in the amount of up to NIS 250 million to be taken by the Company. For details, see the Company's immediate report of March 29, 2016 (Ref.: 2016-01-017358), which is included herein by way of reference.

On July 5, 2016, Midroog issued a stable Aa1 rating for the issue of a new bond series (Series D), in a total amount of up to NIS 2.2 billion, to be raised by the Company. For details see the Company's immediate report of March 29, 2016 (Ref. 2016-01-074611), which is included herein by way of reference.

On July 20, 2016, Midroog confirmed a stable Aa1 rating for the Company's bond series (Series A and Series D). For details see the Company's immediate report of July 20, 2016 (Ref. 2016-01-086899), which is included herein by way of reference.

15. Legal Proceedings

For an update with respect to the legal proceedings conducted against the Group's companies, see Note 3R to the Financial Statements as of September 30, 2016.

Annex A – Details about the Granite Segment

1. General Information on the Granite Segment

As of the date of the financial statements as of September 30, 2016, the Company holds, through Canit Hashalom, 100% of the issued and paid-up capital of Granite Hacarmel which is active mainly both in the marketing of energy substitutes (LPG and natural gas), through the subsidiary Supergas Israel Gas Distribution Company Ltd. ("**Supergas**") and in issues of treatment of water, sewage and chemicals through the subsidiary G.E.S. Global Environmental Solutions Ltd. ("**GES**").

Financial information regarding Granite's operations

Set forth below is financial information regarding Granite's operations

	For the period ended		
	September 30, 2016 (NIS in thousands)	**December 31, 2015 (NIS in thousands)**	**December 31, 2014 (NIS in thousands)**
Revenues			
From outsiders	472,578	731,309	856,518
From other operating segments	-	-	-
Total	472,578	731,309	856,518
Attributed costs			
Costs not representing revenues from other operating segments	406,861	643,854	783,121
Costs representing revenues of other operating segments	-	-	-
Total	**406,861**	**643,854**	**783,121**
Profit from operations attributed to the operating segment	**65,717**	**87,455**	**73,397**
Fixed costs attributed to the operating segment	145,058	190,372	185,709
Variable costs attributed to the operating segment	261,803	453,482	597,412
Profit from operations attributed to owners of the parent company	**66,136**	**86,723**	**70,627**
Profit from operations attributed to non-controlling interest	**(419)**	**732**	**2,770**
Total assets attributed to the operating segment	**1,293,029**	**1,175,267**	**2,578,984**

Energy Substitutes

2. General Information

Granite operates in the marketing of energy substitutes through Supergas.

2.1 Marketing of energy substitutes

Supergas engages in the marketing of energy substitutes such as LPG, natural gas and compressed natural gas (“**CNG**”). The main use of the energy substitutes is for operating burners in industry, for operating ovens at bakeries and restaurants, for heating institutions, for heating henhouses in agriculture as well as for cooking and heating in households. In the context of such activity, Supergas purchases locally, imports, stores, markets and distributes LPG and natural gas to industrial, business, institutional and domestic customers.

2.2 Restrictions, legislation, standards and special constraints that apply to Supergas’ business

Supergas’ business is subject to laws, regulations and orders which pertain, *inter alia*, to the determination of specific instructions pertaining to the marketing of the products, to the determination of standards of quality, safety, security, storage, marking and identification of products, transportation, proper business management, consumer protection, the environment, price control and various legislation and standards restrictions. For details regarding restrictions, legislation, standards and special constraints that apply to Supergas’ business, see Section 16 below.

Various regulatory requirements, including those mandating compliance with strict safety requirements for the supply of LPG and CNG, impose on Supergas an obligation to make considerable financial investments in order to comply therewith. See further details in Section 16 below.

2.3 Changes in the business volume and profitability of Supergas

See Section 1.10.5 of Chapter A of this Report (the contribution of the Granite segment to the results of operations).

2.4 Developments in the markets of Supergas’ business or changes in the characteristics of its customers

In recent years, there has been an apparent increase in competition in the marketing of energy substitutes, mainly due to a rise in the number of competitors which leads to a decrease in prices in the sector. However, the level of service and the goodwill of Supergas are also components in the customers’ decision regarding choosing a supplier in this sector.

2.5 The critical success factors in Supergas’ business and the changes that occur therein

The main success factors are: developed marketing, distribution and logistics systems, reliable supply, the ability to extend credit to customers, a developed billing and collection system, professional know-how, safety standard, quality of service and price.

2.6 Changes in the suppliers and raw materials for the operating segment

For details regarding the raw materials and suppliers, see Section 13 below.

2.7 The main barriers to entry and exit of Supergas' business and changes that occur therein

Engaging in the marketing of LPG requires a gas supplier license. Receipt of this license and compliance with the terms and conditions thereof, as well as with the conditions of additional legal provisions that apply to the entities operating in the sector, involve considerable investments in manpower and equipment.

Engaging in natural gas issues requires an engagement for the purchase of natural gas. Activity in the field of CNG requires receipt of a license from the Ministry of National Infrastructures, Energy and Water Resources (the "**Ministry of National Infrastructures**").

Supergas has engagements in long-term agreements with suppliers and customers which may constitute a barrier to exiting the segment. In addition, vacating various facilities and sites may involve costs and may also constitute an exit barrier.

2.8 Structure of the competition in Supergas' business and changes that occur therein

For details regarding the structure of the competition in the operating segment and changes that occur therein, see Section 8 below.

3. Products and Services

3.1 Energy substitutes

As aforesaid, Supergas mainly engages in the field of marketing LPG, natural gas and CNG. Supergas' products are used as energy for operating burners in industry, for operating ovens at bakeries and restaurants, for heating institutions, for heating henhouses in agriculture as well as for cooking and heating in households. The LPG is marketed to customers in portable gas containers (at capacities of 12kg and 48kg) and by filling gas in stationary tanks on the premises of the customers. In addition, Supergas markets LPG-operated appliances to its customers (water heaters, heating furnaces and domestic heating radiators). The natural gas is marketed to customers via the distribution network of the natural gas directly to plants or by transporting CNG in tanker trucks to plants which the distribution network has not yet reached.

4. Breakdown of Income and Profitability of Products and Services

Supergas' income from the business of marketing energy substitutes for 2014 and 2015 and for the nine-month period ended September 30, 2016, amounted to the sum of NIS 544,384 thousand, NIS 498,921 thousand and NIS 358,411 thousand, respectively, which constitute a rate of 24%, 21% and 20% of the sum of the company's income, respectively.

5. Customers

Customers of Supergas in the energy substitutes sector include industrial customers, various commercial and institutional customers, customers from the fields of agriculture, trade and private households. In addition, Supergas is the only LPG supplier to the IDF, the police and the prison service.

Supergas' engagements with its commercial customers include the installation of equipment, storage of the LPG and for some of the customers the supply of end equipment. The period of the engagement between Supergas and its customers is affected, *inter alia*, by the scope of the investment in the equipment that was provided to the customer. With its institutional customers, the engagements are generally made based on winning tenders.

Supergas is not dependent on a single customer or on a limited number of customers, the loss of which would significantly affect it. In addition, Supergas does not have a single customer, the income from which constitutes 10% or more of the sum of Supergas' income.

6. Marketing and Distribution

Marketing of energy substitutes

Supergas markets its products directly and by independent agents who act to find and engage with customers. LPG sales to small business and domestic customers are also made through call centers located at the various branches of Supergas. The LPG is supplied to customers through the transportation of portable gas containers (at capacities of 12kg and 48kg) and through the transportation of LPG by tanker trucks for the purpose of filling stationary tanks (of various volumes) on the premises of the customers.

Supergas, through wholly-owned subsidiaries, acts for the marketing of natural gas and CNG among potential institutional and industrial customers in various regions throughout the State of Israel. For the purpose of marketing the natural gas, Supergas recruited professionals who specialize in the planning and establishment of natural gas and CNG systems in order to provide customers with services to convert the energy systems installed at customers to work with natural gas. The natural gas is supplied to customers through the gas pipe that travels from the Tamar reservoir to the natural gas terminal on the shores of Israel, and from there to the national transmission network and the regional distribution networks. In addition, Supergas markets CNG in tanker trucks to plants which the transmission network has not yet reached.

7. <u>Order Backlog</u>

Most of the orders of energy substitute products are placed shortly before the supply date.

8. <u>Competition</u>

The energy substitutes market is characterized by the existence of competition, both in the types of products and with respect to the marketing and distribution to commercial, institutional customers and private customers. There is competition for the products that Supergas markets from various fuel products that are also used for the operation of burners and ovens for industry. In recent years, competition has increased between the companies active in the sector which has led, *inter alia*, to growth in discounts for customers and to flexibility in credit that is extended to customers and in payment terms. The market is characterized by fierce competition since the product marketed by Supergas and its competitors in the market is uniform.

The main competitors of Supergas in the marketing of LPG are: Pazgas Ltd., the American-Israeli Gas Corporation Ltd. (known by the name Amisragas) and the New Dorgas Ltd. In this market there are also several other small gas companies. In the estimation of Supergas' management, as of the Report Date, the market share of Supergas in the marketing of LPG is approx. 18%.

In the marketing of natural gas through the distribution network, Supergas' main competitors are Dor-Alon Gas Technologies Ltd., Delek Natural Gas Ltd., Amisragas, and Oshrad Natural Gas Ltd.

The main considerations that the customer takes into account when choosing the LPG and natural gas supplier are: a professional engineering and technical system, supply reliability, safety, service and price of the product. Supergas invests efforts to improve the service for its customers, *inter alia* through improving availability, safety and reliability. In addition, Supergas acts on an ongoing basis to expand the professional know-how of its employees.

9. <u>Seasonality</u>

LPG consumption is affected by seasonality. LPG sales in the winter period are higher since LPG is used, *inter alia*, for heating.

10. <u>Fixed Assets, Land and Facilities</u>

10.1 <u>Energy substitutes</u>

Supergas operates two main logistic facilities for the storage, filling and supply of LPG: (1) a storage, filling and distribution facility in Kiryat Ata of a total area of approx. 15 thousand sqm. This area is leased by Supergas from the Israel Land Administration. The facility includes LPG warehouses with an overall storage capacity of approx. 300 tons in tanks and approx. 250 tons in containers; (2) a central logistics center located in the Ramla industrial zone of a total area of approx. 4.4 thousand sqm. This area is leased by Supergas from the Israel Land Administration. This facility includes a warehouse for the storage of LPG cylinders with an overall storage capacity of 100 tons, equipment warehouses, a heating department, a workshop, a laboratory and a machining shop; (3) Supergas also leases storage volume of approx. 1,500 tons in the facilities of EAPC in Ashkelon, which allows it, *inter alia*, to import LPG, to store an LPG inventory and thereby reduce the import of LPG in the winter season.

In addition, Supergas also stores LPG in tanks installed on the customers' premises, and it rents out equipment owned thereby to its customers (gas containers, regulators and gas meters) against the deposit of a deposit in accordance with the State Economy Arrangements Regulations (Legislative Amendments) (The Gas Sector – Replacement of a Gas Supplier), 5751-1991.

Supergas has permits for the construction and operation of LPG warehouses across the country, including the logistics center in Ramla and Supergas' filling, storage and distribution facility in Kiryat Ata. For the past several years, the facility in Kiryat Ata has not had a business license due to the relevant local authority's refusal to grant a business license, as aforesaid. With regards to legal proceedings pertaining to the gas farm in Kiryat Ata and regarding the conditions required for its operation, see Note 33C to the financial statements as of December 31, 2015 and Note 3R to the financial statements as of September 30, 2016. Supergas has a fire department approval for the Kiryat Ata facility, effective until January 2017, in the framework of which the facility will operate at a reduced capacity as a filling and distribution facility, while reducing the quantities of LPG held, all in accordance with the restrictions set forth in the said approval.

Toxic materials permit – following discussions between Supergas and the Ministry of Environmental Protection, the Ministry's approval was received for the continued operation of the gas farm in Kiryat Ata in the outline specified in the approval that is valid until June 3, 2017, which permits Supergas to use the facility subject to the conditions specified in the permit.

Supergas holds a natural gas compression plant in the Alon Tavor industrial zone, of a total area of approx. 11 thousand sqm. The plant has an advanced system for treatment of natural gas that arrives at the plant through the transmission network and the high pressure compression thereof. The CNG is transported to the customers' premises via tanker trucks held by Supergas.

11. <u>Intangible assets</u>

11.1 <u>Trademarks</u>

Supergas has registered trademarks through which it is identified as a longstanding, well-known company with a dominant standing in the Israeli market. The main trademarks are: "Supergas Israel Gas Distribution Company Ltd." which includes the Supergas logo, and "Supergas Natural" which includes the Supergas Natural logo.

11.2 Distribution rights

Over the years, Supergas has purchased rights for the distribution of gas from agents that worked therewith in various geographic regions. The payments that were made for the purchase of the rights are presented in the financial statements as distribution rights at amortized cost of NIS 53 million.

11.3 Licenses

Supergas has a gas supplier license on behalf of the Ministry of National Infrastructures for the purchase of LPG and the marketing thereof in portable and stationary containers, storage of LPG in portable containers, transportation of LPG, filling of LPG in portable containers and storage of LPG in a tank, purchase of LPG and marketing in non-refillable containers and purchase of LPG and marketing thereof for gas-powered vehicles at fueling stations. In addition, Supergas for the Home Ltd., which is a wholly-owned subsidiary of Supergas, has a gas supplier license for the purchase of LPG and the marketing thereof in portable and stationary containers.

Supergas Natural has a CNG supplier license from the Gas Authority at the Ministry of National Infrastructures, for filling and unloading portable pressure canisters through a permanent compression station or a permanent unloading facility and for transportation and storage of portable pressure canisters for consumers and transportation thereof back to the compression facility for filling through CNG tanker trucks.

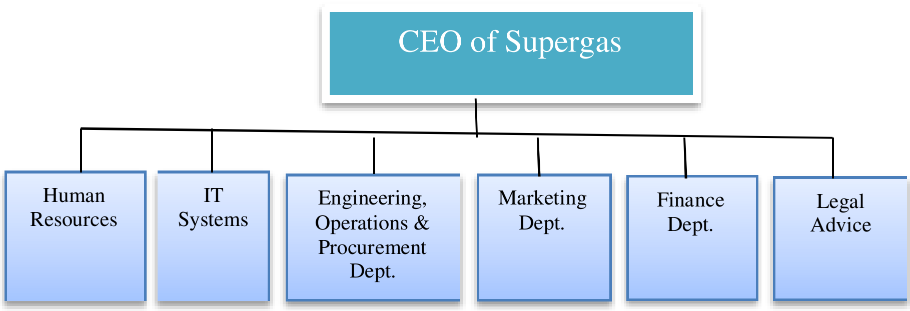
Super N.G. Ltd. ("**SuperNG**") and Super N.G. Hadera and the Valleys Ltd. ("**SuperNG Hadera**") have licenses for the establishment and operation of a network for natural gas distribution.

12. Human capital

12.1 Organizational structure and workforce

Supergas places special emphasis on the quality of the human capital, through the employment of professional manpower, having know-how and considerable experience in a variety of fields that are required in the framework of its fields of business. The majority of the company's employees, mainly in its managerial backbone, have significant seniority at the company and considerable experience in its fields of business.

12.2 Set forth below is a chart describing the organizational structure of Supergas as of the Report Date:



As of September 30, 2016, approx. 340 workers are employed at Supergas. The breakdown of the employees in the main fields is as specified below:

Position	No. of employees September 30, 2016	No. of employees September 30, 2015
Officers and senior management workers	6	6
Marketing and sales	241	252
Finance	26	29
IT	4	4
HR and administration	2	2
Engineering, operations and procurement	64	69
Total employees	343	362

12.3 Investments in training, instructing and developing the human capital

Supergas carries out professional training and instruction seminars for its employees in accordance with the employee's position and Supergas' needs. Supergas' employees participate, *inter alia*, in fairs, seminars and professional courses on various issues pertaining to Supergas. Instruction seminars on issues of safety, fire, work at heights, etc. are held in accordance with the duties set forth in the legal provisions that apply to Supergas and its business. In addition, special emphasis is placed on training in the field of safety and service.

12.4 Employment agreements

255 workers employed by Supergas and its subsidiaries are employed according to the provisions of two collective bargaining agreements which are updated in negotiations once every period (approx. three years). The said collective bargaining agreements are currently in negotiations for extension thereof (according to the agreed negotiation arrangements). Until their formal renewal, the collective bargaining agreements continue to apply, are automatically renewed for an additional period, pursuant to law. In cases of disputes in the negotiations, industrial peace clauses apply until resolution of the disputes.

The collective bargaining agreements regulate the gamut of employment relations and, *inter alia*, employment conditions (including for unique groups such as the technicians), social benefits (pension or managers insurance, study fund, leave, sickness, recuperation etc.), participation in expenses such as telephone and car, prior notice, termination, confidentiality and non-competition, discipline, etc.

The employment conditions of the other employees, who include also the officers and the senior management employees, are regulated through personal agreements, and their salary and conditions are determined on an individual basis.

13. Raw materials and suppliers

13.1 Energy substitutes

Supergas, like other gas companies in Israel, is dependent on Oil Refineries Ltd. ("**ORL**") and on the Ashdod Oil Refinery Ltd. ("**ORA**") as the main and central suppliers of LPG. In the event that ORL and ORA do not provide Supergas with the quantity of LPG it wishes to purchase therefrom, and Supergas is required to increase the quantity of LPG directly imported thereby, a preparation period will be required and additional costs may be involved. Such import will be subject to and contingent on finding a solution to an existing problem of a lack of sufficient storage space for the imported LPG and the possibility of unloading it. However, it is noted that ORL and ORA are obligated by law to refrain from discrimination in the supply of LPG to their customers. Due to the growth in LPG consumption in the winter months and the inability of the refineries in Israel to supply these quantities, an LPG shortage is created in the winter months. Therefore, Supergas imports LPG. The price of the imported LPG is usually higher than the price of its purchase from the refineries in Israel.

In 2014 and 2015 and in the period ended September 30, 2016, Supergas purchased from refineries in Israel approx. 83%, approx. 73% and approx. 78% of the total LPG purchased thereby, respectively. The remaining LPG that was purchased by Supergas in those years was purchased mainly from import.

The State Economy Arrangements Regulations (Legislative Amendments) (Gas Sales by Gas Suppliers and Refineries), 5769-2009 determine the quotas that shall be supplied by the refineries to the gas marketing companies in months of shortage. See Section 16 below with respect to these regulations.

Supergas purchases the natural gas that it markets to its customers from the Tamar partnership, which produces the natural gas from the Tamar reservoir in the Mediterranean Sea. Supergas, like the other natural gas marketers, is absolutely dependent on the Tamar partnership, which is the sole source for the supply of natural gas.

The Leviathan reservoir, which is located in proximity to the Tamar reservoir, constitutes a potential gas source for future use. According to public information held by the company, the estimated quantity of gas in the Leviathan reservoir is significantly larger than the quantity in the Tamar reservoir. As of the Report Date, it is still not possible to make commercial use of the Leviathan reservoir.

14. Taxation

For details regarding the taxation that applies to Supergas, see Note 30A to the financial statements as of December 31, 2015.

15. Environmental Risks and the Management Thereof

15.1 General

Supergas deems environmental protection, prevention of environmental damage and ensuring maximum safety in all of the components of its business activity as a key value. Supergas invests considerable time and resources for the purpose of achieving this goal. However, due to the fact that Supergas' business and its working with hazardous substances entail several environmental risks which derive from the possibility that Supergas' activity will lead to various types of damage to the environment. In order to handle these environmental risks, Supergas acts to increase the safety in its various activities and for compliance with the binding legal provisions with respect thereto.

Supergas acts on an ongoing basis for implementation of and compliance with the provisions of the law and the regulation that apply thereto, including the directives and instructions of the Ministry of Energy and the Ministry of Environmental Protection. Supergas also maintains ongoing contact with the local authorities relevant to its business, the fire department and any other relevant authority, all in order to prevent environmental damage and to minimize potential environmental risks.

15.2 Environmental risks having a material effect

LPG is hazardous to both the persons working therewith and the environment. Inappropriate use and/or activity in respect thereof may cause explosion, combustion or poisoning and as a result thereof cause damage to persons, the environment and property. Therefore, working with LPG requires strict compliance with various safety rules and the taking of various precautions, which guide Supergas' activity and which Supergas works to internalize among its workers and suppliers. Due to the aforesaid and as shall be further specified below, Supergas' business is subject to various legal provisions; to various regulatory provisions; it requires various approvals and licenses and it is audited by various administrative authorities, such as: the Ministry of Energy and the Ministry of Environmental Protection.

Supergas has permits for the construction and operation of LPG warehouses across the country, including the logistics center in Ramla and Supergas' filling, storage and distribution facility in Kiryat Ata. For the past several years, the facility in Kiryat Ata has not had a business license due to the local authority's refusal to grant a business license, as aforesaid. With regards to legal proceedings pertaining to the gas farm in Kiryat Ata and regarding the conditions required for its operation, see Note 33C6 and 33C7 to the financial statements as of December 31, 2015.

Toxic materials permit: The Hazardous Substances Law, 5753-1993 prescribes that the holding of LPG at a site, the LPG storage capacity of which exceeds 8,000 kg, requires a "toxic materials permit" from the commissioner authorized therefor by the Minister of Environmental Protection. In addition, a toxic materials permit is required also for the natural gas compression plant in Alon

Tavur. Supergas has toxic materials permits for the filling and supply facilities owned thereby.

15.3 Civil, tort and criminal liability and administrative sanctions

In view of the nature of its activity and business, Supergas is exposed to various civil, criminal, administrative and tort claims, *inter alia* in cases of damage that occur as a result of various incidents relating to LPG or natural gas. This may adversely affect Supergas' business results, its business and its goodwill. In order to insure its assets and its liability deriving from the work with hazardous substances as aforesaid, Supergas purchases standard insurance policies that are accepted in Israel. These policies are subject to various exclusions and restrictions. There is no certainty that the coverage and/or the limits of liability in the policies cover all of the risks entailed by Supergas' business.

In addition, due to the provisions of the law and the regulation that apply thereto, Supergas is exposed to the institution of criminal proceedings against it, including the filing of indictments against officers thereof and against it, and to the exercise of various administrative sanctions against it. A conviction with criminal offenses may lead to a criminal record against the officers of Supergas and against the company and to the imposition of heavy penalties on Supergas. Administrative sanctions against Supergas may lead to the imposition of (temporary or permanent) bans on Supergas' business or parts thereof.

16. Restrictions on and Supervision over Supergas' Business

Set forth below is a concise review of laws, regulations, orders, restrictions and requirements pertaining to Supergas' business:

Licensing and safety

The Gas Law (Safety and Licensing), 5749-1989 (the "**Gas Law**") regulates the issue of licensing for gas suppliers and the issue of safety in work with gas. The law, *inter alia*, requires receipt of a license for the supply of gas and for the performance of gas work, receipt of a permit for the installation of gas facilities. The Gas Law further requires periodic tests to be carried out for the gas systems.

In addition, there are binding standards for gas containers, gas systems, the installation of a central gas system etc. The standards include, *inter alia*, a marking duty, technical instructions, pressure tests and safety tests that must be carried out prior to the supply of gas and the performance of ongoing periodic tests for LPG containers and for gas systems and facilities.

