ICL-ISRAEL CHEMICALS LTD. כימיקלים לישראל בע"מ

Translation from Hebrew. The binding version is the original Hebrew version

Directors Report on the State of the Company's Affairs for the year ended December 31, 2006

This Directors' Report of Israel Chemicals Ltd. ("ICL" or "the Company") is presented as part of the Periodic Report for 2006, and assumes that the reader has before him the other parts of the Periodic Report.

ICL operates in a number of main segments of operation which are grouped according to managerial-functional considerations, as described below:

- **ICL Fertilizers** – ICL Fertilizers produces potash from the Dead Sea, and mines and produces potash and salt from underground mines in Spain and England. ICL Fertilizers refines the potash into various grades and sells it worldwide.
- ICL Fertilizers also mines and processes phosphate rock from open-pit mines in the Negev region, and at its production facilities in Israel it manufactures sulfuric acid, fertilizer-grade phosphoric acid, phosphate fertilizers, complex fertilizers based mainly on potash and phosphate, and specialty fertilizers. ICL Fertilizers also manufactures fertilizers in Holland, Germany and Belgium. In addition ICL Fertilizers manufactures phosphate-based animal feed additives in Turkey and Israel. ICL Fertilizers markets its products worldwide. Its top sales destinations are Europe, Brazil, India, China and Israel.
- **ICL Industrial Products** – ICL Industrial Products manufactures bromine from an end-brine that is created as a by-product of the potash production process in Sdom, as well as bromine-based compounds. In 2006, ICL Industrial Products was the world's leading manufacturer of bromine, producing about 30% of total global production. During this year, ICL Industrial Products used about 80% of the bromine it produces for manufacturing bromine compounds at its production sites in Israel, Holland and China. In addition, ICL Industrial Products produces various salt, magnesia and chlorine products (chlorine is produced together with caustic soda by electrolysis of the salt created as a by-product of potash production, and is used as a raw material in the segment's production processes). ICL Industrial Products also manufactures chlorine-based products in Israel and the U.S.A. ICL Industrial Products markets its products worldwide.
- **ICL Performance Products** – ICL Performance Products purifies some of the fertilizer-grade phosphoric acid manufactured by ICL Fertilizers (to "purified" acid), purchases purified phosphoric acid from other sources and also manufactures thermal phosphoric acid for use in the manufacture of downstream products of high added value – phosphate salts, food additives, hygiene products, phosphorus derivatives and flame retardants. ICL Performance Products also produces specialty products based on aluminum oxide (herein “alumina”) and other raw materials. The lion’s share of ICL Performance Products’ production takes place at sites in Europe (mainly Germany) and the U.S.A., Brazil, Israel, China and some other countries. Products based on special phosphates accounted for about 80% of the sales of ICL Performance Products in 2006.
- **ICL Metallurgy** – ICL Metallurgy manufactures and sells pure magnesium and magnesium alloys. Magnesium production is done in Sdom, from carnallite produced (in the potash production process) from the Dead Sea. The magnesium products of ICL Metallurgy are mainly for casting facilities to produce automotive parts and as a component in the aluminum alloy process in the aluminum industry. ICL Metallurgy's conducts its operations through a joint venture with Volkswagen of Germany.

In addition to these segments, other ICL activities include desalination and land transportation.

Management by segment is generally accomplished group-wide, on a managerial – functional basis. This managerial structure does not necessarily correspond fully with the legal ownership structure of the ICL companies.

For information about the change in the division into segments commencing January 1, 2007, see Section 2.2 in the Periodic Report - "Description of Corporate Activity".

1. RESULTS OF OPERATIONS

1.1 Principal Financial Results

Hereunder the condensed results of operations in the reviewed period, compared with the results for the corresponding period last year, in millions of dollars.

The data for the whole of 2006 and the fourth quarter of 2005 include the results of the operations purchased from Astaris on 4 November, 2005.

	2006		2005		10-12/2006		10-12/2005	
	$ millions	% of sales	$ millions	% of sales	$ millions	% of sales	$ millions	% of sales
Sales	3258.2	100.0	2,986.0	100.0	839.6	100.0	775.0	100.0
Gross profit	1171.7	36.0	1,140.7	38.2	329.4	39.2	265.5	34.3
Operating income	536.4	16.5	561.3	18.8	147.7	17.6	113.5	14.6
Pre-tax income	494.9	15.2	514.3	17.2	117.3	14.0	75.3	9.7
Net income before extraordinary operations	386.4	11.9	426.0	14.3	108.2	12.9	101.1	13.0
Net income	373.9	11.5	422.2	14.1	90.2	10.7	82.0	10.6
Cash flow from current operations	347.4		490.9		88.2		152.2	
EBITDA(*)	730.4	22.4	743.4	24.9	198.6	23.7	172.6	22.3
Investments								
Purchase of shares of consolidated companies	2.1		273.3				265.7	
Property, plant and equipment, less grants	135.3		147.8		42.0		35.4	
Total	137.4		421.1		42.0		301.1	