Since gas is defined as a hazardous substance, various actions that are taken in gas require permits pursuant to the Hazardous Substances Law, 5753-1993 (the "**Hazardous Substances Law**"). The Hazardous Substances Law determines that no person shall work with toxic materials unless he holds a toxic materials permit from the commissioner as defined in the Hazardous Substances Law. Supergas has a general toxic materials permit for its activity and for the facilities thereof which require a toxic materials permit as aforesaid.

In the context of its business, Supergas transports, both itself and through subcontractors, LPG and CNG, which as aforesaid are deemed as hazardous substances. For the purpose of this activity, Supergas holds an appropriate license for transportation and a transportation of hazardous substances license according to the Transportation Regulations.

Purchase of LPG from the refineries

In 2007, the supervision over the refineries by way of determining a maximum price for LPG was removed and in lieu thereof supervision is effected by way of reporting on profitability, prices and quantities in one or more of the following cases: (1) if the refineries fail to fulfill the reporting duties that apply thereto in relation to quantities and prices of oil products; (2) if it transpires that the refinery sold LPG at a price exceeding the import price in the month preceding the month in which the sale was made; or (3) that the refinery supplied LPG to various consumers at a different price on the same date, the control of the ex-refinery LPG maximum price shall be reinstated.

In addition, in 2009, regulations[1] which regulate the issue of the sale of LPG by refineries were promulgated. The regulations define, *inter alia*, new, small and large gas suppliers, and accordingly the gas allocations to such suppliers in months of shortage, i.e. in months in which the refinery is unable to supply the full demand thereof for gas.

Control of LPG prices

The Control of Prices of Commodities and Services Order (Application of the Law to LPG), 5770-2010 determines that the level of supervision over LPG will be reporting on profitability and prices according to Chapter G of the Control of Prices of Commodities and Services Law, 5756-1996 (the "**Control of Prices of Commodities and Services Law**"). According to the said order, in May 2010 the manner of reporting on profitability of LPG was published, while in accordance with the provisions thereof, the gas marketing companies, including Supergas, shall provide to the Supervisor of Prices, each year, data as stated in the manner of reporting on profitability.

In September 2011, a report of the Socioeconomic Change Committee (the "**Trajtenberg Committee**") was published, in which the Trajtenberg Committee proposed, in the short-term, to impose supervision over the ex-refinery and retail LPG price, which would lead to a reduction in the price thereof. Concurrently, the Trajtenberg Committee proposed the establishment of a government team to propose further reform in the LPG sector.

In May 2013, a letter was received at Supergas' offices from the Ministry of National Infrastructures, from which it transpires that the director of the Fuel and Gas Administration and the Supervisor of Prices at the Ministry of Energy are considering recommending the imposition of control of the LPG prices in a sale through central gas dispensers and via containers to the private sector,

[1] The State Economy Arrangements Regulations (Legislative Amendments) (Gas Sales by Gas Suppliers and Refineries), 5770-2009.

further to the supervision at the level of reporting on profitability as described above. The letter includes a preliminary draft of attribution of Supergas' costs to the LPG margin, which was prepared by the Fuel Administration, which, according to the letter, is based on data submitted by Supergas and data processing that was carried out by the Ministry of National Infrastructures. Supergas responded to the Ministry of Energy and, *inter alia*, rejected the majority of the calculations and assumptions underlying the said letter.

As of the Report Release Date, it has not been decided whether control as aforesaid will be imposed. If control is imposed, the manner in which it will be imposed and the repercussions thereof are unclear. Therefore, Supergas cannot predict the effect of the control on the company, if and to the extent imposed.

In addition, the Control of Prices of Commodities and Services Order (Determination of the Level of Control and Maximum Prices for a Deposit for Gas Equipment), 5776-2015 defines the maximum deposit prices that a gas supplier is entitled to charge a domestic gas consumer for the supply of gas equipment, and prohibits the collection of a deposit for gas equipment that is not specified in the order. In addition, the order determines, *inter alia*, provisions regarding updating the deposit price and refunding the deposit to the consumer.

<u>Promotion of competition in the gas sector</u>

In the framework of boosting the competition in gas for domestic consumption, laws and regulations were promulgated with respect to the conduct of the gas companies vis-à-vis the domestic consumers. These laws and regulations regulate, *inter alia*, the manner of replacement of a gas supplier, the prohibition of taking action to retain customers who have given notice of replacement of a gas supplier, the refunding of the gas deposits, the granting of an option to an incoming gas supplier to purchase the gas tanks from the outgoing gas supplier etc.

In addition, Supergas is subject to various provisions in the framework of its being a body that provides a service to consumers, both in the context of the Consumer Protection Law (such as determination of technician arrival times, maximum hold time for a human telephone response, etc.) and in specific legislation (such as which services are included in the gas price, various provisions regarding the manner of charging for gas consumption, conduct vis-à-vis debtors, etc.).

In June 2015, regulations took effect concerning provision of information relating to the supply of gas. These regulations impose a duty on a gas supplier to give the consumer in the gas invoice the addresses of the other consumers who are connected to the same central gas system or an identification code for the supplier's website, where such addresses are accessible. In addition, the gas supplier is required to deliver, at the beginning of each month, to the director of the Gas Administration, a report specifying the average prices which it charged the domestic consumers in the two months preceding the report, with a breakdown by local authority, type of gas infrastructure (12/48 containers, portable container, stationary container) and type of service provided (such as:

installation, connection and supply). The director of the Gas Administration is entitled to post the report also on the website of the Ministry of National Infrastructures. In addition, any gas supplier that has a website is obligated to post the appropriate report on this site.

In addition, the draft 2017-2018 Arrangements Law includes additional legislative amendments, the purpose of which is to boost competition in the gas sector and handle, *inter alia*, changing the majority of apartment owners required for replacement of a gas supplier, prevention of discrimination between consumers who are connected to the same tank and in the deposit fees.

<u>The draft Liquefied Petroleum Gas Bill, 5776-2015, various draft regulations and various orders</u>

The draft bill, the new draft regulations and the new orders (which were published for the public's comments) seek to regulate, *inter alia*, the licensing duty of the suppliers of LPG (including through an agent) and entities that work with LPG, the term of the license of LPG suppliers, the duty to carry out tests for LPG facilities and LPG-operated appliances prior to the supply of LPG and once every period to be determined, a duty to supply LPG only to a consumer with whom there is a written agreement, the duty to take out insurance to cover the liability of an LPG supplier due to any incident in an amount of no less than five million U.S. dollars, the order of the actions that are required to be taken at the time of a gas incident, etc.

In addition to the safety aspect, the gas bill proposes to authorize the Minister of National Infrastructures, Energy and Water Resources, in consultation with the Consumer Protection Commissioner and with the approval of the Knesset's Economic Affairs Committee, to determine criteria regarding the level, nature and quality of the services that a holder of an LPG supplier license provides. In early 2016, Supergas delivered its response to the bill as aforesaid, in which it claimed, *inter alia*, that the proposed amendment contains many provisions that are unreasonable, unconstitutional and also provisions that will damage the LPG market in the State of Israel. The Ministry of National Infrastructures is currently acting in order to publish a new draft of the bill, while addressing the comments of Supergas and other gas companies. In addition, Supergas delivered its comments also on the draft regulations and the various orders and is now awaiting updated drafts on the issue.

<u>Natural gas operations</u>

Supergas' activity in the natural gas marketing sector is subject to the provisions of the Natural Gas Sector Law, 5762-2002 (the "**Gas Sector Law**"), which is the main law that regulates the natural gas sector in Israel. The Gas Sector Law determines, *inter alia*, that it is prohibited to engage in activities for the establishment and operation of a transmission system or part thereof, the establishment and operation of a distribution network or part thereof, and the establishment and operation of a storage facility, other than according to a license that was granted by the Minister of National Infrastructures, and in accordance with the terms and conditions thereof.

In addition, the Gas Sector Law prescribes that the following are prohibited from engaging in the sale and marketing of natural gas: (a) a transmission license holder; (b) an electricity supplier.

According to the Gas Sector Law, engaging in the sale and marketing of natural gas does not require a license, but the Minister of Infrastructures may determine, upon the fulfillment of the conditions set forth in the Gas Sector Law, and with the consent of the Minister of Finance and with the approval of the Knesset's Economic Affairs Committee, that for a period to be determined, engaging in the marketing of natural gas will require a license.

In April 2013, the Control of Prices of Commodities and Services Order (Application of the Law to Natural Gas and Determination of the Level of Control), 5773-2013 was published in the Official Gazette, as was the announcement by the Supervisor of Prices at the Ministry of National Infrastructures, whereby every marketer or entity that has signed a contract for the marketing or sale of natural gas, is required to report on the profitability and prices of the natural gas, once every six months, on the dates and in the manner published by the Supervisor.

Antitrust

Since 1999, Supergas operates an internal enforcement program in a format defined by the Antitrust Authority (the "**Antitrust Authority**"). Supergas is updating from time to time the internal enforcement program and is operating in accordance with the outline that was defined in the framework thereof for efficient and effective internal enforcement of the provisions of the Restrictive Trade Practices Law, 5748-1988 (the "**Restrictive Trade Practices Law**"), the regulations and the orders promulgated thereunder. Participation in the program increases the awareness of Supergas' employees and managers as aforesaid of the requirements of the Restrictive Trade Practices Law and opens up channels of communication between the employees and the senior management of Supergas as well as between them and the officer in charge of internal enforcement of the Restrictive Trade Practices Law, as appointed by Supergas' management. Over and above the aforesaid, through the enforcement program Supergas is doing everything in its power to ensure that Supergas, its managers and its employees act and shall act in accordance with the provisions of the law, thus reducing its exposure and the exposure of its managers and employees to legal proceedings on this issue.

On September 13, 2016, investigators on behalf of the Antitrust Authority arrived at Supergas' offices for the purpose of collecting documents in connection with an investigation being conducted by the Authority, on suspicion of a violation of the Restrictive Trade Practices Law.

Standards and quality control

Supergas markets its products in accordance with various standards that are relevant to the marketing and supply of LPG which are published from time to time by virtue of the Standards Law, 5713-1953. The standards specify technical requirements that apply to products including regarding the product's specifications, methods of production, storage, supply, operation etc.

Supergas has accreditation for quality standard ISO 9001-2000, which concerns quality assurance for the production-supporting management processes. Supergas has a system for quality control, security and quality management in accordance with the requirements of the standard. Once every six months the Standards Institution holds an audit to test compliance with the procedures and requirements. In addition, Supergas was accredited for safety standard OHSAS 18001. In addition, Supergas has systems for quality control, security and quality management in accordance with the requirements of the standards as aforesaid. Compliance with the procedures and requirements is audited by the Standards Institution every six months. Supergas has specific employees who are responsible for quality assurance issues.

17. Material Agreements

17.1 Establishment and operation of natural gas distribution networks

In the field of the establishment and operation of natural gas distribution networks, Supergas operates through the companies SuperNG and SuperNG Hadera which are held in equal shares by Supergas and by Shapir Civil and Marine Engineering Ltd.

In November 2009, SuperNG was granted a license for the establishment of a natural gas distribution network in the central region and for the operation thereof for 25 years. According to the terms and conditions of the license, SuperNG is obligated to invest in the establishment of the distribution network approx. NIS 160 million, over a period of 8 years, in accordance with the milestones determined in the license, and shall receive its income from one-time connection fees and from the distribution fee tariff according to the size of the customer (scope of natural gas consumption).

SuperNG has several contracts signed with customers for natural gas distribution services. In September 2015, approval was received for the piping of natural gas to a distribution pipeline in the Ramla industrial zone. As of the Report Date, the consumers in the said area have not yet begun to consume natural gas.

In view of bureaucratic and regulatory difficulties which are delaying progress in the rollout of the network and connection of the consumers, SuperNG is acting to update the timetables determined in the license.

In April 2013, SuperNG Hadera was granted a license for the establishment of a natural gas distribution network in the region of Hadera and the valleys and for the operation thereof for 25 years. According to the terms and conditions of the license, SuperNG Hadera is obligated to invest in the establishment of the distribution network approx. NIS 217 million, over a period of 5 years, in accordance with the milestones determined in the license, and shall receive its income from one-time connection fees and from the distribution fee tariff according to the size of the customer (the scope of natural gas consumption).

SuperNG Hadera is acting for the completion of the planning of initial segments of the distribution network and is continuing to develop the establishment of the network. In August 2015, work began on the rollout of a pipeline near the city of Hadera. In view of bureaucratic and regulatory difficulties which are delaying progress in the rollout of the network and connection of the consumers, SuperNG Hadera is acting to update the timetables determined in the license.

The shareholders of SuperNG and SuperNG Hadera have also given a guaranty in favor of the Natural Gas Authority, in accordance with their holdings and in accordance with the terms and conditions of the tender and the license.

Water and Wastewater Treatment and Chemicals

18. General Information about GES

In the water, wastewater chemicals and environmental protection segment, Granite operates through GES and consolidated companies thereof (the "**GES Operations**"). GES engages in engineering design, construction and production, operation and maintenance of plants for water filtration and improvement, seawater desalination, pumping stations and water pools, treatment of well water and treated wastewater and treatment of sanitary, industrial, municipal and organic wastewater. In addition, GES, by itself and through its subsidiaries, engages in the marketing and development of chemical products for the purpose of treating and protecting metals, and also in the importation and marketing of oils, adhesives and chemicals for industry.

18.1 Structure of the competition in the GES Operations and changes occurring therein

GES and its consolidated companies act in this segment through two divisions:

The water and wastewater division

The division engages in the production, construction, operation and maintenance of seawater and brackish water desalination plants; wastewater treatment and treated wastewater reclamation; water betterment and wastewater treatment in the industrial sector; water purification and wastewater treatment in the municipal sector; implementation of special chemicals for the treatment of water and wastewater, desalination and cooling towers for the municipal and industrial sectors; provision of system operation and maintenance services; planning and production of systems for wastewater and water treatment. GES presently operates approx. 70 plants all across Israel (approx. 40 water treatment plants and approx. 30 wastewater treatment plants).

Industrial chemicals division

The industrial chemicals division engages in the production, importation and marketing of chemicals and finishing processes for metals; chemicals for the preparation of surfaces for painting and paint strippers for industry; electrochemical coating materials for the high-tech and electronics industries; industrial cleaning materials; special adhesives and lubricants for industry.

18.2 Restrictions, legislation, standardization and special constraints applicable to the GES Operations

The GES Operations in the operating segments thereof is subject to various laws, regulations, orders and permits related to health. Thus, as regards the quality of drinking water and the quality of treated wastewater, its operations are subject to the provisions of the People's Health Ordinance and the regulations promulgated thereunder. As regards environmental protection, the GES Operations are subject to the provisions of permits for disposal into the sea and authorization orders for disposal into a stream under the Prevention of

Marine Pollution by Land-Based Sources Law, 5748-1988, the Water Law 5719-1959 and the Water Regulations (Prevention of Water Pollution) (Use and Disposal of Sewage Sludge), 5764-2004. The GES Operations are also subject, *inter alia*, to the provisions of toxin permits under the Hazardous Substances Law and to specific provisions determined with respect to the provision of services and the marketing of products. The GES Operations are also subject to standardization with respect to quality, safety, security, the storage of raw materials and products, their labeling, their identification and transportation, and also to the provisions of the law with respect to business licensing and consumer protection laws. For details with respect to restrictions, legislation, standardization and special constraints that apply to the operating segment, see Section 30 below.

18.3 Changes in the scope of the GES Operations and the profitability thereof

See Section 1.10.5 of Chapter A of this Report (the contribution of Granite's segment to the results of the operations).

18.4 Developments in the markets of the GES Operations or changes in the characteristics of its customers

Recent years have seen a development trend in the water and wastewater industry. The increased awareness of the shortage of clean water in various areas of the world, including Israel, alongside technological developments that led to reduced water treatment costs, create opportunities in the industry of desalination and water and wastewater treatment.

18.5 Critical success factors in the GES Operations and the changes occurring therein

In the water and wastewater segment

The integration and implementation of advanced water and wastewater treatment methods and technologies, which lead to energetic and operational streamlining, are a factor that affects the production costs in water and wastewater plants constructed and operated by GES. Such streamlining leads to tenders being won and to engagement in agreements in the water and wastewater segment for the sale and operation of water and wastewater treatment plants, in Israel and abroad.

In the chemicals segment

The production and distribution of high-quality chemicals of world leading producers to customers that demand high-quality and not necessarily inexpensive products.

18.6 Changes in suppliers and raw materials

Several factors, which are specified below, support the continued construction activity, upgrade, operation and maintenance of plants for the treatment and desalination of wells and for the treatment and purification of wastewater and reclamation thereof for industrial and agricultural use, and possibly even an increase in the use of such means. Thus, such factors include the shortage of drinking water in some areas of Israel, the high costs of the potable water used both for drinking and for industry along with the damage to wells due to the salinization and contamination of aquifers in past years and the strict enforcement of the regulation that governs the treatment of municipal and industrial wastewater.

For details with respect to raw materials and suppliers, see Section 27 below.

18.7 Key entry and exit barriers of the GES Operations and changes occurring therein

The principal barriers for entry into operations in GES's business field in the desalination and water and wastewater treatment, are the accumulation of proven experience in the construction and operation of similar plants, which is a threshold requirement in most tenders and engagements in the sector, skilled and experienced manpower, including water and wastewater engineers and technicians, and the receipt of the appropriate contractor licenses required for the purpose of construction of plants of such type.

The principal barriers for exit from this field are the completion of the construction of the plants, supply of which has been undertaken by GES, the expiration of the warranty period granted in the framework of the plant construction agreements, the termination of maintenance and operation agreements undertaken by GES.

In the chemicals sector in which GES operates, the principal barriers for entry are the existence of a suitable production facility, which requires approvals by various authorities, chief of which is the Ministry of Environmental Protection, and the knowledge required for the production of the materials, as well as engagements with leading producers in the world for receipt of intellectual property usage rights for the purpose of producing and supplying ready-made products for sale and distribution.

The principal barriers for exit from this segment mainly pertain to the termination of the lease agreement of the production facility's premises and the duties imposed on GES in connection with the requirements of the law and the Ministry of Environmental Protection in the vacation of land on which operations of such type were conducted.

18.8 Structure of the competition in the GES Operations and changes occurring therein

For details with respect to the structure of the competition in the GES Operations and changes occurring therein, see Section 22 below.

19. Products and Services

19.1 Water and wastewater segment

The primary systems used by GES for the treatment of water and wastewater are: membranal high-pressure systems for the separation of salts, systems of filtration and purification through chemicals, anaerobic and aerobic systems for the treatment of industrial and municipal wastewater and systems for the treatment of sewage sludge. The systems include dosage, command and control units.

GES offers its customers a broad range of water and wastewater treatment systems and solutions, the principal of which are: Brackish water and seawater treatment systems; wastewater treatment systems; well betterment and improvement plants; water treatment methods based on diverse technologies; treatment of steam systems and energy centers; plants for the desalination of treated wastewater to irrigation level.

GES offers customers project supervision and management, including construction, professional support and backup services, which include the instruction of operators at the customer's site, professional advice and consultation in the operation of the project, maintenance and operation services, monitoring and supervision for the purpose of performing process optimization and the performance of periodic surveys and ongoing maintenance of the project.

19.2 Chemicals segment

The principal services and products of GES in the chemicals segment include surface treatments, adhesives and sealing materials, chemicals for electrolytic coating and printed circuit boards, special industrial lubricants, industrial maintenance products, recycling of industrial cleaning materials, fuel additives.

20. Customers

GES's customers include water corporations and local authorities, government-owned companies and industrial companies.

21. Marketing and Distribution

GES invests great efforts in diverse marketing activities in each of its operating segments. Such marketing activities include the following:

(1) Domestic sales agents – some of GES's people are domestic sales agents who are on the ground on a daily basis in order to identify new customers, address the needs of existing customers, and market GES's products.

(2) Distributors – there are some 10 large nationwide distributors (mostly stores) in the chemicals segment, through which GES markets some of its products.

(3) Management and maintenance of informational websites at the addresses: www.ges.co.il and www.ges-texma.co.il, which include an extensive description of the company's operations and products and contact information.

(4) Activity amongst professionals – GES maintains relations with professionals in the context of exhibitions (in Israel and abroad), professional conferences, training sessions, seminars, etc.

(5) Tenders – GES has a system for identifying tenders and requests for proposals for the performance of projects relevant to its operating segments, including the preparation of tender bids and proposals for such requests.

GES also conducts export activities in all of its operating segments. Most of GES's products marketed abroad are marketed under the "GES" brand.

22. Competition

In its operating segments, GES faces competition by a large number of companies engaged in the construction of systems for water purification and wastewater treatment, as well as companies engaged in the manufacture and import of chemicals. Competition exists both in the search for and identification of new customers and in the provision of high-quality services in all of GES's operating segments. The competition revolves around prices, service quality, financing terms and technical specifications.

23. Production Capacity

GES's production layout is centered in two sites: Akko South and Askar (in the Akko area).

Water and wastewater segment

The production layout responsible for the construction of water and wastewater treatment systems is based in the Askar site, which is situated in the municipal area of Regional Council Matteh Asher. GES has the capacity to simultaneously produce a large number of plants.

Chemicals segment

The Akko South site, which is situated in the municipal area of the Akko Municipality, hosts the production layout responsible for the production of unique chemicals for the treatment of water, wastewater, desalination, and cooling towers for the municipal and industrial sectors.

All finished products in the chemicals segment are manufactured to order. Under GES's policy, the production site does not produce a regular inventory of finished materials, but rather per customers' orders.

GES uses approx. 60% of the production potential of the production site. The potential production capacity is approx. 5,000 tons of various types of chemicals, assuming that production work is performed in two shifts per 24 hours, with work presently performed in one shift.

24. Fixed Assets, Real Property and Plants

GES and its wholly-owned subsidiary GES Plant Operation Ltd. have several water and wastewater treatment plants in the framework of BOT and BOO agreements with the private and municipal sectors. GES has machines and equipment that are used to produce chemicals and an evaporation plant for the treatment of industrial wastewater, which are situated in the Akko South production site.

GES's production layout is centered in two sites: Akko South and Askar (in the Akko area), which are leased from a third party. GES's water and wastewater division has the capacity to simultaneously produce a large number of plants.

25. Intangible Assets

25.1 Trademarks

GES has a trademark on goods and services supplied thereby which include: the provision of environmental protection solutions, seawater and brackish water desalination, wastewater treatment and treated wastewater reclamation, water betterment and and implementation of special chemicals for water treatment.

The registration of the trademarks is highly important, since they serve as means for the identification of GES's products in its business field with GES.

25.2 Distribution rights

In the chemicals segment, GES has a large number of marketing and distribution agreements with companies in Israel and around the world which are leading in their fields. Under such agreements, GES is the official representative in the marketing, production and import of these companies in Israel.

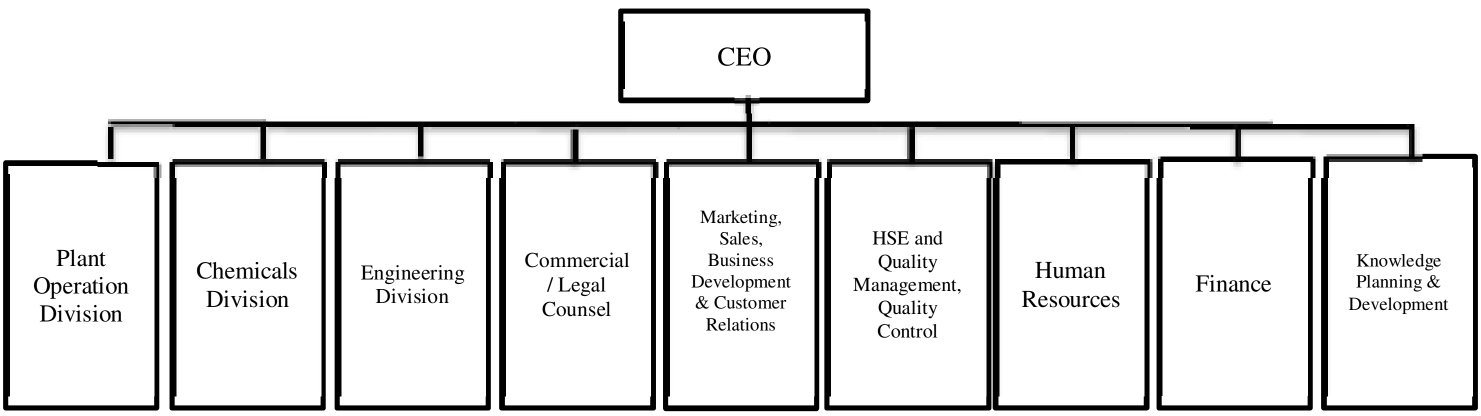
25.3 Marketing and distribution Agreements

The chemicals segment has a large number of marketing and distribution agreements with companies in Israel and around the world which are leading in their fields. Under such agreements, GES is the official representative in the marketing, production and import of such companies in Israel.

26. Human Capital

As of September 30, 2016, GES employs approx. 206 employees.

26.1 A description of the organizational structure of GES follows:



26.2 Breakdown of employees by position:

The breakdown of GES's employees is detailed below:

Position/Division	**Number of Employees September 30, 2016**	**Number of Employees September 30, 2015**
GES Management	24	22
Water and Wastewater Division		
Production and operation	91	85
Marketing and sales	21	21
Chemicals Division		
Production and operation	33	33
Marketing and sales	37	34
Total employees	**206**	**195**

26.3 GES's investments in training and instruction

GES has methodical annual training and instruction programs. Instruction and training are carried out in the following key fields: (1) Training sessions mandated by law, e.g. safety laws (including with respect to driving) and quality assurance; (2) Training sessions aimed at increasing and improving the professional skills of GES employees in their various fields of occupation, in the internal systems of GES and toward its customers and suppliers; (3) Training sessions for the personal development of managers and employees.

In certain cases, GES also participates in the payment of its employees' tuition in professional and academic institutions according to a methodical professional advanced study program suited to the needs of the employee, according to the needs and abilities of the system as part of the retention and development of such employees in GES.

26.4 Benefits and the nature of employment agreements

GES employs permanent employees, 49 of whom are employees who are subject to special collective bargaining agreements.

The other employees of GES are employees employed under personal employment agreements, temporary employees employed under the general labor law and contractor employees engaged under agreements with employment agencies.

The permanent, monthly and temporary employees are divided as follows:

Permanent employees – are divided into two groups as follows:

(1) Permanent employees employed under a collective bargaining agreement – As of the Report Date, this group consists of 49 employees (Generation A and Generation B). The terms and conditions of their employment are provided by a collective bargaining agreement of 1988, which is valid to date. GES employees working in the production department, workshop and junior clerks (according to an agreed list of professions) are subject to the terms and conditions of such collective bargaining agreement.

(2) Permanent employees under personal agreements – As of the Report Date, this group consists of 157 employees. Standard employment agreements apply between GES and such employees which provide, in most cases, the employee's salary, working hours, social benefits, such as managers' insurance, provident funds, pension funds, advanced study fund, entitlement to leave, recuperation pay and sick leave, participation in mobile telephone expenses, reimbursement of *per diem* expenses, the period of prior notice for resignation and for dismissal, confidentiality and non-compete. Most of the employees are employed based on an overtime-inclusive salary. About one half of the employees receive a company car for their use for the purpose of fulfilling their duties. Salespersons are granted quarterly incentives. All personal contracts include an express provision as to the application of Section 14 of the Severance Pay Law, 5723-1963, and the balance is covered by full provisions for severance pay.

Monthly employees – are employed under special personal agreements in a part-time position and receive their wages on an hourly basis. Most of the monthly employees are students who work at GES as part of the performance of a final project or internship. At the end of the period, they terminate their employment or join GES as regular employees.

In addition, GES has agreements in place with several employment agencies for the placement of temporary professional employees. The temporary employees are usually employed for specific purposes and for predefined time periods.

26.5 Liabilities for the termination of employment relations

The liabilities of GES and its subsidiaries to employees for the termination of employment relations are covered by current payments to insurance companies for managers' insurance policies, pension funds and provident funds, and by a provision in the Group's financial statements reflecting liabilities thereof which are not so covered.

27. Raw Materials and Suppliers

The main raw materials used by GES for the water and wastewater operation are: finished equipment, which includes pumps, membranes, pressure cabins, tanks and chemicals for the operation of water and wastewater plants. Such raw materials and equipment items are acquired from leading companies in the world. All of the purchased raw materials and parts are checked by a quality control lab and the Quality Assurance Department of GES according to international standards. In some cases, equipment items are manufactured specifically for GES according to defined requirements for specific projects, especially when particularly good abilities and quality of materials are required according to the customer’s demand. Supply times of such equipment range between one month to a period exceeding one year. The substantial raw materials are mainly purchased from local suppliers, and parts are also imported, mainly from the U.S., Canada, Korea and European countries.

In the chemicals operation, GES uses numerous raw materials for its and its customers’ purposes, the principal ones of which are: 60% nitric acid and technical hydrochloric acid. These raw materials are purchased chiefly from the local market. All of the purchased raw materials are checked by a quality control lab and the Quality Assurance Department of GES. Supply time of the raw materials in the chemicals segment is immediate when purchased from the local market and around two months when imported. Most of the imported raw materials are purchased from U.S. and European suppliers.

28. Taxation

For details regarding the taxation applicable to GES, see Note 30A to the financial statements as of December 31, 2015.

29. Environmental Risks and their Management

29.1 GES’s operation in the water and wastewater segment is subject to the environmental protection provisions relevant to the operating segment. The water and wastewater operation is performed under the supervision of the Ministry of Health which performs routine tests to examine the quality of the water generated in the treatment plants and in the desalination plant, and under the supervision of the Ministry of Environmental Protection and the Water Authority over the quality of the wastewater treatment in the treatment plants and compliance with the production permit. In addition, in the context of this activity, supervision is exercised also by government authorities such as the Water Commission and the Water Economy Administration, local authorities and water and sewage corporations.

GES treats industrial wastewater created in the production of chemicals at GES's Akko South production site in full and in accordance with the provisions of the law and the requirements of the Ministry of Environmental Protection and the Municipal Association for Environmental Protection. GES also handles poisonous and hazardous substances within its business operation of manufacturing products in the segment of water and industrial chemicals and within the maintenance of GES's water and wastewater treatment plants. GES has valid toxin permits and a hazardous substances certification.

GES's chemicals production site includes a wastewater treatment plant. The plant treats the production site's wastewater and customers' wastewater which are transported to GES’s plant with the approval of the Ministry of Environmental Protection.

Furthermore, since a large part of the GES Operations is based on the use of chemicals, GES is supervised by the Ministry of Environmental Protection and the municipal authorities and is committed to the protection of the environment and to working in accordance with the environmental standards, laws and regulations of the Ministry of Environmental Protection and the relevant municipal associations, including the provisions of the Hazardous Substances Law.

29.2 GES's policy on environmental risk management

GES's policy is to fully comply with all of the requirements of the provisions of the law pertaining to environmental protection. GES's business is in the field of treatment of industrial and sanitary wastewater, recycling of materials, and treatment and betterment of water. GES regularly implements Environmental Protection Standard ISO 14001 and is annually certified by the Standards Institution of Israel.

GES implements an internal environmental enforcement program, under which periodic inspections are performed to ascertain that the company's operations in the various sites comply with the requirements of the various environmental protection laws and the business licenses applicable to the various plants operated by GES. GES conducts environmental and occupational monitoring on an annual basis to ascertain that there are no deviations from the level permitted under the standardization.

Once in three years, GES conducts a "job safety analysis" (JSA) in all of the company's sites and carries out the remedial actions required pursuant to the analysis.

GES employs a full-time safety and environmental protection manager, whose responsibility includes management, monthly supervision of sites, training and the organization of emergency teams for an environmental event, investigation of events and implementation of remedial actions, in order to reduce the exposure to environmental risks.

GES annually carries out occupational medical check-ups, for employees who are exposed to hazardous substances and to noise in their work, in accordance with the provisions of the law. The check-ups for the employees and the medical follow-up are performed by the occupational clinic of the Rambam Hospital.

30. Restrictions on and Supervision of the GES Operations

30.1 Water and wastewater

This operation in Israel is subject to various legal provisions that regulate environmental protection and the quality of the water and wastewater treated by GES in the various plants, chief of which are the Water Law and the regulations thereunder, the Prevention of Marine Pollution by Land-Based Sources Law, the Water Regulations (Prevention of Water Pollution – Use and Disposal of Sewage Sludge), the People's Health Ordinance and the regulations thereunder, the Water and Sewage Corporations Law and their rules, the Hazardous Substances Law, the Environmental Protection Law (Emissions and Transmissions to the Environment – Register and Reporting Duties) and more.

Such laws, ordinances and regulations prescribe a line of provisions pertaining to the protection of water sources and the prevention of water contamination, the quality of the water and treated wastewater produced at the plants, the types of treated wastewater, the manner of disposal of the sewage sludge and wastewater in various cases, the hazardous substances that are used and the manner of storage thereof, the emission of contaminators from the GES plants and more. In addition to the aforesaid, GES operates in accordance with and by virtue of certificates, permits and specific instructions by the various authorities.

30.2 Chemicals

This operation is subject to legal provisions which regulate environmental protection, chief of which is the Hazardous Substances Law and the regulations thereunder, the Clean Air Law, the Environmental Protection Law (Emissions and Transmissions to the Environment – Register and Reporting Duties) and more. Such laws, ordinances and regulations regulate the manner of preventing the emission of contaminators from GES's production plants and reporting of such emissions, procurement, storage, production and trade in the hazardous substances distributed by GES and more. In addition to the aforesaid, GES operates in accordance with and by virtue of certificates, permits and specific instructions by the various authorities.

February, 2013 saw the publication of the Organization of Labor Inspection Regulations (Safety Management Program), 5773-2013 (the "**Safety Regulations**"). The Safety Regulations took effect in August 2014 (18 months as of the date of publication thereof), and are applicable to a "Factory", within the meaning thereof in the Work Safety Ordinance [New Version], 5730-1970, wherein at least 50 workers are employed. Under the Safety Regulations, the Chemical Division is required to conduct an occupational health and safety management program, with the purpose of preventing work accidents and occupational diseases, reducing the risks to the employees and complying with the legislation's requirements on issues of occupational health and safety. The Regulations further prescribe that the "Holder of the Workplace" (as defined in the Regulations) will be responsible for compliance with the provisions thereof, will act to ensure the implementation of the program and will take the appropriate measures in order to ensure that every employee appointed by him follows the provisions. As of the Report Date, GES estimates that the Safety Regulations are not expected to have a material effect on the manner and costs of the operations of GES.

GES holds all of the licenses and permits required by law, as aforesaid.

Other Operations and Information about the Granite Segment as a Whole

31. General Information

Other than the operations described above, Granite is a 50%-partner in a limited partnership that was incorporated thereby and operates an unique tourist attraction named “Mini Israel”, which presents miniature models of renowned Israeli sites.

32. Working Capital

As of the Report Date, the Granite segment (Supergas and GES) has a net working capital in the sum of approx. NIS 90 million, which includes the total of current assets (which mainly consist of cash, trade receivables, other receivables and inventory) net of current liabilities (which mainly consist of current liabilities to banks, current maturities of bonds and trade and other payables). The working capital does not include balances of the Granite Group vis-à-vis the parent company, Canit Hashalom.

33. Financing

33.1 Financing sources

Supergas and GES finance their operations from self-funded sources, short-term bank credit, and funds received from the issue of non-negotiable bonds to institutional investors.

33.2 Loans and interest rates

Following are details of the average interest rate and the effective interest rate on long-term loans and short-term loans from bank sources and from non-bank sources as of September 30, 2016:

	Long Term			**Short Term**		
	Sum (NIS in thousands)	**Average Interest Rate**	**Effective Interest Rate**	**Sum (NIS in thousands)**	**Average Interest Rate**	**Effective Interest Rate**
Non-bank sources – index-linked	402,282	4.9%	5.26%	716	4%	4%
Bank sources – index-linked	38,151	3.77%	3.77%	-	-	-
Bank sources – NIS	151	2.12%	2.12%	23,112	2.1%,2.65%	2.1%,2.65%
Total financial liabilities	440,584	-	-	23,828	-	-

33.3 Issue of bonds

In July 2007, a consolidated company of Supergas, which was incorporated for the purpose of the issue and to which most of the household gas operation and some of the commercial gas operation for gas marketing in movable gas containers were transferred, issued to institutional investors by way of private placement, bonds in the total par value of approx. NIS 600 million. The bonds are rated Aa1 by Midroog Ltd., are for an 18-month period, and are repaid in quarterly principal installments as of 2010. The bonds are linked to the Consumer Price Index (principal and interest) and bear interest in an annual rate of 4.9%, which is paid once every calendar quarter. As of September 30, 2016, Supergas's liability due to the bonds totals approx. NIS 394 million.

In June 2014, Supergas completed a process for modifying the bonds issued thereby in 2007, which consists of the acceleration of certain principal payments (that constitute approx. 11.5% of the balance of the bonds), which were scheduled for repayment under the original terms of the issue over the course of the next five years, and for flattening of quarterly principal payments to render them uniform and equal. Accordingly, Supergas has repaid 51,829,380 par value in the total amount of approx. NIS 75 million, which includes a sum of approx. NIS 12.3 million paid due to the repayment date being pushed forward. In addition, Granite Hacarmel undertook that in the event that Canit Hashalom Investments ceases to be a controlling shareholder of Supergas, Granite Hacarmel will make the bondholders an offer to purchase the bonds in the amount of no less than NIS 45 million par value and at a price reflecting the adjusted value of the bonds at such time.

The bonds are secured by a first-ranking floating charge, in an unlimited amount, on all of the assets of the consolidated company of Supergas. In addition , Supergas pledged, in a first-ranking fixed charge in an unlimited amount, all of the shares of the consolidated company owned and held thereby, including the rights deriving from such shares. According to the terms of the bonds, the consolidated company of Supergas is required to comply with financial covenants. A deviation from the financial covenants will allow the bondholders to demand acceleration of the repayment or prepayment. As of September 30, 2016, the consolidated company of Supergas complies with the determined covenants.

33.4 Credit facilities

In the Granite segment, Supergas and GES have agreed short-term credit facilities in the amount of approx. NIS 240 million, some of which are secured and some of which are not secured due to the high credit allocation fees. The used credit balances as of the Report Date total approx. NIS 75 million (including use in respect of guarantees). The short-term bank credit bears NIS, unlinked interest at a variable rate which is a function of the Prime interest rate. The Prime interest rate changes on a monthly basis according to the decision of the Bank of Israel.

Registered in favor of the banks that finance its operations, in order to secure the bank credit extended to Supergas, are a floating charge in an unlimited amount and a fixed charge on its uncalled and/or unpaid share capital, its goodwill, securities and pledged documents. In the framework of the floating charge, Supergas undertook not to create additional charges without the consent of the banks and subject to the terms and conditions as specified in the bonds. To the best of the Company's knowledge, there is an inter-bank agreement between the banks holding the pledges, whereby they hold a *pari passu* pledge on the assets of Supergas. In order to secure the bank credit extended to GES, a guarantee has been provided by Granite. Furthermore, GES has long-term loan agreements with banks, which are intended for financing the construction of plants for desalination and water and wastewater treatment. Such loan agreements are backed by cash flows of revenues from the operation of such plants, which are pledged in favor of the financing banks and are partly backed by Granite's guarantee.

34. Goals and Business Strategy

Supergas and GES periodically examine their strategic plans and update their goals according to the developments in the markets in which they operate. Supergas aspires to expand the variety of energy solutions supplied thereby to its customers and to expand and diversify its customers in its operating segments. Furthermore, Supergas and GES act for the constant improvement of customer service and for strict compliance with environment protection and safety rules, and also act for the identification of new business opportunities.

Annex B - The Senior Housing Segment

1. General Information about the Senior Housing Segment

1.1 General

The Group's operations in the senior housing segment are currently concentrated under the "Palace" brand ("**Palace**" or the "**Palace Chain**") and it engages in the operation and development of senior housing homes for the elderly population, which homes feature a high finishing level and the provision of high-level related services, and are designated for tenants who are able to lead an independent life. As specified below, all senior housing homes managed by Palace operate LTC units (whether within the bounds of the senior housing homes or adjacently thereto). The construction of LTC units is planned also in the senior housing homes that are under development and construction.

During Q3/2016, Palace continued to develop the senior housing operation, following its purchase of the "Palace Tel Aviv" senior housing home in 2015 and of the "Palace Ra'anana" senior housing home in 2016, as specified below. Palace also purchased rights in three different sites designated for senior housing homes.

As of the date of this Report, Palace holds and operates two premium senior housing homes as specified below:

(1) **Palace Tel Aviv** – A senior housing home in the center of Tel Aviv, including an advanced medical center for recuperation and LTC, also known as "Palace Tel Aviv"", which consists of 231 senior housing units and "Palace Medical", which contains 132 beds, in 4 different units (jointly: "**Palace Tel Aviv**").

(2) **Palace Ra'anana** - A luxurious senior housing home in Ra'anana, including an LTC unit, also known as "Palace Ra'anana" (formerly "Ahuzat Bayit"), which consists of 328 residential units and 67 LTC beds ("**Palace Ra'anana**"), as well as an active retail center located adjacently to the senior housing home and known by the name of "Park Mall".

Furthermore, Palace acquired rights in three sites, on which it is planning and constructing additional senior housing homes which are in various stages of development and construction, including: (1) Palace Modi'in – a senior housing home in the city of Modi'in, which, as of the Report Date, is under advanced construction stages and expected to consist of approx. 240 residential units and approx. 136 LTC beds ("**Palace Modi'in**"); (2) Palace Lehavim – land located within the Lehavim Local Council, which is under advanced planning stages for the construction of a retirement village, which is expected to include approx. 350 residential units and approx. 144 LTC beds ("**Palace Lehavim**"); and (3) Palace Rishon LeZion – in March 2016, the Group won a tender issued by the Israel Land Authority for the purchase of long-term leasehold rights in a lot of approx. 3.4 *dunam* designated for senior housing and situated in HaRakafot Neighborhood in East Rishon LeZion, which is designated for the construction of approx. 250 residential units and an LTC unit and approx. 3,000 sqm of retail spaces ("**Palace Rishon LeZion**").

1.2 Structure of the senior housing operating segment and the changes occurring therein[1]

To the best of Palace's knowledge, recent years have seen an increase in the life expectancy of the elderly population in Israel, along with an increase in the standard of living of such population. According to the data of the Central Bureau of Statistics[2], at the end of 2015, approx. 938,900 residents at the age of 65 years or older were living in Israel, representing a rate of approx. 11.1% of the population of Israel's residents. Nearly one half of them (approx. 44%) are older than 75. According to population forecasts, by 2035 persons who are 65 years of age or older will be 1,660,000 in number and represent approx. 14.6% of the population. According to the data of the Central Bureau of Statistics and publications by Standard & Poor's Ma'alot ("**Ma'alot**")[3], alongside the increase in life expectancy, there is considerable improvement in the standard of living of the elderly, which is reflected in their increased participation in the Israeli employment market, improvement of their physical, financial and social wellbeing, and an increase in their general satisfaction with their lives. In the elderly housing sector, a distinction may be made between two main solutions: retirement homes and senior housing homes. Most retirement homes are characterized by elderly residents of middle-to-low socioeconomic status, who are not independent and require constant nursing and medical services. Residents of the traditional retirement homes mostly share one room and their schedule is dictated by the retirement home's operator. According to Ma'alot's publications, retirement homes in Israel consist of approx. 10,000 residential units.

Unlike retirement homes, the senior housing market is aimed at an aged population which is financially established and independent for the most part. Senior housing homes feature prestigious and modern services and facilities, including luxurious complexes that include expansive public areas containing facilities such as: a swimming pool, spa and fitness club, class rooms, restaurant, cafeteria, clinic, and the like. Senior housing homes provide a respectable and high-quality solution for the elderly, and allow the tenants to lead an independent life in the residential units, along with a social life in the public complexes and the provision of initial medical attention and LTC when necessary. According to Ma'alot's publications, as of the Report Date, the senior

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[1] This information is taken from the following sources:
Mashav (National Information Center for Old Age Planning) – the Elderly in Israel, Statistical Year Book2014 - https://goo.gl/ouxS3D
The Central Bureau of Statistics – Press Release for the Senior Citizen Day of October 1, 2015 - https://goo.gl/CgI8GN
Amidar – Senior Housing – https://goo.gl/JAkoGT
Standard & Poor's Ma'alot – the Senior Housing Market in Israel – Potential for Expansion – 2015 - https://goo.gl/O4nLuM
Midroog – Rating of Senior Housing Companies in Israel – Methodological Report 2014 – https://goo.gl/1wAjC9
Globes Dun's 100 – Senior Housing Ratings for 2015 - https://goo.gl/Bj0Rjp
[2] The Central Bureau of Statistics - Press Release for the Senior Citizen Day of October 1, 2016 - https://goo.gl/EzVAjZ
[3] Ma'a lot – The Senior Housing Market in Israel, June 2015 - https://goo.gl/F3oj4l

housing market consists of approx. 12,500 senior housing units. As arises from the publications specified above, as a result of the increase and improvement in the life expectancy of the elderly as reviewed above, and due to the desire of such tenants to conduct an active and social lifestyle, there has been an increase in the demand for senior housing units.

The Senior Housing Law, 5772-2012 (the "**Senior Housing Law**"), which took effect in 2012, has regulated the operations in the senior housing sector for the first time. The Senior Housing Law prescribes various rules in relation to the permits and requirements for the operation of senior housing homes, including the duty to receive a license for the purpose of operation of senior housing homes, and also prescribes sanctions for the violation of such rules. For additional details with respect to regulation in the senior housing sector, see Section 3 below.

<u>Tenant agreements</u>

Palace's engagements with the tenants of the senior housing homes are made by means of tenant agreements that grant the tenants the right to use the residential unit and the public areas and also grant them entitlement to the service basket offered and provided by every senior housing home to its tenants, *inter alia*, in view of the provisions of the Senior Housing Law and by virtue of the relevant engagement agreement. The language of the agreements with the tenants varies among the various senior housing homes operated by Palace (*inter alia*, considering the fact that some were purchased from previous owners), and according to the time of their signing and the provisions of the law at such time.