(*) Calculated as follows in millions of dollars:

2006	2005	10-12/2006	10-12/2005
373.9	422.2	90.2	82.0
169.2	166.0	43.0	43.8
39.3	10.2	14.2	7.1
136.7	101.8	31.4	2.5
11.3	43.2	19.8	37.2
730.4	743.4	198.6	172.6

1.2 Results of operations for the period January – December 2005

The results for 2006 include, for the first time, the financial results of the operations and assets acquired from Astaris in November 2005. In the prior year, those operations were included only for November and December.

Sales

Sales of the ICL Group in the reporting period amounted to approximately $3.26 billion, compared with $2.99 billion last year, an increase of approximately 9.1%

The increase in income is mainly due, as noted, to the inclusion of the operations of Astaris, and the price rises in some of the Group's products, which were partially offset by a decrease in quantities sold of potash and some of the products of ICL Industrial Products.

Below is a breakdown of sales by geographical region:

Sales CIF	2006		2005	
	$ millions	%	$ millions	%
Israel	207.4	6.4	215.1	7.2
North America	717.8	22.0	390.0	13.1
South America	331.0	10.2	309.1	10.4
Europe	1,203.5	36.9	1,228.6	41.1
Asia	678.8	20.8	704.8	23.6
Rest of the world	119.7	3.7	138.4	4.6
Total	3,258.2	100.0	2,986.0	100.0

The breakdown of sales in 2006 shows a sharp increase in sales in North America and in its part in total revenue, due mainly to additional sales in the ICL Performance Products segment following the acquisition of the Astaris operations. In Asia, the decrease in revenue reflects the decrease in sales of potash to India and China, which resulted from the delayed signing of agreements for sales of potash in 2006 and the smaller quantities sold of some of the products of the Industrial Products segment. In Europe, the decrease in sales reflects mainly the decrease in sales of ICL Fertilizer products.

Gross Profit

Gross profit amounted to approximately $1.172 billion, an increase of 2.7% compared with last year. The gross profit margin out of sales turnover for the year reached 36.0% compared with 38.2% last year.

Gross profit for the period includes compensation of approximately $52 million from insurance companies, recorded in the first, third and fourth quarters, for consequential loss following flood damage in Sdom at the end of 2004. In the prior year, compensation of $12.1 million was recorded for this loss. The compensation recorded in 2006 ends all the Company's claims in respect of the flood claim. A portion of the total amount, which has not yet been received, will be paid during 2007.

Gross profit was adversely influenced mainly by the decrease in quantities of potash sold, the increase in principal input costs such as energy prices, the prices of some raw materials and the costs of land transportation. In addition, the appreciation of the shekel against the dollar at the end of the period resulted in an increase in shekel expenses in dollar terms: the dollar / shekel exchange rate at the end of the period was 8.2% lower than at the beginning of the period. The effects of the change in the exchange rate generated, in addition, a non-cash expense of $12.6 million, deriving from an increase in the dollar value of shekel denominated liabilities for employee benefits upon retirement. In the prior year, the shekel was devalued against the dollar by 6.8% at the end of the period compared with the beginning of the period, generating a $8.5 million non-cash income.. Nevertheless, the aforementioned rise in selling prices and the acquisition of the Astaris operations, together with the ongoing efficiency operations, succeeded in partially offsetting the erosion in gross profit.

The percentage of gross profit out of sales turnover is 36.0%, compared with 38.2% last year. The decrease in the gross profit rate was influenced mainly by the decrease in quantities of potash sold, as well as by the profitability of the Astaris operations, which is lower than the average of ICL.

The improvement in selling prices at ICL Industrial Products resulted in record profits for the segment in the reporting period.

Sales and Marketing Expenses

Expenses amounted to approximately $475.1 million, an increase of about 7.2% compared with last year. The increase in these expenses derives mainly from the inclusion of the operations acquired from Astaris.

General and Administrative Expenses

These expenses totaled $125 million, an increase of about 18.2% compared with the same period last year, mainly due to inclusion of the Astaris operations and the stronger shekel against the dollar.

Research and Development Expenses

R&D expenses (net of grants from the Chief Scientist) amounted to approximately $35.1 million, an increase of about $4.8 million compared with last year, partially influenced by the acquisition of the Astaris operations.