As a rule, the engagement is made by means of the standard track, i.e., the deposit forfeiture track, which includes the resident depositing a deposit for the duration of the term of the agreement. Mostly, the amount of the deposit is determined according to the location of the home and the services provided thereby, the size of the apartment and the finishing level, the levels of demand, and more (the "**Deposit**"). The tenant agreement determines the period over which the deposit will be forfeited (mostly over the course of 12 years) (the "**Forfeiture Period**") and the rate at which it will be forfeited every year (mostly a rate ranging between 3% and 4%, plus V.A.T. as required by law). At the elapse of the Forfeiture Period, the forfeiture of the Deposit comes to an end and the balance of the principal plus linkage differentials is repaid to the tenant or his survivors upon the expiration of the tenant agreement and the use of the residential unit.

The tenant agreement also provides the collateral to be provided to secure the Deposit.

In view of the Group's financial soundness, Palace also enables the tenants to engage in alternative tracks to the deposit forfeiture track described above, including a lease track in which the tenant pays rent on a monthly basis etc.; however, the scope of such tracks is significantly smaller than that of the track described above.

In addition to the forfeiture of the Deposit and/or the payment of rent as described above, the tenant agreement provides the amount of the monthly maintenance fees to be collected from the tenant. Subject to the provisions of the Senior Housing Law, Palace may increase the maintenance fees at a real rate and subject to an actual increase in the operating expenses of the home, and, in any event, by no more than the maximum increase rate specified in the tenant agreement.

1.3 Restrictions, legislation, standardization and special constraints applicable to the senior housing operating segment

For details with respect to restrictions, legislation, standardization and special constraints applicable to the operating segment, see Section 3 below.

1.4 Changes in the scope of the senior housing operating segment and the profitability thereof

According to the various publications as specified in Section 1.2 above, the increase in life expectancy combined with the increase in population and the improvement of the standard of living among the elderly population targeted by Palace leads to an increase in the scope of demand for high-quality and luxurious senior housing solutions in Israel and the expansion of Palace's operations in the segment.

Furthermore, the increased awareness of the target group to the advantages of senior housing and the recognition that senior housing homes for the aged population are a respectable and high-quality solution for this population, while differentiating this operating segment from the image associated with traditional retirement homes, contributes to the development of this segment. As specified in Section 1.1 above, on the date of this Report, the construction of the senior housing homes in Modi'in, Lehavim and Rishon LeZion has not yet been completed and Palace's management expects that their completion and occupancy will increase the scope of its operations in the senior housing segment and turn Palace into a significant and leading player in the senior housing market in Israel.

The information regarding the factors that, in the estimation of Palace's management, may affect the scope of the operations in the senior housing segment and the implications thereof on Palace's profitability as aforesaid constitute forward-looking information, as defined in the Securities Law, 5728-1968, which is based on Palace's estimations. Such estimations are based on external information sources and subjective assessments by Palace's management. Actual results may differ from the estimations so predicted.

1.5 Developments in the markets or changes in the characteristics of customers

As aforesaid, the scope of the operations in the senior housing segment is growing, as a result of the increased life expectancy of the aged population. This trend is also characterized by the desire of parts of such population to preserve the high standard of living and quality of life to which they have become accustomed during the years of their life, and the feeling of loneliness and lack of independence created due to the difficulty of accessibility to the various community services compared with the fulfillment of needs provided by senior housing. In addition, whereas the elderly population had been deterred in the past from moving to senior housing due to the negative image associated therewith and the poor level of services that characterized it, the senior housing setting presently grants a high quality of life while ensuring a safe environment that preserves the tenant's independence, cares for his health, ensures an active daily routine, which includes of culture, sports, social interaction and community, and facilitates living at a high level of comfort in luxurious centers. The entry of leading players such as Palace into the senior housing sector, which players introduce a modern construction standard of high-level senior housing homes into the sector, also contributes to the improvement of this image. These developments have brought with them new market demands for expansion of the services offered in senior housing. Therefore, recent years have seen an increased demand for an environment that offers, in addition to basic services, a variety of social and cultural activities, such as a swimming pool, spa, classes, restaurant, cafeteria, alternative medicine services and more.

1.6 Critical success factors in the senior housing operating segment and the changes occurring therein

It is Palace's management's position that there are several critical success factors in the operating segment, which include: (1) Knowledge, experience and management: The senior housing segment is complex and requires experience and knowledge of issues that are unique to the elderly population, with an emphasis on the operation of senior housing homes. The ability to optimally manage a senior housing home bears great importance in the competition Palace faces against the existing competitors in the sector; (2) Financial soundness: The Group's ability to withstand the costs involved in the construction, purchase and/or operation of premium high-level senior housing homes is critical to the subsistence of Palace's operations and its positioning as a leading player in the senior housing market, and may be a central consideration in the choice of a senior housing home by a potential tenant. In addition, Palace's ability to provide collateral to the tenants and repay the funds of the Deposit deposited by them, as mandated by the Senior Housing Law, constitutes, in the estimation of Palace's management, a key success factor; (3) Structure of the senior housing home, the residential units and the surroundings: Since the senior housing sector is on the course of constant developments, both in terms of the quality of the structures, the residential units and in terms of the level and variety of services, it is necessary to maintain a high level of construction and finishing in the senior housing home and the public areas thereof, which constitutes a critical success factor in the sector; (4) Location and nationwide presence: A central and accessible location that also facilitates access to nearby centers, recreation and cultural institutions, convenient access to railway stations and public transportation as well as traffic arteries, in the area of the senior housing home, constitutes an advantage and a central consideration in the choice of a senior housing home. Furthermore, the location of the senior housing home in relation to the place of residence of the children and family and former life center of the tenant is a highly significant factor that affects the tenant's choice of such or other senior housing home. A more attractive location of the housing home brands the housing home as a more luxurious place and affects the price and the amount of the deposits that may be charged for the residential unit; (5) The size of the residential center: A large residential center consisting of hundreds of residential units holds economies of scale in view of the number and diversity of the tenants residing therein, which enables and creates an abundance of activities and a vibrant community and social life; (6) Reputation and branding: The right branding of a housing home, i.e., the attribution of positive values such as quality, enjoyment, luxury, value for money, the branding of the company running the senior housing home, years' long reputation, the company's stability, etc., and the creation of a positive position and perception among consumers with respect to the housing home, bear importance in the positioning of the senior housing home in relation to its competitors; (7) Tenant satisfaction: Tenants who express high satisfaction with their standard of living in the senior housing home are a major tool of marketing to potential clients, which has a high cost-benefit ratio. Palace ensures that it is attentive to the needs of the tenants and provides them with quick response, while maintaining a high level of service and personal response to each and every tenant. Furthermore, Palace holds various multigenerational events that involve the tenants of the homes and their families in order to expose Palace's senior housing homes and the services provided thereby to as many potential clients as possible.

1.7 <u>Key entry and exit barriers of the senior housing operating segment and the changes occurring therein</u>

<u>In the estimation of Palace's management, the principal barriers for entry into the senior housing operating segment are</u>:

(1) The need for unique knowledge, experience and reputation, which are required for the construction and management of a senior housing home;

(2) The need for material capital investments for the purpose of purchase or construction of modern senior housing homes at a high finishing level and for their marketing;

(3) The shortage of potentially economically viable land for the construction of senior housing homes;

(4) The ability to comply with regulation requirements that prescribe threshold conditions for the operation of senior housing homes;

(5) The requirement for financial soundness and current cash flow for the purpose of ensuring the ability to repay deposits, and, *inter alia*, the provision of collateral to the tenants according to the provisions of the Senior Housing Law.

In the estimation of Palace's management, the principal barriers for exit from the senior housing operating segment are:

(1) The difficulty in finding a purchaser for such operation due to the substantial scope of investment, the knowledge and the experience required for the operation of a senior housing home under the provisions of the Senior Housing Law;

(2) Long term contractual obligations and the difficulty in evicting tenants within a short time.

1.8 Alternatives to the senior housing sector and the changes occurring therein

As of the Report Date, the principal alternative to the senior housing sector is the residence of the elderly in households. Thus, for example, in 2015, approx. 97% of persons of 65 years or older and approx. 89% of persons of 85 years or older lived in households[4]. Among the reasons that may be listed as leading to such high rates, one may specify the improvement in the lifestyle and health of the aged population in recent years, which allow for independent living, and the increase in the variety of services offered to the aged population at their home (for example, emergency call centers, medical care at home, etc.). Furthermore, the ability to be assisted by live-in caregivers makes it easier for the elderly to stay at their home.

Another alternative to the operating segment are retirement homes which are mostly characterized by elderly residents of middle-to-low socioeconomic status, who are not independent and are in need of constant medical and nursing services, with the cost of residence in such homes being lower than that of senior housing homes.

It is noted that Palace's management estimates that the existing alternatives on the market do not fully address the social and cultural life aspects that Palace offers in the senior housing homes, and the sense of security that senior housing homes provide to their tenants, which constitutes a significant consideration when choosing an alternative to senior housing,

2. Competition

To the best of Palace's knowledge, as of the Report Date, there are more than 50 entities operating approx. 100 senior housing homes in Israel, among which are Mish'an Center, Mediterranean Towers, Ahuzot Rubinstein, Bayit Bakfar and others, with half of them located in the Tel Aviv District. In the estimation of Palace's management, the following may be listed among the factors that affect the structure of the competition in the sector: (1) Geographical location, which constitutes a central consideration in the choice of a senior housing home by potential tenants, who tend to prefer a senior housing home located in the proximity of their family members' place of residence or in the proximity of their previous living environment; (2) The nature of the tenants in the senior

[4] The Central Bureau of Statistics - Press Release for the Senior Citizen Day of October 1, 2016 - https://goo.gl/EzVAjZ

housing home and their lifestyle due to the importance of the cultural and social life that senior housing homes offer tenants; (3) The level of the residential units, public areas and other facilities that the senior housing home offers its tenants; (4) The amount of the deposit and the usage fees collected from the tenants. In Palace's estimation, as of the date of this report, Palace's market share in the senior housing market is approx. 4.5% based on the presently existing homes and irrespective of the operation of the Medical units.

Principal methods for coping with the competition

In order to preserve Palace's competitive position in the senior housing market and cope with the existing competition, Palace acts, *inter alia*, through the following means:

(1) Preserving and ensuring a high level of services and maintenance in the senior housing homes. In Palace's estimation, the level of maintenance and services that Palace provides its tenants is among the highest in the sector.

(2) Constructing new senior housing homes in attractive and competitive geographic locations, at a high finishing level that includes public areas, luxurious convenience facilities, including infrastructure for the grant of functional services for the tenants' needs.

(3) Preserving and ensuring a high level of tenant satisfaction, attention to their various needs and quick personal response.

(4) Maintenance of an effective marketing and sales layout and branding of the chain as a premium chain under the "Palace" brand.

In the estimation of Palace, its competitive position is favorably affected by the following factors: The reputation and high branding of the existing homes (Palace Tel Aviv and Palace Ra'anana), impeccable management and service, the Group's financial soundness, presence in demanded marketing areas and more.

In the estimation of Palace, its competitive position may be adversely affected by the following factors: entry into and/or expansion of competitors into the senior housing market, mainly in the geographical areas in which Palace operates.

3. Restrictions on and Supervision of the Palace Operating Segment

The operation in the senior housing segment is mostly regulated by the provisions of the Senior Housing Law, which prescribes, *inter alia*, the duty to receive an operation license for the management and operation of a senior housing home, provisions in respect of the requirements and conditions for the receipt of a license for the operation of a senior housing home, the contractual relationship between the operator and the tenant, the duty to enter into a written engagement agreement, the provision of collateral to secure the repayment of the funds of the tenant's deposit, and more.

3.1 The Senior Housing Law

The Senior Housing Law prescribes, *inter alia*, that the operation of senior housing homes requires the receipt of an operation license on behalf of the Commissioner of Senior Housing Homes at the Ministry of Social Affairs and Social Services and compliance with several conditions prescribed by the said law, including the applicant for the license being the owner or long-term leaseholder of the land of the senior housing home in respect of which the license is requested, there being no conviction of the applicant for the license and the senior housing home manager of certain offences, proof of the financial stability of the applicant for the license to ensure the proper operation of the senior housing home and so forth. The operation of a senior housing home without an operation license or other than according to the conditions of the license constitutes an offence that carries various fines and incarceration penalties.

Furthermore, the Senior Housing Law regulates additional matters, including the following: (1) The duty to make a written engagement agreement between the holder of the operation license of the senior housing home (the "**Operator**") and the person seeking to be a tenant of the senior housing home; (2) The specification of basic mandatory services the Operator is obligated to provide the tenants; (3) The duty to set up an LTC unit for senior housing homes consisting of at least 250 residential units[5]; (4) Limitation on arbitrary increases of the management fees and any other payment the tenant does not have actual ability to waive; (5) The right of the tenants to set up a tenants' representative body at the senior housing home, and more.

In addition, the Senior Housing Law prescribes that in any case in which the tenant is required to deposit sums on account of the deposit[6], which exceed a rate of 7% of the sum of the deposit or NIS 70,000, whichever is lower, the Operator will be required to provide the tenant collateral to secure the funds of the deposit, according to the Operator's choice and pursuant to the following alternatives: (1) Bank guarantee; (2) Insurance of the tenant with an insurer and specification of the tenant as an irrevocable beneficiary in the insurance contract, provided that the insurance fees were paid in advance; (3) Transfer of 40% of the amount of the deposit to a trustee under a trusteeship contract in which the tenant is specified as beneficiary; or (4) Registration of a first-ranking mortgage on the real property in favor of the tenant. It is noted that the tenant may waive the receipt of such collateral, provided that the waiver is given in writing. Furthermore, the Operator is obligated to bear 20% of the cost of provision of the collateral, and the balance of the cost, at the rate of 80% as aforesaid, will be borne by the tenant. The Senior Housing Law lists causes for enforcement of the collateral by the tenant, including insolvency of the

[5] It is noted that the provisions of the Senior Housing Law concerning the setting up of an LTC unit are scheduled to take effect at the elapse of five years as of the date on which the law took effect, i.e., on December 3, 2017.

[6] "Deposit" – A payment made by a tenant to an operation license holder under an engagement agreement, including as collateral for his compliance with the terms and conditions of the engagement agreement, which, under the terms and conditions of the engagement agreement the operation license holder must repay the tenant, in whole or in part, when the engagement comes to an end, after deduction of any sum deducted from such payment under the provisions of the engagement agreement and the law;

Operator, an order for stay of proceedings, an order for receipt of assets, a liquidation order, an order for appointment of a receiver, or circumstances wherein an absolute impediment to the repayment of the funds of the deposit is created.

3.2 Bill for amendment of the Senior Housing Law

On February 3, 2016, a bill for amendment of the Senior Housing Law (the "**Bill**") was approved in preliminary reading in the Knesset, which Bill concerns the amendment of the provisions pertaining to the collateral that serve to secure the funds of the tenants' deposits. According to the Bill, the provisions of the Senior Housing Law shall be amended as follows: (1) Imposition of a duty on the Operator to provide collateral to secure the full amount of the deposit deposited by the tenant (i.e., "from the first Shekel"); (2) The Operator bearing all of the costs involved in the provision of the guarantee (as opposed to the obligation to bear 20% of such costs under the present provisions of the Senior Housing Law); (3) Cancellation of the third and fourth alternatives listed in the Senior Housing Law (which pertain to deposit with a trustee and registration of a mortgage) with two exclusive alternatives left as financial collateral: (a) Bank guarantee; or (b) Insurance of the tenant with an insurer, while specifying his name as an irrevocable beneficiary in the insurance contract and paying the insurance fees in advance; (4) Denial of a tenant's right to waive such collateral, such that the provision of collateral is mandatory.

As arises from the explanatory notes to the Bill, the purpose of the amendment of the Law is to expand the protection of the sums of the deposit deposited by the tenants when entering the senior housing home by obligating the operators to provide financial collateral. As of the Report Date, and to the best of Palace's management knowledge, it appears that the relevant feasible alternative under the Bill, if and insofar as approved, is the bank guarantee.

It is clarified that the Bill is merely in preliminary legislation stages, has not yet been discussed by the Labor, Welfare and Health Committee of the Knesset and has not yet been prepared for first reading. As of the Report Date, Palace's management has no certainty that the Bill will be approved and Palace is unable to estimate the effect of such amendment (if passed) on its operations and cash flow needs.

3.3 The Senior Housing Regulations

As of the Report Date, secondary legislation under the provisions of the Senior Housing Law has not yet been completed. The following may be listed among the draft regulations prepared thus far:

Draft Senior Housing Regulations (Application for a Senior Housing Home Operation License), which specify the conditions and the documents required for submitting an application for the grant or renewal of a license to operate a senior housing home;

Draft Senior Housing Regulations (Disclosure Document), which address the disclosure document the Operator is obligated to present to the tenant a reasonable time prior to their entering into an engagement agreement;

Draft Senior Housing Regulations (Tenants' Committee), which prescribe procedures for the purpose of establishment of a tenants' committee at the senior housing home and rules with respect to the manner of operation thereof;

Draft Senior Housing Regulations (Apartment Specifications), which obligate the Operator to attach an apartment specifications form to the engagement agreement with the person seeking to be a tenant;

3.4 Invalids and the mentally frail– The People's Health Ordinance and Regulations

The People's Health Ordinance, 1940, the People's Health Regulations (Registration of Hospitals), 5726-1966, and the People's Health Regulations (Nursing Staff in Clinics), 5726-1966, prescribe that the operation of hospitals, including units for invalids and the mentally frail, requires receipt of a permit from the Ministry of Health and is subject to supervision thereby. Such regulations include provisions with respect to the physical structure, the condition of the equipment, the manner of management, the rights of hospitalized patients and manpower capacities and training.

3.5 Labor law

Palace has employees in the senior housing operation and has also engaged with manpower agencies and contractors for the receipt of various services in the senior housing homes, including cleaning, protection and security. Therefore, Palace is subject to the labor law and particularly the law applicable to engagement of contractor employees, including the Employment of Workers by Manpower Contractors Law, 5756-1966, the regulations promulgated thereunder, and the Enhancement of Labor Law Enforcement Law, 5772-2011.

3.6 Planning and building law, work safety and accessibility and consumer legislation

In the context of the planning, development and construction processes of senior housing homes, Palace is subject, *inter alia*, to the planning and building laws, including the decisions of local authorities and the various planning committees, and is also subject to the Equal Rights for Persons with Disabilities Law, 5758-1998 and the secondary regulation thereunder, and to the work safety laws. Furthermore, the operation of senior housing homes is subject to consumer laws, such as: the Consumer Protection Law, 5741-1981 and the Control of Products and Services Law, 5718-1957.

4. Legal Proceedings

As of the Report Date, there are no material legal proceedings in the senior housing operating segment.

5. Goals and Business Strategy

The Group routinely examines various ventures for the construction of new senior housing homes, the identification of suitable land plots, and the purchase of existing senior housing homes. The Group has set its sights on becoming a leading player in the senior housing market, both in terms of the number of residential units offered to tenants and in terms of the level of the provided services.

6. Development Forecast for the Coming Year

During the last quarter of 2016 and over the course of 2017, Palace intends to act for the promotion of the following:

(1) Promotion of construction activities at Palace Modi'in;

(2) Promotion of licensing and construction activities at Palace Lehavim;

(3) Completion of planning and submission of a permit application at Palace Rishon LeZion;

(4) Launch of renovations at Palace Ra'anana;

(5) Continued significant marketing of the homes under construction and increase of the number of engagements in preliminary agreements with potential tenants who pay the commitment fee;

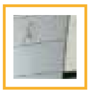
(6) Continued construction of the chain's management and control layout and establishment thereof as a general framework for management of the existing homes and the senior housing homes under construction;

(7) Enhancement of the "Palace" brand and establishment thereof as a leading brand in the senior housing market.

The forecast for development in the coming year as specified above includes forward-looking information. Such information is uncertain and is based on the information held by Palace as of the Report Date. Actual results may materially differ from the results implied by such information.

Part C

Consolidated Financial Statements
Dated 30 September 2016



AZRIELIGROUP

Azrieli Group Ltd.

Condensed Consolidated Financial Statements
as of September 30, 2016

(Unaudited)

Azrieli Group Ltd.

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Deloitte.

Review report of the Auditors to the shareholders of
Azrieli Group Ltd.

Introduction
We reviewed the attached financial information of **Azrieli Group Ltd.**, the Company and subsidiaries (the "**Group**") which includes the Condensed Consolidated Statements of Financial Position as of September 30, 2016 and the Condensed Consolidated Statements of Profit or Loss and other Comprehensive Income, Changes in Capital and Cash Flows for periods of nine and three months then ended. The Board of Directors and management are responsible for the preparation and presentation of the financial information for these interim periods in accordance with IAS 34 "Interim Financial Reporting", and they are responsible for the preparation of information for these interim periods under Chapter D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970. Our responsibility is to express a conclusion on the financial information for these interim periods, based on our review.

We did not review the condensed interim financial information of consolidated companies whose consolidated assets constitute approx. 7.3% of all the consolidated assets as of September 30, 2016, and whose consolidated revenues from continuing operations constitute approx. 12.5% and approx. 21.2%, respectively, of the total consolidated revenues for the periods of nine and three months then ended, and whose consolidated revenues from discontinued operations constitute approx. 40.8% of the total consolidated revenues for the nine months period then ended. The condensed interim financial information of such companies was reviewed by other auditors whose review report was furnished to us and our conclusion, insofar as it relates to the financial information for such companies, is based on the review report of the other auditors.

Scope of the review
We performed our review in accordance with Review Standard 1 of the Institute of Certified Public Accountants in Israel "Review of Interim Financial Information Performed by the Auditor of the Entity". A review of interim financial information consists of clarifications, mainly with the persons responsible for financial and accounting matters, and applies analytical and other review procedures. A review is considerably more limited in scope than an audit which is performed in accordance with Generally Accepted Auditing Standards in Israel, and therefore does not enable us to obtain assurance that we will be aware of all the significant matters which could have been identified in an audit. Consequently, we are not issuing an audit opinion.

Conclusion
Based on our review, and on the review reports of the other auditors, nothing has come to our attention which would lead us to believe that the above financial information is not prepared, in all material respects, in accordance with IAS34.

In addition to the statements in the previous paragraph, based on our review and on the review reports of the other auditors, nothing has come to our attention which would lead us to believe that the above financial information does not meet, in all material respects, the disclosure provisions under Chapter D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

Brightman Almagor Zohar & Co.
Certified Public Accountants
Member of Deloitte Touche Tohmatsu Limited

Tel Aviv, November 22, 2016

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Azrieli Group Ltd.

Condensed Consolidated Statements of Financial Position

	As of September 30		As of December 31
	2016	2015	2015
	NIS in thousands		NIS in thousands
	(Unaudited)		
ASSETS			
Current Assets			
Cash and cash equivalents	1,562,488	1,065,449	934,724
Short-term deposits and investments	53,072	53,303	36,302
Trade accounts receivable	283,782	1,139,014	1,102,160
Other receivables	139,193	161,130	167,227
Inventory	59,776	176,458	173,450
Current tax assets	18,139	11,365	14,894
	2,116,450	2,606,719	2,428,757
Assets of disposal group held for sale	958	-	8,850
Total Current Assets	2,117,408	2,606,719	2,437,607
Non-current Assets			
Investments and loans of associates	79,716	51,583	70,755
Investments, loans and receivables	335,805	199,382	218,321
Financial assets	1,721,091	1,733,983	1,659,927
Long-term receivables in respect of franchise arrangement	50,363	38,776	44,372
Investment property and investment property under construction	23,236,558	20,191,552	20,528,554
Fixed assets	425,655	1,055,858	1,059,657
Intangible assets	346,324	365,783	342,955
Pre-paid long-term rent	-	38,998	36,637
Deferred tax assets	21,976	46,339	46,320
Total Non-current Assets	26,217,488	23,722,254	24,007,498
Total Assets	28,334,896	26,328,973	26,445,105

The notes to the condensed consolidated financial statements form an integral part thereof.

Azrieli Group Ltd.

Condensed Consolidated Statements of Financial Position

(Continued)

	As of September 30		As of December 31
	2016	2015	2015
	NIS in thousands		NIS in thousands
	(Unaudited)		
LIABILITIES AND CAPITAL			
Current liabilities			
Ccurrent maturities and credit from banks and other credit providers	2,396,138	2,214,428	2,030,205
Trade payables	192,111	492,279	524,638
Payables and other current liabilities	185,663	352,303	375,208
Deposits from customers	760,316	396,766	402,066
Provisions	12,273	76,547	77,515
Current tax liabilities	37,635	90,575	110,241
	3,584,136	3,622,898	3,519,873
Liabilities of disposal group held for sale	90	-	3,387
Total current liabilities	3,584,226	3,622,898	3,523,260
Non-current liabilities			
Loans from banks and other credit providers	2,489,189	3,046,569	2,989,456
Bonds	4,514,338	2,976,413	2,962,731
Employee benefits	7,590	19,203	18,981
Other liabilities	49,008	53,244	53,685
Deferred tax liabilities	3,056,721	2,967,873	3,027,164
Total non-current liabilities	10,116,846	9,063,302	9,052,017
Capital			
Ordinary share capital	18,223	18,223	18,223
Share premium	2,518,015	2,518,015	2,518,015
Capital reserves	428,539	467,290	407,396
Retained earnings	11,622,768	10,540,448	10,827,591
Total equity attributable to the shareholders of the Parent Company	14,587,545	13,543,976	13,771,225
Non-controlling interests	46,279	98,797	98,603
Total Capital	14,633,824	13,642,773	13,869,828
Total Liabilities and Capital	28,334,896	26,328,973	26,445,105

November 22, 2016			
Date of approval of the financial statements	**Danna Azrieli** **Chairman of the Board**	**Yuval Bronstein** **CEO**	**Irit Sekler-Pilosof** **CFO**

The notes to the condensed consolidated financial statements form an integral part thereof.

Azrieli Group Ltd.

Condensed Consolidated Statements of Profit or Loss and of Other Comprehensive Income

	For the nine-month period ended Sept. 30		For the three-month period ended Sept. 30		For the year ended Dec. 31
	2016	2015 (*)	2016	2015 (*)	2015 (*)
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
	(Unaudited)		(Unaudited)		
Revenues					
From sales, labor and services	476,120	558,652	139,173	134,634	732,349
From rent, management and maintenance fees	1,287,556	1,200,136	451,064	424,539	1,622,543
Net gain (loss) from fair value adjustment of investment property and investment property under construction	517,727	36,013	127,261	(5,038)	179,071
Financing	17,135	19,695	3,331	5,327	18,144
Other	13,075	16,082	1,134	10,170	16,008
Total revenues	2,311,613	1,830,578	721,963	569,632	2,568,115
Costs and Expenses					
Cost of revenues from sales, labor and services	292,151	365,747	89,150	81,945	480,606
Cost of revenues from rent, management and maintenance fees	324,740	283,836	124,505	110,368	385,098
Sales and marketing	119,102	113,465	44,914	39,418	155,842
G&A	72,645	74,667	25,418	24,071	101,631
Share in results of associates, net of tax	6,292	4,894	2,452	1,689	8,562
Financing	132,204	116,688	59,602	42,556	145,210
Other	884	8,657	843	223	8,918
Total Costs and Expenses	948,018	967,954	346,884	300,270	1,285,867
Income before income taxes	1,363,595	862,624	375,079	269,362	1,282,248
Taxes on income	(157,230)	(241,682)	(90,436)	(78,320)	(355,656)
Income from continuing operations	1,206,365	620,942	284,643	191,042	926,592
Loss from discontinued operations (after tax) (see Note 4)	(8,501)	(81,718)	(5,634)	(88,800)	(98,927)
Net profit for the period	1,197,864	539,224	279,009	102,242	827,665
Other comprehensive income:					
Amounts that will not be classified in the future to profit or loss, net of tax:					
Actuarial gain (loss) due to defined benefit plan, net of tax	-	24	-	24	(977)
Amounts that were classified or that will be classified in the future to profit or loss, net of tax:					
Change in fair value of financial assets available for sale, net of tax	54,184	72,761	39,389	(59,560)	18,172
Translation differences from foreign operations	(41,409)	6,990	(26,001)	40,324	1,506
Total	12,775	79,751	13,388	(19,236)	19,678
Other comprehensive income (loss) for the period, net of tax	12,775	79,775	13,388	(19,212)	18,701
Total Comprehensive Income for the Period	1,210,639	618,999	292,397	83,030	846,366

(*) Restated due to discontinued operations, see Note 4.

The notes to the condensed consolidated financial statements form an integral part thereof.

The Azrieli Group Ltd.

Condensed Consolidated Statements of Profit or Loss and of Other Comprehensive Income

(Continued)

	For the nine-month period ended Sept. 30		For the three-month period ended Sept. 30		For the year ended December 31
	2016	2015	2016	2015	2015
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
	(Unaudited)		(Unaudited)		
Net income for the year attributable to:					
Shareholders of the Company	1,195,177	532,853	278,999	101,262	820,991
Non-controlling interests	2,687	6,371	10	980	6,674
	1,197,864	539,224	279,009	102,242	827,665
Total comprehensive income for the year attributable to:					
Shareholders of the Company	1,209,200	612,289	293,160	80,676	839,538
Non-controlling interests	1,439	6,710	(763)	2,354	6,828
	1,210,639	618,999	292,397	83,030	846,366
	NIS	NIS	NIS	NIS	NIS
Basic and diluted earnings (in NIS) per one ordinary share of par value NIS 0.1 attributable to shareholders of the Company:					
Continuing operations	9.93	5.07	2.35	1.57	7.59
Discontinued operations	(0.07)	(0.68)	(0.05)	(0.74)	(0.82)
	9.86	4.39	2.30	0.83	6.77
Average weighted number of shares used for calculating the basic and diluted earnings per share	121,272,760	121,272,760	121,272,760	121,272,760	121,272,760

The notes to the condensed consolidated financial statements form an integral part thereof.

Azrieli Group Ltd.

Condensed Consolidated Statements of Changes in Capital

For the nine-month period ended September 30, 2016

	Share capital	Share premium	Revaluation fund for financial assets available for sale	Capital reserve for translation differences from foreign operations	Capital reserve for transactions with related parties	Capital reserve from the acquisition of non-controlling interests in a consolidated company	Other capital reserves	Retained earnings	Total attributed to shareholders of the Company	Non-controlling interests	Total
	NIS in Thousands										
	(Unaudited)										
Balance as of January 1, 2016	18,223	2,518,015	391,356	30,469	(30,974)	18,641	(2,096)	10,827,591	13,771,225	98,603	13,869,828
Net profit for the period	-	-	-	-	-	-	-	1,195,177	1,195,177	2,687	1,197,864
Change in fair value of financial assets available for sale, net of tax	-	-	54,099	-	-	-	-	-	54,099	85	54,184
Translation differences from foreign operations	-	-	-	(40,076)	-	-	-	-	(40,076)	(1,333)	(41,409)
Total comprehensive income for the period	-	-	54,099	(40,076)	-	-	-	1,195,177	1,209,200	1,439	1,210,639
Dividend to the shareholders of the Company	-	-	-	-	-	-	-	(400,000)	(400,000)	-	(400,000)
Dividend to holders of non-controlling interests	-	-	-	-	-	-	-	-	-	(75)	(75)
Capital reserve for transactions with related parties	-	-	-	-	(28)	-	-	-	(28)	28	-
Investment of non-controlling interests in a subsidiary	-	-	-	-	-	-	-	-	-	4,432	4,432
Acquisition of non-controlling interests in a subsidiary	-	-	-	-	-	7,148	-	-	7,148	(58,148)	(51,000)
Total transactions with shareholders of the Company	-	-	-	-	(28)	7,148	-	(400,000)	(392,880)	(53,763)	(446,643)
Balance as of Sept. 30, 2016	18,223	2,518,015	445,455	(9,607)	(31,002)	25,789	(2,096)	11,622,768	14,587,545	46,279	14,633,824

The notes to the condensed consolidated financial statements form an integral part thereof.

Azrieli Group Ltd.

Condensed Consolidated Statements of Changes in Capital
(Continued)

	For the nine-month period ended September 30, 2015										
	Share capital	Share premium	Revaluation fund for financial assets available for sale	Capital reserve for translation differences from foreign operations	Capital reserve for transactions with related parties	Capital reserve from the acquisition of non-controlling interests in a consolidated company	Other capital reserves	Retained earnings	Total attributed to shareholders of the Company	Non-controlling interests	Total
	NIS in Thousands										
	(Unaudited)										
Balance as of January 1, 2015	18,223	2,518,015	373,253	29,054	(30,974)	18,641	(2,096)	10,327,571	13,251,687	96,867	13,348,554
Net profit for the period	-	-	-	-	-	-	-	532,853	532,853	6,371	539,224
Change in fair value of financial assets available for sale, net of tax	-	-	72,691	-	-	-	-	-	72,691	70	72,761
Actuarial gain due to defined benefit plan, net of tax	-	-	-	-	-	-	-	24	24	-	24
Translation differences from foreign operations	-	-	-	6,721	-	-	-	-	6,721	269	6,990
Total comprehensive income for the period	-	-	72,691	6,721	-	-	-	532,877	612,289	6,710	618,999
Dividend to the shareholders of the Company	-	-	-	-	-	-	-	(320,000)	(320,000)	-	(320,000)
Write-off of non-controlling interests due to disposition of a subsidiary	-	-	-	-	-	-	-	-	-	(4,780)	(4,780)
Total transactions with the shareholders of the Company	-	-	-	-	-	-	-	(320,000)	(320,000)	(4,780)	(324,780)
Balance as of Sept. 30, 2015	18,223	2,518,015	445,944	35,775	(30,974)	18,641	(2,096)	10,540,448	13,543,976	98,797	13,642,773

The notes to the condensed consolidated financial statements form an integral part thereof.

Azrieli Group Ltd.

Condensed Consolidated Statements of Changes in Capital

(Continued)

	For the three-month period ended September 30, 2016										
	Share capital	Share premium	Revaluation fund for financial assets available for sale	Capital reserve for translation differences from foreign operations	Capital reserve for transactions with related parties	Capital reserve from the acquisition of non-controlling interests in a consolidated company	Other capital reserves	Retained earnings	Total attributed to shareholders of the Company	Non-controlling interests	Total
	NIS in Thousands										
	(Unaudited)										
Balance as of July 1, 2016	18,223	2,518,015	406,066	15,621	(31,002)	25,789	(2,096)	11,343,769	14,294,385	45,603	14,339,988
Net profit for the period	-	-	-	-	-	-	-	278,999	278,999	10	279,009
Change in fair value of financial assets available for sale, net of tax	-	-	39,389	-	-	-	-	-	39,389	-	39,389
Translation differences from foreign operations	-	-	-	(25,228)	-	-	-	-	(25,228)	(773)	(26,001)
Total comprehensive income for the period	-	-	39,389	(25,228)	-	-	-	278,999	293,160	(763)	292,397
Dividend to holders of non-controlling interests	-	-	-	-	-	-	-	-	-	(75)	(75)
Investment of non-controlling interests in a subsidiary	-	-	-	-	-	-	-	-	-	1,514	1,514
Total transactions with the shareholders of the Company	-	-	-	-	-	-	-	-	-	1,439	1,439
Balance as of Sept. 30, 2016	18,223	2,518,015	445,455	(9,607)	(31,002)	25,789	(2,096)	11,622,768	14,587,545	46,279	14,633,824

The notes to the condensed consolidated financial statements form an integral part thereof.

Azrieli Group Ltd.
Condensed Consolidated Statements of Changes in Capital
(Continued)

	For the three-month period ended September 30, 2015										
	Share capital	Share premium	Revaluation fund for financial assets available for sale	Capital reserve for translation differences from foreign operations	Capital reserve for transactions with related parties	Capital reserve from the acquisition of non-controlling interests in a consolidated company	Other capital reserves	Retained earnings	Total attributed to shareholders of the Company	Non-controlling interests	Total
	NIS in Thousands										
	(Unaudited)										
Balance as of July 1, 2015	18,223	2,518,015	505,574	(3,245)	(30,974)	18,641	(2,096)	10,439,162	13,463,300	96,443	13,559,743
Net profit for the period	-	-	-	-	-	-	-	101,262	101,262	980	102,242
Change in fair value of financial assets available for sale, net of tax	-	-	(59,630)	-	-	-	-	-	(59,630)	70	(59,560)
Actuarial gain due to defined benefit plan, net of tax	-	-	-	-	-	-	-	24	24	-	24
Translation differences from foreign operations	-	-	-	39,020	-	-	-	-	39,020	1,304	40,324
Total comprehensive income for the period	-	-	(59,630)	39,020	-	-	-	101,286	80,676	2,354	83,030
Balance as of Sept. 30, 2015	18,223	2,518,015	445,944	35,775	(30,974)	18,641	(2,096)	10,540,448	13,543,976	98,797	13,642,773

The notes to the condensed consolidated financial statements form an integral part thereof.

Azrieli Group Ltd.

Condensed Consolidated Statements of Changes in Capital

(Continued)

	For the year ended December 31, 2015										
	Share capital	Share premium	Revaluation fund for financial assets available for sale	Capital reserve for translation differences from foreign operations	Capital reserve for transactions with related parties	Capital reserve from the acquisition of non-controlling interests in a consolidated company	Other capital reserves	Retained earnings	Total attributable to shareholders of the Company	Non-controlling interests	Total
	NIS in Thousands										
Balance as of January 1, 2015	18,223	2,518,015	373,253	29,054	(30,974)	18,641	(2,096)	10,327,571	13,251,687	96,867	13,348,554
Net income for the year	-	-	-	-	-	-	-	820,991	820,991	6,674	827,665
Change in fair value of financial assets available for sale, net of tax	-	-	18,103	-	-	-	-	-	18,103	69	18,172
Actuarial loss due to defined benefit plan, net of tax	-	-	-	-	-	-	-	(971)	(971)	(6)	(977)
Translation differences from foreign operations	-	-	-	1,415	-	-	-	-	1,415	91	1,506
Total comprehensive income for the year	-	-	18,103	1,415	-	-	-	820,020	839,538	6,828	846,366
Dividend to shareholders of the Company	-	-	-	-	-	-	-	(320,000)	(320,000)	-	(320,000)
Dividend to holders of non-controlling interests	-	-	-	-	-	-	-	-	-	(312)	(312)
Write-off of non-controlling interest due to disposition of subsidiary	-	-	-	-	-	-	-	-	-	(4,780)	(4,780)
Total transactions with shareholders of the Company	-	-	-	-	-	-	-	(320,000)	(320,000)	(5,092)	(325,092)
Balance as of December 31, 2015	18,223	2,518,015	391,356	30,469	(30,974)	18,641	(2,096)	10,827,591	13,771,225	98,603	13,869,828

The notes to the condensed consolidated financial statements form an integral part thereof.

Azrieli Group Ltd.

Condensed Consolidated Statements of Cash Flows

	For the nine-month period ended Sept. 30		For the three-month period ended Sept. 30		For the year ended December 31
	2016	2015	2016	2015	2015
	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands
	(Unaudited)		(Unaudited)		
Cash Flows - Current Operations					
Net profit for the period	1,197,864	539,224	279,009	102,242	827,665
Depreciation and amortization	69,110	76,374	16,229	26,197	103,153
Impairment of goodwill	25,227	80,000	-	80,000	103,000
Forfeiture of senior housing tenants' deposits	(10,869)	(3,227)	(5,170)	(3,227)	(6,311)
Net gain (loss) from fair value adjustment of investment property and investment property under construction	(517,727)	(36,013)	(127,261)	5,038	(180,307)
Financing and other expenses, net	114,037	106,856	54,741	22,209	140,741
Gain (loss) from liquidation of fixed assets, investment property and intangible assets, net	(306)	(2,447)	(169)	952	(1,846)
Share in losses of associates accounted for by the equity method	6,292	4,894	2,452	1,689	8,562
Change in recording of benefit in respect of share-based payment and employee benefits	31	3,145	31	31	2,493
Tax expenses recognized in the income statement	166,134	241,582	90,436	75,729	364,780
Change in financial assets	(71)	81	(62)	91	116
Loss from realizing investment in subsidiary (Annex A)	5,634	8,627	5,634	-	9,437
Income taxes paid, net	(204,358)	(167,331)	(68,167)	(48,495)	(197,601)
Erosion (revaluation) of financial assets designated at fair value through profit and loss	(2,592)	(7,277)	972	61	(2,715)
Change in inventory	(1,062)	64,834	(1,494)	5,744	67,841
Change in trade and other receivables	66,163	117,957	(1,756)	170,035	137,504
Change in receivables in respect of franchise arrangement	(8,207)	12,177	(1,684)	(4,175)	6,566
Change in trade and other payables	52,811	(157,735)	8,695	(160,259)	(154,688)
Receipt of deposits from senior housing tenants	61,177	10,959	48,399	10,959	25,796
Return of deposits from senior housing tenants	(15,377)	(4,083)	(9,793)	(4,083)	(6,864)
Change in employee provisions and benefits	(459)	17,914	462	23,064	13,475
Net cash - current operations	1,003,452	906,511	291,504	303,802	1,260,797

The notes to the condensed consolidated financial statements form an integral part thereof.

Azrieli Group Ltd.

Condensed Consolidated Statements of Cash Flows
(Continued)

	For the nine-month period ended Sept. 30		For the three-month period ended Sept. 30		For the year ended December 31
	2016	2015	2016	2015	2015
	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands
	(Unaudited)		(Unaudited)		
Cash flows - Investment Activity					
Proceeds from liquidation of fixed and intangible assets	2,173	6,446	670	326	7,157
Proceeds from liquidation of investment property	4,536	172	-	172	2,836
Down payments on account of investment property	-	(2,889)	-	(1,674)	(4,815)
Purchase of and investment in investment property and investment property under construction	(1,777,859)	(834,705)	(559,279)	(231,074)	(1,016,466)
Purchase of fixed and intangible assets	(98,269)	(95,123)	(11,258)	(18,424)	(118,589)
Investment in and granting of loans to associates	(15,997)	(21,035)	(7,474)	(6,492)	(3,435)
Change in short-term deposits	(12,944)	(6,917)	1,856	8,725	10,049
Change in restricted investments	(357)	15,127	(57)	43	15,279
Receipt (payment) for settlement of derivative financial instruments, net	725	(506)	-	5,214	(5,304)
Change in financial assets designated at fair value through profit and loss, net	3,979	2,338	3,238	193	2,338
Change in marketable securities, net	-	14,874	-	-	14,874
Granting of long-term loans	(1,176)	(9,117)	(347)	(5,053)	(44,862)
Collection of long-term loans	16,329	13,239	1,738	2,605	15,593
Interest and dividend received	25,941	41,634	3,650	12,857	45,937
Acquisition of companies consolidated for the first time (Annex B)	(60,864)	(254,641)	-	(227,593)	(254,661)
Proceeds from liquidation of investments in investee companies, net (Annex A)	116,339	415,948	116,339	-	415,948
Institutions for the purchase of real estate	(29,396)	-	(22,796)	-	-
Proceeds from sale of investments	-	115,174	-	-	115,174
Tax paid for sale of companies	-	(22,045)	-	(9,931)	(22,745)
Net cash - investment activity	(1,826,840)	(622,026)	(473,720)	(470,106)	(825,692)

The notes to the condensed consolidated financial statements form an integral part thereof.

Azrieli Group Ltd.

Condensed Consolidated Statements of Cash Flows

(Continued)

	For the nine-month period ended Sept. 30		For the three-month period ended Sept. 30		For the year ended December 31
	2016	2015	2016	2015	2015
	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands
	(Unaudited)		(Unaudited)		
Cash flows - Financing Activity					
Acquisition of non-controlling interests	(51,000)	-	-	-	-
Dividend distribution to shareholders	(400,000)	(320,000)	-	-	(320,000)
Repayment of bonds	(401,458)	(398,537)	(8,370)	(8,430)	(406,994)
Bond offering net of issue expenses	2,176,535	2,209,284	2,176,535	996,858	2,209,284
Receipt of long-term loans from banks and others	1,139,994	112,030	83,363	-	112,203
Repayment of long-term loans from banks and others	(860,682)	(812,710)	(686,846)	(499,502)	(876,330)
Short-term credit from banks and others, net	5,135	(41,919)	(305,773)	(32,596)	(202,735)
Repayment of deposits from customers	(3,902)	(4,548)	(984)	(1,674)	(6,034)
Deposits from customers that were received	5,228	6,361	1,682	2,689	8,802
Dividend to holders of non-controlling interests	(75)	(125)	(75)	-	(437)
Investment of non-controlling interests in a subsidiary	4,432	-	1,514	-	-
Interest paid	(160,470)	(183,809)	(63,625)	(56,043)	(231,501)
Net cash - Financing Activity	1,453,737	566,027	1,197,421	401,302	286,258
Increase in cash and cash equivalents	630,349	850,512	1,015,205	234,998	721,363
Cash and cash equivalents at beginning of period	934,724	163,578	492,043	827,037	163,578
Change in net cash from disposal group held for sale	888	51,423	56,765	-	50,487
Effect of exchange rate changes on cash balances held in foreign currency	(3,473)	(64)	(1,525)	3,414	(704)
Cash and cash equivalents at end of period	1,562,488	1,065,449	1,562,488	1,065,449	934,724

(*) The nine- and three-months periods ended on September 30, 2016 included a change in receivables due to the sale of an investment in an investee in the sum of NIS 125,088 thousand.

The notes to the condensed consolidated financial statements form an integral part thereof.