Operating income

Operating income decreased by $24.9 million compared with last year, to $536.4 million. The decrease derived mainly from the decrease in the operating income of the Fertilizers segment due to the delay in signing a potash sales agreement with China and India, and weakness in European markets, despite the increase in the operating income of the Industrial Products segment and the profit from the Astaris operations.

The percentage of operating income out of turnover is 16.5%, compared with 18.8% last year.

Financing Expenses

Financing expenses amounted to about $39.3 million, compared with $10.2 million last year, an increase of $29.1 million.

In the prior year, the Company had income of $21 million from exchange rate differences compared to an expense of approximately one million dollars this year. In addition, financing expenses were influenced by a rise of about 1.3% in the average dollar interest rate for the period.

Other Expenses, Net

Other expenses net amounted to approximately $2.3 million, compared with net expenses of $36.8 million last year. In the prior year, other expenses included a provision for impairment of the assets of the magnesium company and expenses deriving from a change in the actuarial assumptions in a pension plan of one of the non Israeli companies. .

Tax expenses

These expenses amounted to approximately $136.7 million, compared with $101.8 million last year.

The low tax rate last year derived from an amendment to the Income Tax Ordinance by the Knesset in July 2005, which revised the corporate tax rates to be gradually lowered to 25%. As a result of this amendment, the income tax expense for 2005 decreased by approximately $29 million.

Net Income

Net income amounted to approximately $373.9 million, compared with $422.2 million last year, a decrease of 11.4%.

1.3 Results of operations for the period October - December 2006

Sales

Sales of ICL Group in the quarter amounted to approximately $839.6 million, compared with $775 million last year, an increase of about 8.3%.

The increase in Group sales derives from the increase in quantities sold by the Fertilizers segment, mainly to China, India and Brazil, and the inclusion of the Astaris operations for the full quarter, compared with inclusion only from November in 2005. The increase was offset by a decrease in the sales of the Industrial Products segment as a result of smaller quantities sold, mainly in south-east Asia.

Below is a breakdown of sales by geographical region:

Sales / CIF	10-12/2006		10-12/2005	
	$ millions	%	$ millions	%
Israel	55.8	6.6	53.3	6.9
North America	147.2	17.5	147.4	19.0
South America	81.5	9.7	61.8	8.0
Europe	303.4	36.1	282.1	36.4
Asia	220.1	26.2	189.2	24.4
Rest of the world	31.6	3.9	41.2	5.2
Total	839.6	100.0	775.0	100.0

The increase in sales to South America and Asia derives mainly from the increase in sales of potash in those regions.

Gross Profit

Gross profit amounted to approximately $329.4 million, an increase of 24.1% compared with last year.

The increase in gross profit derives mainly from an increase in sales of potash and the ongoing efficiency operations, as well as income of $23 million from insurance in respect of consequential loss.

Conversely, the strengthening of the shekel against the dollar and a rise in the prices of some of the raw materials of the Group partially offset the increase.

Sales and Marketing Expenses

These expenses amounted to approximately $137.9 million, an increase of about 18.6% compared with the same period last year. The increase was due mainly to an increase in quantities sold of some products, as well as an increase in the tariffs of bulk marine transportation compared with the tariffs that prevailed in the fourth quarter of 2005.

General and Administrative Expenses

These expenses amounted to approximately $34.7 million, an increase of about 21.5% compared with the same period last year. The increase derives mainly from the revaluation of the Shekel against the Dollar, and the inclusion of the Astaris operations in the entire quarter, compared with the months included last year.

Research and Development Expenses

These expenses amounted to approximately $9.1 million, an increase of about $2 million compared with last year.

Operating Income

Operating income amounted to approximately $147.7 million, which is approximately 30.1% more than in the corresponding period last year. The percentage of operating income increased from 14.6% last year to 17.6% this in this quarter. The increase in gross profit noted above, influenced the increase in operating income despite the increase in marine transportation prices.

Financing Expenses

Financing expenses amounted to $14.2 million, compared with $7.1 million last year.

During the reporting period, the Company recorded expenses of approximately $6 million from exchange rate differentials. In addition, financing expenses were influenced by a rise of approximately 1.3% in the average dollar interest rate for the quarter.

Other expenses – Net

Other expenses net amounted to $ 16.3 million compared to $ 31.2 million in the same period last year. Other expenses net during that quarter included expenses deriving from a change in provisions for employees retirement and pension plans, reversal of a provision for impairment of the value of inventory and a provision for tax assessment abroad. In 2005 other expenses included a provision for impairment of the assets of the magnesium company and expenses deriving from a change in the actuarial assumptions in a pension plan of one of the non Israeli companies.