Azrieli Group Ltd.
Condensed Consolidated Statements of Cash Flows
(Continued)

	For the nine-month period ended Sept. 30		For the three-month period ended Sept. 30		For the year ended December 31
	2016	2015	2016	2015	2015
	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands
	(Unaudited)		(Unaudited)		
Annex A -					
Proceeds from sale of investment in previously-consolidated Green Anchors Ltd.:					
Working capital (excluding cash and cash equivalents)	-	(2,975)		-	(2,975)
Fixed and intangible assets, net	-	105		-	105
Investment property	-	24,081		-	24,081
Long-term liabilities including current maturities	-	(7,317)		-	(7,317)
Liabilities for deferred taxes, net	-	(4,365)		-	(4,365)
Non-controlling interests	-	(4,780)		-	(4,780)
Loss from liquidation of investment in subsidiary	-	(42)		-	(42)
	-	4,707		-	4,707
Proceeds from sale of investment in previously-consolidated Via Maris Desalination (Holdings) Ltd.:					
Working capital (excluding cash and cash equivalents)	-	79,678		-	80,488
Investments and loans	-	3,799		-	3,799
Receivables in respect of franchise arrangement	-	822,932		-	822,932
Fixed and intangible assets, net	-	126,037		-	126,037
Long-term liabilities, net	-	(697,358)		-	(697,358)
Liabilities for deferred taxes, net	-	(23,481)		-	(23,481)
Restricted investments	-	60,661		-	60,661
Loss from liquidation of investment in subsidiary	-	(8,585)		-	(9,395)
	-	363,683		-	363,683

The notes to the condensed consolidated financial statements form an integral part thereof.

Azrieli Group Ltd.

Condensed Consolidated Statements of Cash Flows

(Continued)

	For the nine-month period ended Sept. 30		For the three-month period ended Sept. 30		For the year ended December 31
	2016	2015	2016	2015	2015
	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands
	(Unaudited)		(Unaudited)		
Annex A – (Cont.)					
Proceeds from sale of investment in previously-consolidated Sonol Israel Ltd.:					
Working capital (excluding cash and cash equivalents)	(183,085)	-	(183,085)	-	-
Investments and loans	73,246	-	73,246	-	-
Fixed and intangible assets, net	684,366	-	684,366	-	-
Pre-paid long-term lease payments	37,045	-	37,045	-	-
Investment property	12,420	-	12,420	-	-
Deferred tax assets	7,100	-	7,100	-	-
Employee benefits and provisions	(72,094)	-	(72,094)	-	-
Long-term liabilities including current maturities	(311,938)	-	(311,938)	-	-
Loan granted due to the sale of the investment	(97,500)	-	(97,500)	-	-
Receivables due to the sale of the investment	(27,587)	-	(27,587)	-	-
Loss from disposition of investment in subsidiary	(5,634)	-	(5,634)	-	-
	116,339	-	116,339	-	-
Receivables for the sale of an investment in previously-consolidated S. Solar Ltd., net	-	47,558	-	-	47,558
Total proceeds from the sale of investments, net	116,339	415,948	116,339	-	415,948

The notes to the condensed consolidated financial statements form an integral part thereof.

Azrieli Group Ltd.
Condensed Consolidated Statements of Cash Flows
(Continued)

	For the nine-month period ended Sept. 30		For the three-month period ended Sept. 30		For the year ended December 31
	2016	2015	2016	2015	2015
	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands
	(Unaudited)		(Unaudited)		
Annex B -					
Acquisition of a company consolidated for the first time – Palace America Senior Housing Ltd.:					
Working capital (excluding cash and cash equivalents and short-term deposits)	-	10,574	-	10,574	10,574
Liabilities for deposits from customers	-	284,721	-	284,721	284,721
Fixed and intangible assets, net	-	(141,907)	-	(141,907)	(141,927)
Investment property	-	(552,083)	-	(552,083)	(552,083)
Long-term liabilities including current maturities	-	54,189	-	54,189	54,189
Reserve for deferred taxes, net	-	89,865	-	89,865	89,865
	-	(254,641)	-	(254,641)	(254,661)
Acquisition of a company consolidated for the first time – Ahuzat Bayit Raanana – Retirement Home Ltd., see Note 3E:					
Working capital (excluding cash and cash equivalents and short-term deposits)	(31,361)	-	-	-	-
Liabilities for deposits from customers	327,655	-	-	-	-
Fixed and intangible assets, net	(13,460)	-	-	-	-
Investment property	(530,627)	-	-	-	-
Long-term liabilities including current maturities	212,454	-	-	-	-
	(35,339)	-	-	-	-
Acquisition of a company consolidated for the first time – Azrieli eCommerce Ltd. (formerly: Netex New Media Ltd.), see Note 3J:					
Working capital (excluding cash and cash equivalents)	5,025	-	-	-	-
Fixed and intangible assets, net	(65,360)	-	-	-	-
Long-term liabilities including current maturities	35,032	-	-	-	-
	(25,303)	-	-	-	-
Acquisition of a company consolidated for the first time – Bio Clean Air Innovation Ltd.:					
Working capital (excluding cash and cash equivalents)	6,078	-	-	-	-
Fixed and intangible assets, net	(7,124)	-	-	-	-
Reserve for deferred taxes, net	824	-	-	-	-
	(222)	-	-	-	-
Down payment on account of the acquisition of a company – Assisted Living Modi'in Ltd.	-	-	-	(27,048)	-
Total acquisition of companies consolidated for the first time	(60,864)	(254,641)	-	(227,593)	(254,661)

The notes to the condensed consolidated financial statements form an integral part thereof.

<u>AZRIELI GROUP LTD.</u>

<u>Notes to the condensed consolidated financial statements</u>

<u>as of September 30, 2016</u>

Note 1 – General

A. Azrieli Group Ltd. (the "**Company**") is a company domiciled and incorporated in Israel and whose registered address is 1 Azrieli Center, Tel Aviv. The Company is traded on the TASE and is included in the Tel Aviv 25 Index. The Group's consolidated financial statements as of September 30, 2016 include those of the Company and of its subsidiaries (jointly, the "**Group**"), as well as the Group's rights in associates and in jointly-controlled entities.

As of the Report Release Date, Azrieli Holdings Inc., the controlling shareholder of the Company ("**Azrieli Holdings**"), directly and/or indirectly holds (through its holding of the entire share capital of Nadav Investments Inc. (the "**Parent Company**")) (both private companies registered in Canada), approx. 55.62% of the Company's share capital and approx. 61.31% of the Company's voting rights.

As the Company was informed, on April 13, 2015, shares of Mr. David Azrieli OBM in Azrieli Holdings and in a Canadian holding corporation controlled by him ("**David's Holding Corporation**") were distributed from his estate. Following such distribution, each one of Sharon Azrieli, Naomi Azrieli and Danna Azrieli, holds, directly and through David's Holding Corporation, approx. 27.24% of the capital rights in Azrieli Holdings and approx. 33.13% of the voting rights in Azrieli Holdings, and they jointly hold approx. 81.73% of the capital rights in Azrieli Holdings and approx. 99.39% of the voting rights therein. The remainder of Azrieli Holdings' shares are mainly held by the Azrieli Foundation of Canada (an interested party of the Company), which following the distribution of the estate holds (indirectly, through a holding of shares of David's Holding Corporation) approx. 15.93% of Azrieli Holdings' shares, with no voting rights (which constitutes, indirectly, a holding of approx. 8.86% of the capital rights of the Company), in addition to and separately from its direct holding of approx. 8.55% of the capital and voting rights in the Company.

As the Company was informed, all of the shareholders of Azrieli Holdings are bound by a shareholder agreement between them which, *inter alia*, confers on each one of Sharon Azrieli, Naomi Azrieli and Danna Azrieli the right to appoint one of the three directors on the boards of directors of Azrieli Holdings and Nadav Investments.

In view of the aforesaid, as of the Report Date, Sharon Azrieli, Naomi Azrieli and Danna Azrieli are the controlling shareholders of the Company.

B. These Condensed Consolidated Statements should be reviewed in the context of the Group's Annual Financial Statements as of December 31, 2015, and for the year then ended, and the notes accompanied thereto.

Note 2 – Significant Accounting Policies

A. The basis for the preparation of the financial statements:

(1) The Group's condensed consolidated financial statements ("**Interim Consolidated Statements**") were prepared in accordance with IAS 34 – Interim Financial Reporting ("**IAS 34**").

In the preparation of these Interim Financial Statements the Group has applied the accounting policy, rules of presentation and methods of calculation identical to those used in the preparation of its financial statements as of December 31, 2015 and for the year then ended.

The condensed consolidated financial statements were prepared in accordance with the disclosure provisions in Chapter D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

(2) The addition to the accounting policy – as a result of the acquisition of Netex New Media Ltd. (see Note 3J):

- **Intangible Assets**:

  Intangible assets acquired separately, are measured at the time of initial recognition according to the cost plus the direct acquisition costs. An intangible asset deriving from in-house development, shall be recognized if, and only if, the following conditions are proven: technological feasibility of completion of the intangible asset, so that it will be available for use or sale; intention and ability to use the intangible asset or sell it; the manner in which the intangible asset will create future economic benefits, the existence of technological, financial and other required resources, which are available for the completion of the intangible asset, and the ability to reliably measure the expenses therefor, during the development thereof.

  The Group discounts the costs for development of software for self-use, commencing from the date of fulfillment of the criteria for the recognition of an intangible asset deriving from in-house development, as detailed above. The discounting of the costs, as aforesaid, is discontinued when the software is substantially completed and is ready for its designated use. Improvements and upgrades which add functionality to the software are discounted to the cost.

  Following the initial recognition, intangible assets are presented at their cost net of accumulated amortization and net of accumulated impairment losses.

  According to management's assessment, the intangible assets have a defined life span. The assets are amortized over their useful life, as detailed below:

  Software and websites – 5 years.
  Advertisement rights – according to actual utilization.

Note 2 – Significant Accounting Policies (Cont.)

(2) (Cont.)

- **Research and Development Expenses**:

  R&D expenses are recorded in the income statement as incurred (other than as provided in the intangible assets section above).

B. Use of estimates and discretion:

(1) In the preparation of the condensed financial statements in accordance with IFRS, the Group's managements are required to use discretion, evaluations, estimates and assumptions which affect the application of the policy and the amounts of assets and liabilities, revenues and expenses. It is clarified that the actual results may differ from such estimates.

The evaluations and discretion used by management to apply the accounting policy and prepare the Consolidated Interim Financial Statements were identical to those used in the preparation of the financial statements as of December 31, 2015.

(2) Further to Note 3(C)1 to the annual financial statements, as of June 30, 2016, the Group updated the valuations for some of its investment property in Israel (which are attributed to the retail centers and malls segment, to the office and other space for lease segment and to other segments in the senior housing sector).

The valuations were performed by an independent external appraiser, possessing the appropriate professional skills.

The valuations for the investment property for lease and under construction were mainly prepared using the method of discounting the expected cash flows from the properties.

The cap rates used by the appraiser are mainly between 6.75% and 8.75%. The cap rates were determined considering the type, designation and location of the property, the amount of the rent versus the market price and the nature of the tenants.

The valuations of the lands as of March 31, 2016 and September 30, 2016 were performed by the comparison method (for additional details see Notes 3G and 3P) and of the property under construction by discounting the expected cash flows from the property, net of construction cost balance and developer profit. The cap rates used by the appraiser for the property under construction are between 7.75%-8.5%. The cap rate was determined in consideration of the type of the property, the level of risk and uncertainty with respect to receipt of the expected cash flow, the size of the property and the timing of the completion of the construction.

Note 2 – Significant Accounting Policies (Cont.)

B. Use of estimates and discretion: (Cont.)

(2) (Cont.)

For one of the investment properties under construction which the company first revaluated for September 30, 2016, the Company included an additional cost for the land (the "**Additional** Cost"), in a sum that is non-material to the Company, following a betterment levy assessment that was received during the Report period, most of which was paid under protest by the Company. The balance of the aforesaid payment, exceeding the Additional Cost was recognized as an asset within the current assets in the Company's books, in view of the Company's forecast of the repayment of these amounts, in reliance on the opinion of an independent assessor.

In regards to the remaining properties, the Company's estimation is that no significant changes occurred in the properties' value compared to the last date on which a valuation was performed.

C. Rates of exchange and linkage basis:

(1) Balances that are stated in foreign currency or linked thereto are recorded in the financial statements according to the representative exchange rates published by the Bank of Israel and which were in force on the end of the reporting period.

(2) Balances that are linked to the CPI are presented according to the last known index at the end of the reporting period (the index for the month preceding the month of the date of the financial statements) or according to the index for the last month of the period of report (the index for the month of the date of the financial statements) according to the terms of the transaction.

Note 2 – Significant Accounting Policies (Cont.)

C. Rates of exchange and linkage basis: (Cont.)

(3) The following is data on the significant exchange rates and the Index:

	Representative exchange rate of the		Israeli Index	
	Euro	**USD**	**“Due”**	**“Known”**
	(1 Euro = NIS)	**(1 USD = NIS)**	**Basis 1993**	**Basis 1993**
Date of the financial statements:				
As of September 30, 2016	4.203	3.758	221.13	221.35
As of September 30, 2015	4.4038	3.923	222.02	222.92
As of December 31, 2015	4.247	3.902	221.13	221.35
Rates of change:	%	%	%	%
For the nine-month period ended:				
September 30, 2016	(1.03)	(3.69)	-	-
September 30, 2015	(6.79)	0.87	(0.60)	(0.20)
For the three-month period ended:				
September 30, 2016	(1.89)	(2.29)	-	0.40
September 30, 2015	4.37	4.09	(0.40)	0.30
For the year ended				
December 31, 2015	(10.11)	0.33	(1.00)	(0.90)

Note 3 – Material Events during the Report Period

A. On March 22, 2016, the Company's Board of Directors decided upon the distribution of a dividend in the sum of NIS 400 million (reflecting NIS 3.30 per share), paid on May 4, 2016.

B. On April 13, 2016, the Company closed a transaction, that was signed on March 2, 2016, between the Company and Lodzia-Rotex Investment Ltd. (the "**Seller**"), after the Antitrust Commissioner's approval was received, which constituted a condition precedent to the transaction, in connection with the acquisition of all of the ownership rights of the Seller in a property of a registered area of approx. 53,000 sqm, situated in the Holon industrial zone, with a built-up area of approx. 14,300 sqm of workshops and commercial buildings thereon, which are leased to various tenants. In consideration for the property, the Company paid approx. NIS 280 million plus V.A.T. The designation of the land according to the valid zoning plan is a special employment area with a commercial front and it includes building rights for approx. 193 thousand sqm above-ground and as well as parking basements.

The Seller is entitled to all the revenues net of expenses for the management of the property (NOI) in the 12 months from the execution date of the agreement, in the estimated amount of NIS 10 million.

C. On March 6, 2016, the Company's general meeting approved the Company's engagement in an agreement for the purchase of one share of Canit Hashalom Investments Ltd. ("**Canit Hashalom**"), a subsidiary in which the Company held approx. 99.1% from Azrieli Foundation (Israel) (R.A.), in consideration for NIS 51 million. Following the purchase, the Company holds 100% of the issued share capital of Canit Hashalom.

The closing of the transaction had no effect on the Company's income statement.

D. On January 4, 2016, the plenum of the Knesset approved the Law for Amendment of the Income Tax Ordinance (No. 216), 5776-2016, which determined, *inter alia*, a decrease in the corporate tax rate, commencing 2016 and onwards, by a rate of 1.5%, to 25%. As a result of the change in the tax rate, there was a reduction of the deferred tax liability balances in an amount of NIS 170 million and a reduction in the deferred tax asset balances in an amount of NIS 3 million. The update of the deferred tax balances was recorded against deferred tax income in an amount of NIS 162 million, and the other comprehensive income of the Company increased by NIS 167 million.

Note 3 – Material Events during the Report Period (Cont.)

E. On March 23, 2016, a consolidated company (the "**Buyer**") entered into a contingent agreement (the "**Agreement**" or the "**Transaction**") with unrelated third parties (the "**Sellers**"), for the purchase of 100% of the shares of a private company that is a reporting corporation, as defined in the Securities Law, 5728-1968, which holds and manages the "Ahuzat Bayit" senior home and the "Park Mall" retail center in Ra'anana (the "**Purchased Company**").

Below are the main details of the engagement:

- The property – "Ahuzat Bayit" is an active senior home located at Ahuza Street in Ra'anana, in proximity of the route of Road 531, which included at the time of the engagement approx. 335 senior housing units and a long-term care unit.

  "Park Mall" is an active retail center located near the senior home, with approx. 20 tenants in an area of approx. 4,500 sqm.

- The consideration – for the shares of the Purchased Company, the Buyer will pay a total consideration of NIS 55 million. The full consideration amount will be paid at the closing date of the Transaction, as defined in the Agreement.

- Indemnification – in the context of the engagement, the Buyer undertook that it, jointly with others, will be liable to indemnify the Purchased Company and/or the Company for past activity of the Purchased Company that is unrelated to the senior home and the retail center.

- Condition precedent – the closing of the Transaction is conditioned on the approval of the Antitrust Commissioner, insofar as required, up to and by no later than 120 days of the execution date of the Agreement.

On April 13, 2016, the Antitrust Commissioner rendered notice of his consent for effecting the transaction and on May 25, 2016, the transaction was closed.

On June 29, 2016, the Purchased Company ceased to be a reporting corporation, as defined in the Securities Law, 5728-1968, following the early redemption by the Purchased Company of the Bonds (Series A) it issued to the public. For details see Note 3K below).

F. On March 31, 2016, the Azrieli Foundation Canada, an interested party in the Company, sold approx. 5% of the Company's shares, as part of the preparations towards the indices reform recently announced by TASE.

As a result of the sale, the Azrieli Foundation Canada holds approx. 8.55% of the Company's shares.

Note 3 – Material Events during the Report Period (Cont.)

G. Further to Note 14F to the annual financial statements, on March 31, 2016, the Company paid a sum of NIS 302 million plus VAT, constituting the consideration balance in connection with the purchase of rights in a lot adjacent to the Azrieli Center in Tel Aviv, of an area of approx. 8,400 sqm, at the intersection of Menachem Begin Road and Noah Moses St. in Tel Aviv on which stands a building slated for demolition, known as the "Yediot Aharonot House". Possession of the lot was handed-over to the Company at such date. The property was revaluated in the financial statements as of March 31, 2016, and recorded at its fair value. For further details, see Note 2B(2).

H. On May 24, 2016, a loan was provided to the Company in the sum of NIS 550 million from an institutional body affiliated neither with the Company nor with its controlling shareholders, linked to the CPI, bearing an annual interest at the rate of 1.5%.The repayment of the loan's principal shall commence at the second anniversary of the provision date of the loan and shall be made in 40 equal quarterly installments (the last principal payment shall be made 12 years after the provision date of the loan). The interest on the loan shall be paid on a quarterly basis, until the final repayment date. The Company is entitled to prepay the loan (in whole or in part) against a prepayment fee according to a mechanism defined in the agreement.

To secure repayment of the loan, Canit Hashalom Investments Ltd., a subsidiary wholly owned by the Company, had pledged in favor of the lender, by way of a first-ranking fixed pledge unlimited in sum, the Azrieli Rishonim Center in Rishon LeZion (which is currently under construction), including its rights to receive rent from the property's tenants and its rights under the insurance policies in connection with the property.

In the context of the loan agreement, the Company undertook to comply with the financial covenants that were set forth in the indentures of the Company's Series B and C bonds (the "**Bonds**"), i.e. a net debt to assets ratio that shall not exceed 60% and equity of no less than NIS 5 billion (the "**Financial Covenants**"). The Company further undertook to maintain a LTV ratio that shall not exceed 80%, commencing on the 2017 annual reports. In addition, the agreement includes limitations on the distribution of dividends that correspond with the undertaking set forth in the Bonds' indentures (i.e. that no distribution shall be made if as a consequence thereof the equity shall be less than NIS 6 billion and the debt to assets ratio shall exceed 50%). In addition, the Company undertook not to create a floating charge on all or part of the Company's assets, to any entity, unless it shall grant the lender, on the same date, a floating charge of identical ranking and scope (*pari passu*) (such undertaking also exists in the Bonds' indentures). The causes for acceleration are as customary in agreements of such type and in the Bonds' indentures, including a cause pertaining to the acceleration of another substantial debt of the Company.

As of the date of the financial statements, the Company complies with the contractual limitations determined.

Note 3 – Material Events during the Report Period (Cont.)

I. On May 2, 2016, the Company entered into a credit agreement with an institutional body affiliated neither with the Company nor with its controlling shareholders, for the provision of a loan of NIS 300 million, to be repaid (principal and interest) upon the lapse of six months of the provision date thereof. The loan bears an NIS interest comprising Prime interest minus 0.1%. The loan will be secured by an existing charge on an asset, which was granted to the lender to secure another loan received therefrom. In the context of the loan, the Company undertook to comply with the Financial Covenants that were set forth in the indentures of the Company's Series B and C bonds (the "**Bonds**"), i.e. a net debt to assets ratio that shall not exceed 60% and equity of no less than NIS 5 billion. The causes for acceleration are as customary in agreements of such type and in the Bonds' indentures, including a cause pertaining to the acceleration of another substantial debt of the Company. The agreement prescribes that if the Company grants a floating charge to another entity in the future, it shall grant the lender, on the same date, a floating charge of identical ranking and scope (*pari passu*).

For further details regarding the Financial Covenants, undertakings regarding distribution of dividends and causes for acceleration in the Bonds' indentures, see Note 21B(3) to the annual financial statements.

As of the date of approval of the financial statements, the loan has been repaid.

J. On May 2, 2016, the Company (the "**Buyer**"), entered into an agreement with Buy2 Networks Ltd., a public company whose shares are listed for trade on the Tel Aviv Stock Exchange (the "**Seller**"), for the purchase of the Seller's business in the field of eCommerce (the "**Operating Segment**"), as specified below:

The purchased business – according to the agreement, the Buyer shall purchase from the Seller 100% of the shares of Netex New Media Ltd. (whose name was changed on July 14, 2016 to "Azrieli eCommerce Ltd."), a private company wholly owned by the Seller that is engaged in the Operating Segment (whose trade name is "Buy2"), as well as all of the rights in assets (tangible and intangible) in the Operating Segment which are directly held by the Seller.

The consideration – in consideration for the purchased business and shares, the Buyer shall pay the Seller a sum of NIS 70 million, subject to adjustments, which, as of the report date, are expected to amount to approx. NIS 8 million, such that the net consideration, as of the report date, is approx. NIS 62 million.

In addition, a sum of approx. NIS 5 million per year will be paid for management services in the Operating Segment that will be provided by the Seller to the Buyer during a 24-month period from the closing date of the transaction, payable on a calendar quarter basis throughout the period of the services. In was further agreed that from the closing date of the transaction and for a 4-year period, the Seller shall not compete with the Operating Segment.

Note 3 – Material Events during the Report Period (Cont.)

J. **(Cont.)**

On May 18, 2016 the approval of the Antitrust Commissioner was received, and on June 2, 2016, the transaction was closed.

K. On June 7, 2016, the board of directors of consolidated company Ahuzat Bayit Raanana – Retirement Home Ltd. resolved to perform full early redemption of its Series A bonds. The total amount paid to the bondholders is in the sum of NIS 209,813 thousand.

Payment of the early redemption was made on June 29, 2016 for the entire balance of the principal of the bonds in circulation. The early redemption of the bonds had a marginal effect on the Group's results.

L. On May 10, 2016, the Company engaged, directly and indirectly through companies controlled thereby, in sale agreements for the sale of all of the Company's holdings in the Pi Glilot lands and the shares of Pi Glilot Oil and Pipe Terminals Co. Ltd. (which is the owner of lease rights with respect to land in the Pi Glilot site), to third parties for a total consideration of approx. NIS 130 million. As of the date of approval of the Financial Statements the transactions were not yet closed.