Tax Expenses

Tax expenses amounted to approximately $31.4 million, compared with $2.5 million in the same period last year. Tax expenses comprised about 26.9% of pre-tax income. In the corresponding period in the prior year, the Company had taxable income at a zero tax rate in respect of "Approved Enterprises", which considerably reduced the tax expense.

Net Income

Net income for the quarter amounts to approximately $90.2 million, compared with approximately $82 million last year.

2. SEGMENTS OF OPERATION

The segments of operation of ICL are presented below according to the managerial division into segments described in the preface to this report.

Sales CIF	**2006**		**2005**		**10-12/2006**		**10-12/2005**	
by segment of operations	**$ millions**	**% of total sales**	**$ millions**	**% of total sales**	**$ millions**	**% of total sales**	**$ millions**	**% of total sales**
ICL Fertilizers	1,454.0	41.6	1,573.7	48.5	421.9	47.0	366.3	43.1
ICL Industrial Products	837.8	23.9	805.5	24.8	174.1	19.4	230.6	27.2
ICL Performance Products	1,027.9	29.4	677.0	20.9	251.4	28.0	206.0	24.3
ICL Metallurgy	92.6	2.6	102.8	3.2	24.9	2.8	21.4	2.5
Others and setoffs	(154.1)		(173.0)		(32.7)		(49.3)	
Total	3,258.2		2,986.0		839.6		775.0	

Note: The sales data for the segments and their percentages out of total sales are before setoffs of inter-segment sales.

Operating income	**2006**		**2005**		**10-12/2006**		**10-12/2005**	
by segment of operations	**$ millions**	**% of segment sales**	**$ millions**	**% of segment sales**	**$ millions**	**% of segment sales**	**$ millions**	**% of segment sales**
ICL Fertilizers	263.3	18.1	348.1	22.1	102.1	24.2	71.0	19.4
ICL Industrial Products	208.9	24.9	153.9	19.1	31.0	17.8	43.6	18.9
ICL Performance Products	85.9	8.4	55.0	8.1	17.0	6.8	4.9	2.4
ICL Metallurgy	(35.8)	(38.7)	(9.0)	(8.7)	(9.1)	(36.5)	(9.5)	(44.5)
Others and setoffs	14.1		13.3		6.7		3.5	
Total	536.4		561.3		147.7		113.5	14.6

Note: The sales data for the segments and their percentages out of total sales are before setoffs of inter-segment sales.

2.1 ICL Fertilizers

Sales

The volume of operations in the segment in 2006 amounted to approximately $1.45 billion, a decrease of about 7.6% compared with last year. The decrease in sales turnover derives mainly from a sharp decrease in sales of potash, mainly to south-east Asia, which was partially offset by an increase of sales of green phosphoric acid and phosphate rock, and a rise in the selling prices of the fertilizers and acid.

In the fourth quarter, sales of potash improved considerably, after agreements were signed in India and China during the third quarter.

Operating income

Operating income in the segment amounted to approximately $263.3 million, a decrease of about 24.3% compared with 2005. The percentage of operating income out of sales was approximately 18.1%, compared with 22.1% last year.

The decrease in operating income derives from the decrease in quantities of potash sold and a decrease in production in Europe. In addition, operating income was adversely affected by the appreciation of the shekel against the dollar. The operating income includes insurance payments received during the year in respect of consequential loss following flood damage in Sdom at the end of 2004.

In the fourth quarter, operating income increased, mainly due to the increase in sales of potash to China, India and Brazil.

Potash

Sales revenue from potash includes sales by Dead Sea Works (excluding the operations of Dead Sea Salts), Iberpotash and Cleveland Potash Ltd. ("CPL").

Potash – Sales Revenue and Income (in millions of $)

	1-12/2006	1-12/2005	10-12/2006	10-12/2005
Revenue*	925.1	1,064.1	301.2	247.2
Operating income	245.1	333.6	99.4	71.9

* Including revenue from inter-segment sales

The decrease in sales revenue compared with 2005 derives from the decrease in quantities sold. The decrease in quantity is due to a postponement of several months in signing potash contracts with China and India, as well as weakness in European markets.

In the fourth quarter, as noted, sales revenue increased as sales to China and India resumed, and sales to Brazil increased.

Potash – Production and Sales (in thousands of tons)

	2006	2005	10-12/2006	10-12/2005
Production	5,086	5,263	1,415	1,328
Sales to external customers	3,912	4,721	1,335	1,061
Sales to internal customers	236	252	68	58
Total sales (including internal sales)	4,148	4,973	1,403	1,119

The decrease in potash production derives mainly from the decrease in production in Europe, inter alia as a result of the closure of the Suria mine in Spain. ICL Fertilizers is considering a number of options for reorganization of its mining operations in Europe.

In the fourth quarter, production was higher than last year as a result of increased production at Sdom.