M. In July 2016, the Company issued approx. NIS 2,194.1 million par value registered Series D bonds to the public, on the basis of a shelf prospectus of the Company. The bonds are linked (principal and interest) to the CPI and bear fixed interest at the rate of 1.34% per annum.

The principal shall be paid in 25 equal semi-annual installments on January 5 and July 5 of each of the years 2018 to 2030 (each payment being at the rate of 4% of the par value of the principal from July 5, 2018). The interest will be paid in semi-annual payments from January 5, 2017 of each of the years 2017 to 2030. The bonds were issued without a discount.

The issue proceeds amounted to approx. NIS 2,194 million, and after recording the issue expenses, the net proceeds amounted to approx. NIS 2,177 million. The effective interest rate on the bonds is 1.45% per annum.

On July 5, 2016 Midroog assigned the Series D bonds a stable Aa1 rating.

The bonds are not secured by any collateral.

Note 3 – Material Events during the Report Period (Cont.)

M. (Cont.)

At the time of the issue, the Company undertook to meet financial covenants and undertakings, mainly as follows:

(1) So long as the Series D bonds are not fully repaid, the Company shall not pledge or place a floating (current) charge on all of the Company's assets and rights, present or future, other than in certain conditions set forth in the Indenture.

(2) Maintenance of minimum equity (equity attributable to the shareholders of the Company, excluding minority interests) of at least NIS five billion for two consecutive calendar quarters or more, according to its latest consolidated financial statements.

The ratio between the net financial debt and the net assets, as defined in the Indenture, shall not exceed 60% for two consecutive calendar quarters or more.

The Indenture provides that, in lieu of the said financial covenants, the Company shall be entitled, at its sole discretion, to place a fixed charge (either itself or through an investee company) in favor of the trustee for the Series D bond holders, on permitted assets in accordance with the definitions set forth in the Indenture (i.e., insofar as the Company pledges permitted assets as aforesaid, and the pledges shall be valid, the Company will not be bound by the said financial covenants).

(3) The Company shall make no distribution (as the term is defined in the Companies Law, 5759-1999) to its shareholders if: (1) the Company's equity (equity attributable to the Company's shareholders, excluding minority interests) according to its latest reported consolidated financial statements, net of the distribution amount, is less than NIS six billion; (2) the ratio between the net financial debt and the net assets of the Company as defined in the Indenture, net of the distribution amount, is more than 50%; (3) grounds for acceleration as defined in the Series D bond Indenture are in place on the date of the resolution to perform the distribution or as a result thereof.

It was further determined that if the Company's Series D bond rating falls below Aa2 of Midroog or its equivalent assigned by another agency that shall rate the bonds, the annual interest rate to be borne by the unpaid balance of the bond principal shall rise. In such a case, the annual interest rate to be added to the interest rate on the bonds will be in the range of 0.25%-1%, in accordance with the rating of the bonds.

Note 3 – Material Events during the Report Period (Cont.)

M. (Cont.)

The Series D bonds shall further be accelerated upon fulfillment of certain conditions, including: striking off or dissolution of the Company, receivership, delinquency in payments under the bonds, attachments on all or substantially all of the Company's assets, changes of control, fundamental breach of the terms of the bonds or the Indenture, non-compliance with the above financial covenants, performance of a distribution in violation of the restriction on distributions above, suspension of trade in the bonds (other than on grounds of unclarity), a demand for acceleration by financial creditors above NIS 200 million or of another bond series of the Company, discontinuation of the rating of the bonds due to circumstances within the Company's control, a bond rating lower than Baa3, or a sale of a majority of the Company's assets.

As of the date of the financial statements, the Company complies with the contractual restrictions that were determined.

N. In August 2016, a consolidated company purchased an office building (the construction of which was completed in August 2015), located in Austin, Texas, U.S.A., for U.S. $40.5 million. The size of the property is 128,990 sqf (11,984 sqm) and it is occupied by a single tenant with a lease until 2028, with no option for early exit.

For the purpose of the purchase of the property, the consolidated company took a loan in the amount of U.S. $22 million for a period of 7 years, bearing fixed dollar interest of 3.65%.

O. In July and August 2016, the Group prepaid loans in the sum of approx. NIS 900 million, some of which were secured by collateral, approx. NIS 300 million of which short-term loans and the balance is mostly long-term loans that were due in March 2017.

P. Following Note 14E to the annual financial statements, on August 31, 2016, the Company paid a sum of approx. NIS 134 million that constitutes the remaining of the consideration with respect to the acquisition of the rights of Clalit Health Services in a lot of an area of approx. 10,000 sqm located at 146 Menachem Begin Road, in the Northern Tel Aviv Central Business District, which is designated for the construction of the Azrieli Town project of approx. 75 thousand sqm, comprising leasable office and retail space of approx. 58 thousand sqm (approx. 48 thousand sqm offices and approx. 10 thousand sqm retail), and residential areas of approx. 17 thousand sqm. The property was re-evaluated in the financial statements as of September 30, 2016 and was set on its fair value. For further details, see Note 2B(2).

Note 3 – Material Events during the Report Period (Cont.)

Q. Following Note 37D to the annual financial statements, on August 9, 2016, the general meeting of shareholders approved amendments to the Company's Articles of Association most of which pertain to updates pursuant to modified legislation provisions, expansion of the liabilities and/or expenses for which the Company is entitled to grant indemnification and/or insurance to directors and offices, due to, *inter alia,* the provisions of the Antitrust Law 5748-1988, as well as expansion of the definition of the term "Party Injured by a Breach", such that it shall apply to any act of legislation in respect of which an administrative proceeding may be conducted.

R. Contingent Liabilities:

(1) Following Note 33B(1) to the annual financial statements, during the report period, the parties signed a settlement agreement in immaterial amounts which was sanctioned as a judgment.

(2) Following Note 33C(2) to the annual financial statements, a judgment issued by the Supreme Court in February 2016 in a case conducted between two gas companies and a large number of municipalities, whereby the gas companies are not to be charged municipal tax (*arnona*) for the gas containers buried in their areas. This judgment is significantly strengthening Supergas' claims in the matter of the demand for the payment of municipal tax and several municipalities have already sent a notice on cancelling the charges. In view of the aforesaid, Supergas' management believes, based on its legal counsel, that Supergas' chances on warding off the demand for municipal tax are higher than 50%.

Note 4 – Discontinued Operations

A. Further to Note 10E to the annual financial statements, regarding the sale of all of Granite Hacarmel's holdings in Sonol, on April 14, 2016, Granite Hacarmel entered into an agreement with Israel Oil Gas Fund L.P., a limited partnership incorporated in Israel (the "**Buyer**") for the sale of all of Granite Hacarmel's holdings (100%) in Sonol Israel Ltd. (the "**Agreement**" and "**Sonol**", respectively).

The total consideration amounts to NIS 363.5 million, of which NIS 187.5 million shall be paid in cash upon the closing of the transaction (subject to certain adjustments determined in the Agreement); NIS 21 million of the consideration shall be paid in cash within 18 months of the closing date; a sum of NIS 52.5 million was deducted from the consideration against dividends that were and will be distributed by Sonol up to the closing of the transaction, and NIS 5 million will be paid against the repayment of certain debts of Sonol's debtors.

Note 4 – Discontinued Operations (Cont.)

A. (Cont.)

Of the consideration, a sum of NIS 97.5 million was paid at the closing date through the assumption of a liability of the Buyer to repay a loan that is secured by a charge on all of the sold shares. The loan will bear an annual interest comprising Prime interest + 1% and shall be paid on a quarterly basis (the "**Loan**"). The principal of the Loan shall be paid in one installment within 60 months of the transaction closing date. To secure the repayment of the Loan, the Buyer undertook (1) not to effect distributions, as defined in the Companies Law, until the full repayment of the Loan (principal and interest), unless certain cumulative conditions agreed by the parties shall have been fulfilled; and (2) compliance with limitations on changes of control in the Buyer.

Conditions precedent – the closing of the transaction is contingent on conditions precedent which mainly include the receipt of the approval of the Antitrust Commissioner and receipt of third party approvals. The Agreement included customary terms for the termination thereof.

Buyer's guarantee – to secure the undertakings of the Buyer under the Agreement, other than in connection with the Loan as defined above, the seller was provided, at the execution date of the Agreement, a guarantee for the performance of the closing of the transaction.

Non-competition undertaking – it was further agreed that from the transaction closing date and for a 4-year period, the Company and Granite Hacarmel shall not compete with Sonol's business. The foregoing shall not apply to the activity and business plan of the Supergas group.

On July 24, 2016, the transaction was closed without material modifications, after receipt of the approval of the Antitrust Commissioner. On the closing date, and thereafter, the Buyer paid the portion of the consideration that was due on the closing date. The balance of the consideration will be paid in accordance with the terms and conditions determined in the Agreement.

The transaction does not include Pi Glilot's lands and the shares of Pi Glilot Oil and Pipe Terminals Co. Ltd. For additional details see Note 3L.

In accordance with the provisions of IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations", Sonol's results are presented separately in the income statement as discontinued operations and comparative figures in the income statement have been re-presented according to Section 34 of IFRS 5.

As of December 31, 2015, Sonol operations were not discontinued operations. The comparative figures for 2015 and for the periods of nine months and three months ended on September 30, 2015, were restated in the consolidated income statements, in order to present the discontinued operations separately from the current operations.

Note 4 – Discontinued Operations (Cont.)

B. Set forth below are the results attributed to the discontinued operations:

	For the nine-month period ended Sept. 30		For the three-month period ended Sept. 30		For the year ended December 31
	2016	**2015**	**2016**	**2015**	**2015**
	NIS in Thousands	**NIS in Thousands**	**NIS in Thousands**	**NIS in Thousands**	**NIS in Thousands**
	(Unaudited)		**(Unaudited)**		
Results of the discontinued operations:					
Revenues	1,595,571	2,882,791	-	962,148	3,740,421
Expenses	1,589,537	2,964,609	-	1,053,539	3,830,228
Income (loss) before income taxes	6,034	(81,818)	-	(91,391)	(89,807)
Income taxes	8,901	100	-	2,591	9,120
Loss after income taxes	(2,867)	(81,718)	-	(88,800)	(98,927)
Sale costs and expenses	(4,772)	-	(4,772)	-	-
Loss from sale of discontinued operations, net of tax	(862)	-	(862)	-	-
Loss for the period	(8,501)	(81,718)	(5,634)	(88,800)	(98,927)
Cash flows from discontinued operations:					
Net cash which derived from current operations	186,602	163,243	-	105,759	268,603
Net cash (used for operations) which derived from investment activity	130,694	(28,082)	116,339	(6,396)	(39,070)
Net cash used for financing activity	(63,925)	(50,637)	-	(18,507)	(106,350)
Effect of exchange rate fluctuations on cash and cash equivalents balances	(14)	51	-	116	22
Net cash which derived from discontinued operations	253,357	84,575	116,339	80,972	123,205

Note 4 – Discontinued Operations (Cont.)

C. Effect of the disposition on the Group's Statements of Financial Position:

	As of date of disposition
	NIS in Thousands
	(Unaudited)
Cash and cash equivalents	54,729
Trade accounts receivable	817,176
Trade and other receivables	29,877
Inventory	116,577
Current tax assets	3,913
Long-term loans and investments	71,365
Investment property	12,420
Fixed assets, net	624,973
Intangible assets, net,	59,393
Pre-paid long-term lease payments	37,045
Deferred tax assets	24,189
Credit from banks and other credit providers	(677,308)
Trade payables	(377,671)
Other payables, including derivatives	(233,794)
Current tax liabilities	(1,456)
Provisions	(66,637)
Long-term liabilities to banks and other credit providers	(151,797)
Other long-term liabilities	(12,254)
Employee benefits	(12,010)
Deferred tax liabilities	(17,089)
Assets and liabilities, net	301,641
Consideration received in cash and cash equivalents (net of costs of sale)	171,068
Cash and cash equivalents balance written off	(54,729)
Positive cash flow, net	116,339

(*) Inter-company transactions (between the Group and Sonol) were written off from the results of the selling/service-providing company, as the case may be. In addition, an asset or a liability referring to an inter-company transaction was written off from the assets or liabilities of the discontinued operations, as the case may be.

Note 5 – Fair Value

A. Fair value vs. Book value:

Other than as specified in the following table, the Group believes that the book value of the financial assets and liabilities that are presented in depreciated cost in the financial statements is almost identical to their fair value.

	As of Sep. 30, 2016		As of Sep. 30, 2015		As of December 31, 2015	
	Book value	Fair value	Book value	Book value	Fair value	Book value
	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands
	(Unaudited)		(Unaudited)			
Non-current assets:						
Receivables in respect of franchise arrangement (*)	54,409	67,661	40,029	47,825	45,639	55,074
Current liabilities						
Deposits from customers	105,815	71,423	108,212	72,834	106,825	72,433
Non-current liabilities:						
Loans from banks and other credit providers (*)	3,239,737	3,299,466	3,376,332	3,513,097	3,300,780	3,388,536
Bonds (*)	5,177,292	5,233,237	3,181,947	3,289,355	3,173,645	3,264,573
	8,417,029	8,532,703	6,558,279	6,802,452	6,474,425	6,653,109
Surplus of liabilities over assets	(8,468,435)	(8,536,465)	(6,626,462)	(6,827,461)	(6,535,611)	(6,670,468)

(*) The book value includes current maturities and accrued interest.

Note 5 – Fair Value (Cont.)

B. The interest rates used in the determination of the fair value:

The interest rates used in the discounting of the expected cash flows, where relevant, are based on the government yield curve for each individual type of loan, as of the Report Date, plus an appropriate fixed credit margin, and were as follows:

	As of September 30		As of December 31
	2016	2015	2015
	%	%	%
Non-current assets:			
Receivables in respect of franchise arrangement	3.0-3.39	3.79-5.7	3.31-5.7
Current liabilities:			
Deposits from customers	1.45	1.45	1.45
Non-current liabilities:			
Loans from banks and other credit providers	0.69-3.96	0.76-4.33	1.0-4.2
Bonds	1.06-1.70	1.03-1.77	1.2-1.6

C. The levels of fair value:

The following table presents an analysis of the financial instruments that are measured at fair value, using an evaluation model.

The various levels were defined as follows:

Level 1 - Quoted (not adjusted) prices in an active market for identical instruments.

Level 2 - Data observed, directly or indirectly, and not included in level 1 above (in respect of investments in financial assets designated at fair value through profit and loss, use is made of current market transactions between a willing buyer and a willing seller).

Level 3 - Data that is not based on observed market data.

Note 5 – Fair Value (Cont.)

C. The levels of fair value: (Cont.)

	As of September 30, 2016			
	Level 1	Level 2	Level 3	Total
	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands
Financial assets held for trading:				
Securities	577	-	-	577
Financial assets available for sale:				
Marketable shares	1,006,633	-	-	1,006,633
Non-marketable shares	-	87,923	602,760	690,683
Financial assets designated at fair value through profit and loss:				
Non-marketable investments	-	23,775	-	23,775
Total financial assets	1,007,210	111,698	602,760	1,721,668

	As of September 30, 2015			
	Level 1	Level 2	Level 3	Total
	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands
Financial assets held for trading:				
Securities	541	-	-	541
Financial assets available for sale:				
Marketable shares	1,034,183	-	-	1,034,183
Non-marketable shares	-	-	670,075	670,075
Financial assets designated at fair value through profit and loss:				
Foreign currency forward contracts	115	-	-	115
Non-marketable investments	-	29,724	-	29,724
Total financial assets	1,034,839	29,724	670,075	1,734,638
Financial liabilities:				
Foreign currency forward contracts	-	606	-	606
Total financial liabilities	-	606	-	606
Total fair value of financial assets and liabilities	1,034,839	29,118	670,075	1,734,032

Note 5 – Fair Value (Cont.)

C. The levels of fair value: (cont.)

Financial assets and liabilities

	As of December 31, 2015			
	Level 1	**Level 1**	**Level 1**	**Level 1**
	NIS in Thousands	**NIS in Thousands**	**NIS in Thousands**	**NIS in Thousands**
Financial assets held for trading:				
Securities	506	-	-	506
Derivatives not used for hedging:				
Foreign currency forward contracts	-	1,584	-	1,584
Financial assets available for sale:				
Marketable shares	953,652	-	-	953,652
Non-marketable shares	-	-	681,113	681,113
Financial assets designated at fair value through profit and loss:				
Non-marketable investments	-	25,162	-	25,162
Total financial assets	954,158	26,746	681,113	1,662,017
Financial liabilities:				
Foreign currency forward contracts not used for hedging:	-	56	-	56
Total financial liabilities	-	56	-	56
Total fair value of financial assets and liabilities	954,158	26,690	681,113	1,661,961

Note 5 – Fair Value (Cont.)

D. Financial instruments that are measured at fair value at level 3:

The following table represents the reconciliation between the opening balance and the closing balance in respect of financial instruments that are measured at fair value at level 3 in the hierarchy of the fair value:

	For the nine-month period ended Sept. 30		For the year ended December 31
	2016	2015	2015
	NIS in Thousands	NIS in Thousands	NIS in Thousands
	(unaudited)		
Financial assets available for sale:			
Balance as of beginning of the year	681,113	658,912	658,912
Carried to level 2	(87,923)	-	-
Total profits recognized:			
in other comprehensive income	9,570	7,992	22,201
in profit and loss	-	3,171	-
	602,760	670,075	681,113

Note 6 – Segment Reporting

A. General:

The Company applies the IFRS 8 "Operating Segments" ("**IFRS 8**"). In accordance with the provisions of the standard, operating segments are identified on the basis of the internal reports in respect of the components of the Group, which are reviewed on a regular basis by the Group's Chief Operating Decision Makers ("**CODM**") for the purpose of the allocation of resources and the evaluation of the performance of the operating segments.

The Company's business activities focus primarily on the various property segments, while most of the Group's business activity is in the retail centers and malls in Israel segment, and in the office and other space for lease segment, and land designated for residential lease in Israel. In addition, the Company engages in the income-producing property in the USA segment (office space for lease). The Company engages also in the senior housing segment after having completed the purchase of the "Palace" senior home in Tel Aviv, and recently purchased the "Palace" senior home in Ra'anana (formerly - "Ahuzat Bayit"). Starting from the quarterly financial statements for September 30, 2016, in view of the establishment and expansion of activity and investment in development projects in this segment, the Company is reporting its activity in the senior housing segment as a separate business segment, as this term is defined in GAAP. In addition, the Company engages, through its holding in Granite in the fields of energy substitutes, water and environment. In view of the closing of the transaction and the sale of the Group's holdings in Sonol (commencing from the quarterly report as of June 30, 2016, the activity became a discontinued operation according to GAAP (for further details, see Note 4)), starting from this report, Granite's business activity is reported as a separate business segment, as this term is defined in GAAP.

The Company engages in additional activities which are classified as other operating segments, including financial investments and activity in the eCommerce business which was recently acquired.

The following are the Company's operating segments:

Segment A – Retail centers and malls in Israel.

Segment B – Office and other space for lease in Israel.

Segment C – Income-producing property in the USA.

Segment D – Senior housing.

Segment E – Granite.

Note 6 – Segment Reporting (Cont.)

B. Operating segments:

	For the nine-month period ended September 30, 2016 (unaudited)						
	Retail centers and malls in Israel	**Office and other space for lease in Israel**	**Income-producing property in the USA**	**Senior housing**	**Granite**	**Other**	**Consolidated**
	NIS in thousands	**NIS in thousands**	**NIS in thousands**	**NIS in thousands**	**NIS in thousands**	**NIS in thousands**	**NIS in thousands**
Revenues:							
Total external income	722,613	334,119	166,582	64,242	472,578	3,542	1,763,676
Total segment expenses	143,705	59,485	75,820	44,683	406,861	4,356	734,910
Segment profit (NOI)	578,908	274,634	90,762	19,559	65,717	(814)	1,028,766
Net profit (loss) from fair value adjustment of investment property and investment property under construction	118,740	390,932	(8,316)	16,371	-	-	517,727
Unallocated costs							(73,728)
Financing expenses, net							(115,069)
Other revenues, net							12,191
The Company's share in results of associates, net of tax							(6,292)
Income before income taxes							1,363,595
Segment assets	11,899,383	7,990,061	2,194,241	1,392,556	1,293,029	77,286	24,846,556
Unallocated assets (*)							3,488,340
							28,334,896

(*) Mainly cash and cash equivalents and financial assets available for sale in the sum of approx. NIS 3.3 billion.

Note 6 – Segment Reporting (Cont.)

B. Operating segments: (Cont.)

	For the nine-month period ended September 30, 2015 (unaudited)							
	Retail centers and malls in Israel	Office and other space for lease in Israel	Income-producing property in the USA	Senior housing	Granite	Other	Adjust-ments(**)	Consoli-dated
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Revenues:								
Total external income	694,897	308,418	178,953	17,868	557,874	778	-	1,758,788
Total segment expenses	138,775	54,586	77,826	12,650	490,167	43	-	774,047
Segment profit (NOI)	556,122	253,832	101,127	5,218	67,707	735	-	984,741
Net gain (loss) from fair value adjustment of investment property and investment property under construction	55,676	(16,825)	(2,442)	(396)	-	-	-	36,013
Unallocated costs								(63,668)
Financing expenses, net								(96,993)
Other revenues, net								7,425
The Company's share in results of associates, net of tax								(4,894)
Income before income taxes								862,624
Segment assets	10,894,657	6,605,189	2,075,516	637,288	1,467,141	-	2,008,801	23,688,592
Unallocated assets (*)								2,640,381
								26,328,973

(*) Mainly financial assets available for sale in the sum of approx. NIS 1.6 billion.

(**) Assets of discontinued operations segment.

Note 6 – Segment Reporting (Cont.)

B. Operating segments: (Cont.)

	For the three-month period ended September 30, 2016 (unaudited)						
	Retail centers and malls in Israel	**Office and other space for lease in Israel**	**Income-producing property in the USA**	**Senior housing**	**Granite**	**Other**	**Consolidated**
	NIS in thousands	**NIS in thousands**	**NIS in thousands**	**NIS in thousands**	**NIS in thousands**	**NIS in thousands**	**NIS in thousands**
Revenues:							
Total external income	250,227	114,373	56,692	29,771	136,146	3,028	590,237
Total segment expenses	54,417	22,780	24,998	21,961	125,065	4,290	253,511
Segment profit (loss) (NOI)	195,810	91,593	31,694	7,810	11,081	(1,262)	336,726
Net gain (loss) from fair value adjustment of investment property and investment property under construction	78,235	51,957	(2,931)	-	-	-	127,261
Unallocated costs							(30,476)
Financing expenses, net							(56,271)
Other revenues, net							291
The Company's share in results of associates, net of tax							(2,452)
Income before income taxes							375,079

Note 6 – Segment Reporting (Cont.)