Fertilizers and Phosphates

Sales revenue for these items derives from sales in Israel and abroad of phosphate rock (as a raw material and for direct fertilization), fertilizers (including phosphate, compound, liquid and fully soluble fertilizers, which include differing proportions of nitrogen, phosphorus and potassium), phosphoric acid used as a raw material for the production of fertilizers ("green acid"), as well as other products.

Fertilizers and Phosphates – Sales Revenue and Income (in millions of $)

	2006	2005	10-12/2006	10-12/2005
Revenue*	568.9	548.5	132.1	128.7
Operating income	16.2	15.4	2.1	0.3

* Including revenue from inter-segment sales.

Revenue in the quarter and in the whole of 2005 is higher than last year due to a rise in the prices of most products and an increase in sales of phosphate rock.

The improvement in operating income, both during the full year and during the fourth quarter, derives mainly from the implementation of the strategic plan and the price increase in most of the products, which was partly offset by higher cost of production inputs, namely energy prices and the appreciation of the NIS compared to the US dollar.

Fertilizers and Phosphates – Production and Sales (in thousands of tons)

	2006	2005	10-12/2006	10-12/2005
Phosphate rock				
Production	2,949	3,236	687	686
Sales*	421	365	95	69
Fertilizers				
Production	1,614	1,636	423	401
Sales*	1,656	1,671	357	403

* To external customers (net of sales to Group companies).

Phosphate rock is produced according to demand, both for internal uses and for sales to outside customers, while maintaining suitable stock levels.

The volume of sales of rock in the period derives partially from the segment's policy of diverting most of the output to internal uses of higher added value in the manufacture of acids and fertilizers.

2.2 ICL Industrial Products

Sales

Sales in this segment in the reporting period amounted to approximately $837.8 million, an increase of about 4.0% compared with last year. The increase in revenue derives mainly from rises in the prices of almost all areas of operation, which was partially offset by a decrease in sales quantities of some of the products. The volume of sales in the fourth quarter amounted to $174.1 million, a decrease of 24.5% compared with the same period in 2005. The decrease was mainly in sales of flame retardants to the electronics market, sales of clear brines to the oil drilling market, and sales of elementary bromine.

Income from sales of flame retardants increased as a result of price rises in most of these products, despite the slowdown in the printed circuit market in the second half of the year, which led to a decrease in quantities sold, mainly in south-east Asia. Increased production of the TBBA flame retardant by Chinese manufacturers led to a decrease in sales of flame retardants in the quarter.

Revenue from inorganic bromine products decreased for the period, particularly elementary bromine and clear brines, as a result of the decrease in sales of elementary bromine to the Chinese market and a decrease in quantity of clear brines sold as a result of non-renewal of the agreements with two large accounts. The decrease in sales revenue of clear brines occurred despite the increase in the prices of this product.

Sales of agricultural products decreased in quantities sold in the period compared with last year, due in part to smaller quotas for use of methyl bromide for soil fumigation as a result of implementation of the Montreal Protocol. Nevertheless, the profitability of this operation was not noticeably adversely affected.

In biocides for water treatment, revenue increased considerably as a result of greater quantities sold and a rise in prices in the main target market (North America).

Revenue from magnesia products increased slightly for the period, where price rises were offset by a decrease in sales quantities (particularly due to the decision to terminate production of sintered magnesia for the refractory industry).

Revenue from sales of chlorine-based products from the Dead Sea (Dead Sea salts) decreased, mainly due to the mild winter in North America, which impacted adversely on sales of magnesium chloride, which is the principal product of the unit.

Regarding discussion of the Montreal Protocol and the latest regulation, see section 4.2.16A.3 in the chapter " Periodic Report -Description of Corporate Activity in 2006".

Operating income

Operating income in the segment for the reporting period was approximately $208.9 million, an increase of about 35.7% compared with last year.

The increase stemmed mainly from a rise in the selling prices and a drop in the prices of a principal raw material. The increase in profitability was partially offset by smaller quantities manufactured and sold of some of the segment's products, mainly in the fourth quarter of the year, rising costs, especially of energy, and an increase in local expenses (maintenance and wages) resulting from the appreciation of the shekel against the dollar. Operating income includes $4.5 million income from insurance payments recorded during the year in respect of consequential loss following flood damage in Sdom at the end of 2004.

2.3 ICL Performance Products

After acquisition of the assets and operations of Astaris in the U.S.A. and the Adicor plant in Brazil, ICL implemented an organizational restructuring for the integration of the acquired operations with the existing operations of ICL Performance Products so as to take full advantage of operational synergies. The process included the appointment of Mr. Richard Kennedy, in September 2006, as CEO of ICL Performance Products, as well as managers for the geographical units and areas of operation within the segment.