B. Operating segments: (Cont.)

	For the three-month period ended September 30, 2015 (unaudited)						
	Retail centers and malls in Israel	**Office and other space for lease in Israel**	**Income-producing property in the USA**	**Senior housing**	**Granite**	**Other**	**Consolidated**
	NIS in thousands	**NIS in thousands**	**NIS in thousands**	**NIS in thousands**	**NIS in thousands**	**NIS in thousands**	**NIS in thousands**
Revenues:							
Total external income	243,295	104,114	59,257	17,868	134,377	262	559,173
Total segment expenses	53,660	18,542	25,516	12,650	125,982	16	236,366
Segment profit (NOI)	189,635	85,572	33,741	5,218	8,395	246	322,807
Net gain (loss) from fair value adjustment of investment property and investment property under construction	492	(3,151)	(2,379)	-	-	-	(5,038)
Unallocated costs							(19,436)
Financing expenses, net							(37,229)
Other income, net							9,947
The Company's share in results of associates, net of tax							(1,689)
Income before income taxes							269,362

Note 6 – Segment Reporting (Cont.)

B. Operating segments: (Cont.)

	For the year ended December 31, 2015							
	Retail centers and malls in Israel	Office and other space for lease in Israel	Income-producing property in the USA	Senior housing	Granite	Other	Adjust-ments(**)	Consoli-dated
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Revenues:								
Total external income	931,135	419,607	236,247	35,556	731,309	1,038	-	2,354,892
Total segment expenses	183,508	72,122	104,602	23,819	643,854	124	-	1,028,029
Segment profit (NOI)	747,627	347,485	131,645	11,737	87,455	914	-	1,326,863
Net profit (loss) from fair value adjustment of investment property and investment property under construction	122,972	70,294	(28,294)	14,099	-	-	-	179,071
Unallocated costs								(95,148)
Financing expenses, net								(127,066)
Other revenues, net								7,090
The Company's share in results of associates, net of tax								(8,562)
Income before income taxes								1,282,248
Additional information as of December 31, 2015:								
Segment assets	11,055,969	6,829,670	2,052,023	803,266	1,175,267	-	1,912,532	23,828,727
Unallocated assets(*)								2,616,378
Total consolidated assets								26,445,105
Capital expenditures	373,734	535,870	48,387	716,738	48,706	-	55,612	1,779,047

(*) Mainly financial assets available for sale in the sum of approx. NIS 1.6 billion.

(**) Segment assets and capital investments of discontinued operations.

Note 7 – Material Subsequent Events

A. On October 6, 2016, the general meeting of the Company's shareholders approved the following resolutions:

(1) Approving an updated compensation policy for the Company's officers according to Section 267A of the Companies Law, and accordingly amending to the Company's articles of association in respect of the exemption clause in the updated compensation policy.

(2) Approving an update to the management agreement with the Company's CEO, Mr. Yuval Bronstein, updating the monthly management fees paid to the management company fully owned by him to the sum of NIS 313 thousand, linked to the June 2016 index. The remaining terms and conditions of Mr. Bronstein's engagement remain unchanged.

(3) Approving the extension of the management agreement with the Company's Chairman of the Board, Ms. Danna Azrieli, for a three-year period, with no change to the effective agreement.

B. After the date of the Statement of Financial Position, on November 20, 2016, a claim and a motion for class certification filed against three gas companies, including Supergas, was received in the offices of Supergas Israel Gas Distribution Company Ltd. ("**Supergas**"), a company (indirectly) wholly owned by the Company. The motion claims, *inter alia*, that Supergas and the other gas companies allegedly violated the Restrictive Trade Practices Law, by being a party to a restrictive arrangement. Among the requested remedies is a demand for repayment of amounts customers, so it is claimed, were overcharged by the defendant companies. The motion does not state an amount.

In this preliminary stage of the process, Supergas is unable to estimate the chances of the motion.

Annex to Consolidated Financial Statement

Separate Interim Financial Statement

As of September 30, 2016

(Unaudited)

Azrieli Group Ltd.

Separate Interim Financial Statement
As of September 30, 2016

(Unaudited)

Prepared pursuant to the provisions of Section 38D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970

Azrieli Group Ltd.

Separate Interim Financial Statement

As of September 30, 2016

(Unaudited)

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Deloitte.

To
The Shareholders of
the Azrieli Group Ltd.
1 Azrieli Center
Tel Aviv

Dear Sir/Madam,

Re: Special report for review of the separate interim financial statement pursuant to Regulation 38D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970

We have reviewed the separate interim financial statement, which is presented according to Regulation 38D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970, of **Azrieli Group Ltd.** (the "**Company**") as of September 30, 2016 and for the nine- and three-month period then ended. The separate interim financial statement is the responsibility of the Company's Board of Directors and Management. Our responsibility is to express a conclusion on the separate interim financial statement for such interim periods, based on our review.

We did not review the separate interim financial statement from the financial statements of investee companies, the total investments in which amounted to approx. NIS 754 million as of September 30, 2016 and the profit from such investee companies amounted to approx. NIS 60 million and approx. NIS 8 million for the nine- and three-month periods then ended, respectively. The financial statements of these companies were reviewed by other auditors whose reports were furnished to us, and our conclusion, in so far as it is related to the financial statements in respect of those companies, is based upon the review reports of the other auditors.

The Scope of the Review

We performed our review pursuant to Review Standard 1 of the Institute of Certified Public Accountants in Israel – "Review of financial statement for interim periods prepared by the auditor of the entity". Review of separate financial statement for interim periods is comprised of inquiries, mainly with people responsible for the financial and accounting matters, and of the implementation of analytical and other review procedures. A review is significantly narrower in scope than an audit performed pursuant to Generally Accepted Auditing Standards in Israel and therefore, does not allow us to obtain assurance that we shall become aware of all of the significant matters that could have been identified through an audit. Accordingly, we do not provide an audit opinion.

Conclusion

Based on our review and on the review reports of other auditors, nothing had been brought to our attention that causes us to believe that the aforesaid separate interim financial statement has not been prepared, in all material respects, according to the provisions of Regulation 38D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

Brightman, Almagor, Zohar & Co.
Certified Public Accountants
Member of Deloitte Touche Tohmatsu Limited

Tel Aviv, November 22, 2016

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Azrieli Group Ltd.

Statement of Financial Position

+	As of September 30		As of December 31
	2016	2015	2015
	NIS in thousands	NIS in thousands	NIS in thousands
	(Unaudited)		
Assets			
Current assets			
Cash and cash equivalents	1,322,400	905,599	761,281
Financial assets held for trading	577	541	506
Trade accounts receivable	7,069	7,866	7,375
Other receivables	169,272	142,661	142,801
Total current assets	1,499,318	1,056,667	911,963
Non-current assets			
Financial assets	1,633,168	1,657,128	1,581,575
Investment property and investment property under construction	9,255,730	7,407,140	7,565,747
Investments in investee companies	7,589,590	6,718,525	6,909,576
Loans to investee companies	3,750,237	3,487,871	3,413,982
Fixed assets	8,187	6,438	7,147
Other receivables	6,637	6,246	5,915
Total non-current assets	22,243,549	19,283,348	19,483,942
Total assets	23,742,867	20,340,015	20,395,905
Liabilities and capital			
Current liabilities			
Current maturities and credit from banks and other credit providers	2,069,998	1,175,996	1,019,599
Trade payables	57,442	37,102	51,417
Payables and other current liabilities	56,856	26,610	33,778
Current tax liabilities	19,028	38,482	37,683
Total current liabilities	2,203,324	1,278,190	1,142,477
Non-current liabilities			
Loans from banks and other credit providers	1,529,466	1,763,955	1,733,284
Bonds	4,155,700	2,582,101	2,579,151
Other liabilities	16,617	16,223	15,595
Deferred tax liabilities	1,247,122	1,153,044	1,151,592
Employee benefits	3,093	2,526	2,581
Total non-current liabilities	6,951,998	5,517,849	5,482,203
Capital			
Share capital	18,223	18,223	18,223
Premium	2,477,664	2,477,664	2,477,664
Capital reserves	468,890	507,641	447,747
Retained earnings	11,622,768	10,540,448	10,827,591
Total capital attributable to shareholders of the Company	14,587,545	13,543,976	13,771,225
Total liabilities and capital	23,742,867	20,340,015	20,395,905

November 22, 2016			
Date of approval of Separate Financial Statement	**Danna Azrieli** **Chairman of the Board of Directors**	**Yuval Bronstein** **CEO**	**Irit Sekler-Pilosof** **Chief Financial Officer**

Azrieli Group Ltd.

Statement of Profit and Loss and Other Comprehensive Income

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year Ended December 31
	2016	2015(*)	2016	2015(*)	2015
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
	(Unaudited)		(Unaudited)		
Revenues					
From rent and management and maintenance fees	361,385	339,292	131,151	115,783	458,981
Net gain (loss) from fair value adjustment of investment property and investment property under construction	507,086	(45,756)	177,137	(3,517)	(18,693)
Financing	124,401	123,329	48,943	48,181	145,406
Other	9,965	10,031	(9)	10,029	10,042
Total revenues	1,002,837	426,896	357,222	170,476	595,736
Costs and expenses					
Cost of revenues from rent and management and maintenance fees	9,934	8,759	3,489	3,377	14,395
Sales and marketing	14,109	14,572	6,739	5,369	25,087
G&A	36,886	36,680	11,038	12,305	49,072
Financing	77,139	53,742	39,733	25,324	63,307
Total costs and expenses	138,068	113,753	60,999	46,375	156,861
Income before the Company's share in the profits of investee companies	864,769	313,143	296,223	124,101	438,875
Share in profits of investee companies, net of tax	483,565	378,561	60,299	92,209	591,037
Income before income taxes	1,348,334	691,704	356,522	216,310	1,029,912
Income tax	(144,656)	(77,133)	(71,889)	(26,248)	(109,994)
Income from continued operations	1,203,678	614,571	284,633	190,062	919,918
Loss from discontinued operations (after tax)	(8,501)	(81,718)	(5,634)	(88,800)	(98,927)
Net income for the period	1,195,177	532,853	278,999	101,262	820,991
Other comprehensive income:					
Amounts that were or will be classified in the future to profit or loss, net of tax:					
Change in fair value of financial assets available for sale, net of tax	44,552	64,769	39,389	(67,552)	10,286
Translation differences from foreign operations	(27,694)	6,581	(17,599)	26,835	2,940
Share in the other comprehensive income of investee companies, net of tax	(2,835)	8,086	(7,629)	20,131	5,399
Total	14,023	79,436	14,161	(20,586)	18,625
Amounts that will not be classified in the future to profit or loss, net of tax:					
Actuarial loss due to defined benefit plan, net of tax	-	-	-	-	(78)
Other comprehensive income (loss) for the period, net of tax	14,023	79,436	14,161	(20,586)	18,547
Total comprehensive income for the period	1,209,200	612,289	293,160	80,676	839,538

(*) Restated due to discontinued operations, see Note 4 to the Consolidated Financial Statements.

Azrieli Group Ltd.

Statement of Cash Flows

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2016	2015	2016	2015	2015
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
	(Unaudited)		(Unaudited)		
Cash flows - current operations					
Net profit for the period	1,195,177	532,853	278,999	101,262	820,991
Depreciation and amortization	724	664	251	229	894
Capital loss (gain) from liquidation of fixed assets	35	(8)	9	(29)	(20)
Net loss (gain) from fair value adjustment of investment property and investment property under construction	(507,086)	45,756	(177,137)	3,517	18,693
Financing and other revenues, net	(55,145)	(72,911)	(10,034)	(32,570)	(84,014)
Share in profits of investee companies, net of tax	(475,064)	(296,843)	(54,665)	(3,409)	(492,110)
Expenses for taxes recognized in the income statement	144,656	77,133	71,889	26,248	109,994
Income tax paid, net	(72,418)	(52,369)	(29,292)	(19,515)	(70,709)
Change in financial assets	(71)	116	(62)	91	151
Change in trade and other receivables	8,094	(23,170)	(37,968)	2,969	(34,996)
Change in trade and other payables	12,886	(10,199)	6,564	(3,978)	(6,151)
Change in employee provisions and benefits	513	(10,662)	213	10	(11,288)
Erosion (revaluation) of financial assets designated at fair value through profit and loss	(2,592)	(7,277)	972	61	(2,715)
Change in recording of benefit in respect of share-based payment and employee benefits	-	2,698	-	31	2,637
Receipt of deposits from senior housing tenants	1,350	-	1,350	-	
Net cash – current operations	251,059	185,781	51,089	74,917	251,357
Cash flows - investment activities					
Proceeds from liquidation of fixed assets and intangible assets	35,193	287	146	70	436
Purchase of and investment in investment property and investment property under construction	(1,158,617)	(362,875)	(278,533)	(95,146)	(445,891)
Down payments on account of investment property	-	(1,549)	-	(334)	(4,815)
Purchase of fixed assets and intangible assets	(36,992)	(2,392)	(561)	(1,171)	(3,468)
Investments in investee companies	(91,266)	-	(13,630)	-	(781)
Change in financial assets designated at fair value through net profit and loss	3,979	2,338	3,238	193	2,338
Receipt (granting) of long-term loans investee companies, net	(275,419)	(221,888)	125,759	(152,473)	(163,590)
Interest and dividend received	28,792	12,749	2,443	10,638	31,021
Return of investment in investee companies	-	1,962	-	1,962	1,962
Acquisition of investee companies	(98,680)	-	(73,357)	-	-
Institutions for the purchase of real estate	(22,796)	-	(22,796)	-	-
Net cash - investment activities	(1,615,806)	(571,368)	(257,291)	(236,261)	(582,788)

Azrieli Group Ltd.

Statement of Cash Flows
(Cont.)

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2016	2015	2016	2015	2015
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
	(Unaudited)		(Unaudited)		
Cash flows - financing activities					
Bond offering net of offering expenses	2,176,535	2,209,284	2,176,535	996,858	2,209,284
Dividend distribution to shareholders	(400,000)	(320,000)	-	-	(320,000)
Repayment of bonds	(166,541)	(44,183)	-	-	(44,183)
Receipt of long-term loans from banks and others	800,000	-	-	-	-
Repayment of long-term loans from banks and others	(752,865)	(601,883)	(625,890)	(474,629)	(624,913)
Short-term credit from banks and others, net	353,654	102,290	(309,744)	(1,938)	(53,116)
Deposits from customers, net	1,017	751	570	433	223
Interest paid	(85,740)	(72,510)	(41,053)	(28,477)	(91,927)
Net cash - financing activities	1,926,060	1,273,749	1,200,418	492,247	1,075,368
Increase in cash and cash equivalents	561,313	888,162	994,216	330,903	743,937
Cash and cash equivalents at beginning of period	761,281	19,330	328,009	574,395	19,330
Effect of exchange rate changes on cash balances held in foreign currency	(194)	(1,893)	175	301	(1,986)
Cash and cash equivalents at end of the year	1,322,400	905,599	1,322,400	905,599	761,281

(*) Non-cash transactions include a change in the balances of payables due to purchases on credit of non-current assets for the three months period ended September 30, 2016 in the amount of NIS 6,833 thousand (for the year ended December 31, 2015 – NIS 433 thousand).

Azrieli Group Ltd.

Notes to the Separate Financial Statement

A. General:

The Company's separate financial statement is prepared in accordance with the provisions of Regulation 38D of the Securities Regulations (Immediate and Periodic Reports), 5730-1970.

This separate financial statement is to be inspected with respect to the Company's separate financial statement as of December 31, 2015, and for the year then ended, and the additional figures that were attached thereto.

B. Definitions:

The Company	-	Azrieli Group Ltd.
Investee company	-	Consolidated company, consolidated company under proportionate consolidation and an associated company.

C. Accounting Policy:

The separate financial statement is prepared in accordance with the accounting policy specified in Note B to the Company's separate financial statement as of December 31, 2015 and the year then ended.

D. Material Events during the Reporting Period:

See Note 3 to the Condensed Consolidated Financial Statements which are published with this separate financial statement.

E. Material Subsequent Events:

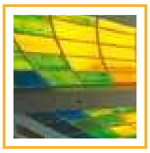
See Note 7 to the Condensed Consolidated Financial Statements which are published with this separate financial statement.

F. Contingent Liability:

Following Note T to the reports on the separate financial statement for 2015, during the Report Period, the parties reached a settlement agreement in immaterial amounts that was sanctioned as a judgment.

Part D

Effectiveness of Internal Control over the Financial Reporting and Disclosure



AZRIELIGROUP

Quarterly report on the effectiveness of internal control over financial reporting and disclosure pursuant to Regulation 38C

Attached please find a quarterly report on the effectiveness of internal control over financial reporting and disclosure pursuant to Regulation 38C(a):

The management, under the supervision of the Board of Directors of Azrieli Group Ltd. (the "**Corporation**"), is responsible for setting and maintaining proper internal control over financial reporting and disclosure at the Corporation.

For this purpose, the members of management are:
1. Yuval Bronstein, CEO;
2. Irit Sekler-Pilosof, CFO;
3. Ran Tal, General Counsel and Company Secretary;
4. Yair Horesh, Chief Comptroller for Accounting and Financial Statements.

Internal control over financial reporting and disclosure consists of controls and procedures existing at the Corporation, designed by, or under the supervision of, the CEO and the most senior financial officer, or by anyone actually performing such functions, under supervision of the Board of Directors of the Corporation, and which are designed to provide reasonable assurance regarding the reliability of the financial reporting and the preparation of the reports according to the provisions of the law, and to ensure that information which the Corporation is required to disclose in reports released thereby according to the law is gathered, processed, summarized and reported within the time frames and in the format set forth by the law.

Internal control includes, *inter alia*, controls and procedures designed to ensure that information which the Corporation is thus required to disclose, is gathered and transferred to the management of the Corporation, including the CEO and the most senior financial officer, or anyone actually performing such functions, in order to enable the timely decision making in reference to the disclosure requirements.

Due to its inherent limitations, internal control over financial reporting and disclosure is not designed to provide absolute assurance that misrepresentation or omission of information in the reports is avoided or discovered.

The Quarterly Report regarding the effectiveness of internal control over financial reporting and disclosure, which was attached to the Quarterly Report for the period ended on June 30, 2016 (the "**Most Recent Quarterly Report on Internal Control**"), the internal control was found to be effective.
Until the Report Date, no occurrence or issue were brought to the knowledge of the Board of Directors and the management, which might change the evaluation of the internal control effectiveness as found in the Most Recent Quarterly Report on Internal Control;
As of the Report Date, based on the Most Recent Quarterly Report on Internal Control, and based on information which was brought to the knowledge of the management and the Board of Directors as aforesaid: the internal control is effective;

Statement of Managers:

Statement of CEO pursuant to Regulation 38C(d)(1):

I, Yuval Bronstein, represent that:

1. I have reviewed the quarterly report of Azrieli Group Ltd. (the "**Corporation**") for Q/3 2016 (the "**Reports**").

2. To my knowledge, the Reports do not contain any misrepresentation nor omission of a material fact required for the representations included therein, given the circumstances under which such representations were included, not to be misleading with regard to the period of the Reports;

3. To my knowledge, the Financial Statements and other financial information included in the Reports adequately reflect, in all material respects, the financial position, operating results and cash flows of the Corporation for the periods and as of the dates covered by the Reports;

4. I have disclosed to the Corporation's auditor and to the Corporation's Board of Directors and the Audit Committee and Financial Statement Committee, based on my most current evaluation of internal control over financial reporting and disclosure:

   a. Any and all significant flaws and material weaknesses in the setting or maintaining internal control over financial reporting and disclosure which may reasonably adversely affect the Corporation's ability to gather, process, summarize or report financial information in a manner which casts doubt on the reliability of the financial reporting and preparation of the Financial Statements in conformity with the provisions of the law; and -

   b. Any fraud, either material or immaterial, which involves the CEO or anyone reporting to him directly or which involves other employees who play a significant role in internal control over financial reporting and disclosure;

5. I, myself or jointly with others at the Corporation:

   a. Have set controls and procedures, or confirmed that such controls and procedures have been set and maintained under my supervision, which are designed to ensure that material information in reference to the Corporation, including consolidated companies thereof as defined in the Securities Regulations (Annual Financial Statements), 5770-2010, is presented to me by others at the Corporation and the consolidated companies, particularly during the preparation of the Reports; and -

   b. Have set controls and procedures, or confirmed that such controls and procedures have been set and maintained under my supervision, which are designed to reasonably ensure reliability of financial reporting and preparation of the Financial Statements in conformity with the provisions of the law, including in conformity with GAAP.

c. No occurrence or issue have been brought to my attention, that occurred during the period between the date of the Most Recent Quarterly Report and the Report Date herein, which can change the conclusion of the Board of Directors and management with regard to the effectiveness of internal control over the corporation's financial reporting and disclosure.

The aforesaid does not derogate from my responsibility or from the responsibility of any other person, pursuant to any law.

November 22, 2016

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Yuval Bronstein, CEO

Statement of Managers:

Statement of the most senior financial officer pursuant to Regulation 38C(d)(2):

I, Irit Sekler-Pilosof, represent that:

1. I have reviewed the Interim Financial Statements and other interim financial information included in the reports of Azrieli Group Ltd. (the "**Corporation**") for Q/3 2016 (the "**Reports**" or the "**Interim Reports**");

2. To my knowledge, the Interim Financial Statements and the other financial information included in the Interim Reports do not contain any misrepresentation nor omission of a material fact required for the representations included therein, given the circumstances under which such representations were included, not to be misleading with regard to the period of the Reports;

3. To my knowledge, the Interim Financial Statements and other financial information included in the Interim Reports adequately reflect, in all material respects, the financial position, operating results and cash flows of the Corporation for the periods and as of the dates covered by the Reports;

4. I have disclosed to the Corporation's auditor and to the Corporation's Board of Directors and the Audit Committee and Financial Statement Committee, based on my most current evaluation of internal control over financial reporting and disclosure:

   a. Any and all significant flaws and material weaknesses in the setting or maintaining internal control over financial reporting and disclosure insofar as it relates to the Interim Financial Statements and the other information included in the Interim Reports, which may reasonably adversely affect the Corporation's ability to gather, process, summarize or report financial information in a manner which casts doubt on the reliability of financial reporting and preparation of the Financial Statements in conformity with the provisions of the law; and -

   b. Any fraud, either material or immaterial, which involves the CEO or anyone reporting to him directly or which involves other employees who play a significant role in internal control over financial reporting and disclosure;

5. I, myself or jointly with others at the Corporation:

   a. Have set controls and procedures, or that such controls and procedures have been set and maintained under our supervision, which are designed to ensure that material information in reference to the Corporation, including consolidated companies thereof as defined in the Securities Regulations (Annual Financial Statements), 5770-2010, is presented to me by others at the Corporation and the consolidated companies, particularly during the preparation of the Reports; and -

b. Have set controls and procedures, or confirmed that such controls and procedures have been set and maintained under my supervision, which are designed to reasonably ensure reliability of financial reporting and preparation of the Financial Statements in conformity with the provisions of the law, including in conformity with GAAP;

c. No occurrence or issue have been brought to my attention, that occurred during the period between the date of the Most Recent Quarterly Report and the Report Date herein, pertaining to the Interim Financial Statements and any other information included in the Interim Reports, which could, in my opinion, change the conclusion of the Board of Directors and management with regard to the effectiveness of internal control over the corporation's financial reporting and disclosure.

The aforesaid does not derogate from my responsibility or from the responsibility of any other person, pursuant to any law.

November 22, 2016

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Irit Sekler-Pilosof, CFO