Sales

Sales in this segment amounted to approximately $1.03 billion, an increase of about 51.8% compared with last year. The increase in turnover derives from the first-time consolidation of the Astaris operations (last year only November and December were included), a rise in some selling prices and the acquisition of Adicor, which manufactures and supplies additives for the Brazilian food industry.

Operating income

Operating income in the segment amounted to $85.9 million, about 56.2% higher than last year. The margin was approximately 8.4%, a slight increase over last year. The increase was the result of linking the operations acquired from Astaris with the existing operations of the segment in this field. The operating margin of the activities acquired from Astaris is lower than that of ICL Performance Products in Europe.

2.4 ICL Metallurgy

Sales

Sales in this segment amounted to approximately $92.6 million, a decrease of about 9.9% compared with last year.

The decrease in revenue derives from a fall in selling prices of the various types of magnesium, mainly due to the effects of a slowdown in the automotive industry n North America and competition from Chinese manufacturers in Europe. The decrease was offset by an increase in quantities sold.

Operating loss

The operating loss in the segment amounted to approximately $35.8 million, compared with a loss of $9.0 million last year. The increase in the loss derives mainly from the falling prices mentioned above and from a rise in the prices of some inputs, particularly energy and raw materials. The appreciation of the shekel against the dollar also contributed to the operating loss.

The sales of the Metallurgy segment to third party customers account for only about 2.2% of the operations of the ICL Group, and therefore, commencing January 1, 2007, the results of Dead Sea Magnesium will be stated as part of "Other operations" and not as a separate segment.

3. THE FINANCIAL POSITION AND SOURCES OF FINANCING OF THE GROUP

3.1 ICL's policy is to diversify sources of financing among various financial instruments and between local and foreign sources.

The net financial liabilities of the Company as at December 31, 2006, amounted to $551.7 million, a decrease during the year of $50.1 million. The decrease in liabilities is after payment of a dividend of $180 million.

The Group's sources of financing are primarily long- and short-term loans from Israeli and international banks.

3.2 Cash flow

ICL's cash flow from ordinary operations in 2006 amounted to $347.4 million, compared with $490.9 million last year, a decrease of approximately $143.5 million.

The decline is potash sales in the Fertilizers segment and in sales in the Industrial Products segment was partially offset by a decrease in customer debt, but led to an increase in stocks of potash and of bromine compounds. Tax payments made in cash also contributed to the decrease in cash flow from current operations. Furthermore, as at the balance sheet date, not all payments had been received from the insurance company in respect of the flood claim, and the balance, approximately $39 million, is expected to be received during 2007. The cash flow from current operations was the principal source of financing for investments in fixed assets, net, which amounted to $135.3 million, and for payment of a dividend of approximately $180 million.

Insurance

The ICL Group carries property insurance for physical damage and loss of profits, under policy terms customary in this industry. The extent of coverage is $575 million, calculated in accordance with the expected maximum loss from an earthquake in the Dead Sea region, based on an assessment prepared for the Company by experts. The Group's property in Israel is insured against physical damage resulting from an act of terror, in accordance with the Property Tax and Compensation Fund Law.

CPL does not purchase insurance for underground property damage, since in that company's opinion, the cost of the premium requested in relation to the coverage offered does not justify purchasing this insurance. A similar policy is followed by peer companies in this field in the world.

The Group carries product liability insurance, third party insurance and employers' liability insurance in the sum of $350 million, under the standard policy conditions in this industry. The Group is also insured under other policies, including marine cargo insurance, credit insurance, insurance for gradual ecological damage, directors & officers insurance and fidelity insurance.

The ICL Group owns a "captive" reinsurance company, which purchases part of the risk from the insurance companies that insure ICL companies at market rates for the respective coverage. In this way, the ICL Group takes retentions beyond the single company level, in order to reduce the cost of the premiums paid to the external insurance market, and the cost of risk to the Group. As at the date of this report, the captive participates in the following insurances: property, product liability and third party, credit, employers' liability, marine insurance and ecology. For ecology, the retention is $5 million per occurrence, and for all other insurances there is also a limit on maximum annual exposure – in property insurance that limit is $15 million and in the other insurances – Between $0.5 million and $5 million, depending on the type of insurance.

4. INVESTMENTS

In the reporting period, investments in property, plant and equipment net of investment grants amounted to approximately $135.3 million, compared with investments in property, plant and equipment less grants amounting to $147.8 million last year.

5. HUMAN RESOURCES

The total number of employees at ICL Group as at December 31, 2006 is 9,307, compared with 9,236 on December 31, 2004. For additional details, see Section 5 in the chapter "Description of the Corporation's Business".

6. MARKET RISK EXPOSURE AND MANAGEMENT

6.1 CPA Avi Doitchman, the CFO of ICL is responsible for managing the market risks to which ICL is exposed. For details of his education, qualifications, business experience and positions in ICL, see the chapter "Additional details" re Article 26A of the Periodic Report.

6.2 **Description of market risks:**

A. **Prices – Selling prices of certain products and prices of certain inputs:**

Some of ICL's products and of some of its inputs are characterized by given market prices which ICL has limited ability to affect. The Group is exposed to changes in the prices of these products and inputs.

The prices of ICL's products have no hedging instruments.

B. **Exchange rates and the CPI:**

The dollar is the principal currency of the business environment in which most of the Group's companies operate. The majority of operations – sales, purchase of materials, selling and marketing expenses and financing, as well as the purchase of property, plant and equipment – are transacted in foreign currency, mainly dollars, and so the dollar is used as ICL's functional currency of measurement and reporting.

ICL has a number of consolidated subsidiaries overseas whose operations are independent and autonomous. The currencies of measurement of those companies are mainly the euro and the pound sterling.

B.1. Some of ICL's sales in non-dollar currencies expose it to changes in the exchange rates of those currencies against the dollar. The income and expenses of the consolidated overseas companies which operate independently / autonomously in local non-dollar currencies, do not constitute exposure, however the income and expenses of those companies in dollars do expose those companies to fluctuations in dollar exchange rates vis-à-vis the currencies in which they operate.

ICL's exposure as aforesaid is based on net income/expenses in any currency which is not the reporting currency of that company.

The prices of certain transactions, despite not being effected in dollars, are affected by the changes in dollar exchange rates as compared with the transaction currency and are adjusted to changes in the exchange rate during a short period.

B.2. Part of the costs of ICL's inputs in Israel are denominated and paid in shekels. Thus, ICL is exposed to a strengthening of the shekel exchange rate against the dollar (shekel appreciation). This exposure is identical in its nature to the exposure described in section B.1, but is of much greater volume than the other currency exposures.

B.3. The results for tax purposes of the Company and some of the ICL companies are measured in a currency other than the dollar – in Israel, CPI-adjusted shekels, and abroad, in the local currency. As a result, ICL is exposed to the difference between the percentage of the change in the dollar exchange rate and the basis of the measurement for tax purposes.

B.4. ICL companies have severance pay commitments which are made in local currency, and in Israel they are also affected by rises in the CPI. The ICL companies in Israel have reserves to cover part of these commitments, which are denominated in shekels and affected by the performance of the funds in which the sums are invested.

B.5. ICL has monetary assets and liabilities in non-dollar currencies or in currencies which are not linked to the dollar, and correspondingly in non- local currency in autonomous overseas companies (except as described in sub-sections B.3 and B.4 above). The differences between the assets and liabilities in the various non functional currencies create exposure.

B.6. Investment in independent / autonomous subsidiaries – ICL has consolidated subsidiaries overseas whose operations are independent and autonomous. The end-of-period balance-sheet balances of these companies are translated into dollars at the end of the period at the exchange rate of the dollar and the currency in which these companies report. The beginning-of-period balance-sheet balances, as well as capital changes during the period, are translated into dollars at the exchange rate at the beginning of the period or on the date of the change in capital, respectively. The differences arising from the effect of the change in the exchange rate between the dollar and the currency, in which the companies report, create exposure. The effects of this exposure are charged directly to shareholders' equity.

C. **Interest Rates:**

The Group has variable-interest loans which expose its financial results (financing expenses) to changes in those interest rates.

ICL hedges against part of this exposure by means of financial instruments, including derivatives.

As at December 31, 2006, ICL has cap options to secure a LIBOR interest ceiling of 3% – 4%, which cover a notional amount of $30 million and $100 million, respectively. The Group has also purchased and written interest options which serve to fix the LIBOR interest in a range of between 2% and 6% (collar). As at December 31, 2006, the options cover a notional amount of $350 million. Some of these transactions combine the writing of options under which, if the variable LIBOR-based interest exceeds 6% – 7%, the transactions at such time will be temporarily void.

6.3 <u>The Corporation's market risk management policy</u>

For financial assets and financial liabilities in currencies which are not the currency of the operations of the companies of the Group, ICL's policy is to minimize this exposure as far as possible by the use of various hedging instruments.

The Company does not hedge against severance pay liabilities and the tax results of ICL, since the exposure is long term.

For hedging against the prices of heavy fuel, income and expenses in currencies which are not the currency of operation of the companies and interest rate, the Company's policy is to hedge according to the following principles.

Heavy fuel prices:

Hedging is coordinated by the Group's Energy Committee. The scope of the hedging is determined after consultation with energy experts in Israel and abroad. In view of the high prices of energy, the Forum has decided, at this stage, to hedge a small percentage of the annual exposure.

Exchange rates:

The Financing Committee of ICL (which is comprised of the senior financial managers of ICL and the segments) periodically examines the extent of the hedging implemented for each of the exposures described above, and decides on the required scope for the subsequent period. ICL uses for its hedging activity various financial instruments, including derivatives.

Interest rates:

The Financing Committee of ICL examines the extent of the hedging in order to adjust the structure of the actual interest to the Company's expectations with regard to developments in interest rates, taking into account the cost of the hedging. The hedging is implemented both by turning fixed interest rates into variable ones **and** vice versa, as circumstances may require.

6.4 <u>Control of Market risk management policy and implementation</u>

ICL's companies regularly monitor the extent of the exposure and hedging in the various areas. The hedging policy for all types of exposure is discussed by the boards of directors of the Company and of ICL's companies as part of the annual budget discussions. At the occasion of presenting quarterly financial results, the finance committees of ICL's companies receive quarterly reports on exposures and hedging as a control device of the existing policy and for its revision and update if necessary. The managements of the companies implement the policy with reference to actual developments and to expectations in the various markets.

ICL uses financial instruments and derivatives (hedging instruments) for hedging purposes only. These hedging instruments neutralize ICL's exposure as described above. Thus, ICL includes the financial impact of the hedging transactions on existing assets and liabilities and on firm commitments in the results of the assets and liabilities which they protect. The financial impacts of all other hedging transactions are charged to financing expenses.

The Company does not save detailed documentation of the designation of all the financial instruments.

Derivatives transactions are made with banks. ICL believes that there is no consequent credit risk. ICL does not demand and does not provide collateral for these derivatives.

6.5 Sensitivity Analysis

Market risks have been defined according to international accounting standard. According securities rules, market risks are defined as the potential for profit or loss as result of the change in fair value of financial instruments with the following risks:

a. Exchange rate risk: as result of the exchange rate of a currency compared to the US dollar, as it has been set for the measurement of fair value.

b. Fair value risk in respect of interest rates: as result of change in market interest rates

The Company calculated as per 31.12.2006 the impact of 6 sensitivity scenarios as result of changes of plus and minus 5% and 10%.

The result of this sensitivity analysis is as follows:

Sensitivity analysis on changes in exchange rates

	Profit (loss) from changes		**Fair value**	**Profit (loss) from changes**	
	Millions$		**Millions$**	**Millions$**	
USD/ILS					
Instrument Type	Rise of 10%	Rise of 5%		Fall of 5%	Fall of 10%
Cash and cash equivalents	(0.4)	(0.2)	**4.7**	0.2	0.5
Marketable securities	0.0	0.0	**0.0**	0.0	0.0
Short-term investments	(0.4)	(0.2)	**3.9**	0.2	0.4
Other receivable	(10.0)	(5.2)	**109.6**	5.8	12.2
Inventories	0.0	0.0	**0.0**	0.0	0.0
Associated companies	0.0	0.0	**0.0**	0.0	0.0
Long term deposits	(0.4)	(0.2)	**4.7**	0.2	0.5
Short-term credit from banks and other	2.5	1.3	**(27.9)**	(1.5)	(3.1)
Suppliers and other	9.4	4.9	**(103.2)**	(5.4)	(11.5)
Other payable	19.0	9.9	**(208.5)**	(11.0)	(23.2)
Employee related obligation	10.2	5.4	**(112.7)**	(5.9)	(12.5)
Options	(4.09)	(2.03)	**1.95**	2.52	5.32
Total	26	14	**(327)**	(15)	(31)

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	Millions$		Millions$	Millions$	
EUR/USD					
Instrument Type	Rise of 10%	Rise of 5%		Fall of 5%	Fall of 10%
Cash and cash equivalents	(0.8)	(0.4)	**9.1**	0.5	1.0
Marketable securities	0.0	0.0	**0.0**	0.0	0.0
Short-term investments	(9.8)	(5.1)	**107.9**	5.7	12.0
Other receivable	(16.5)	(8.7)	**182.0**	9.6	20.2
Inventories	(15.0)	(7.9)	**165.4**	8.7	18.4
Associated companies	(8.9)	(4.7)	**97.7**	5.1	10.9
Long term deposits	(0.3)	(0.2)	**3.7**	0.2	0.4
Short-term credit from banks and other	4.3	2.2	**(46.8)**	(2.5)	(5.2)
Suppliers and other	12.6	6.6	**(138.6)**	(7.3)	(15.4)
Other payable	8.4	4.4	**(92.7)**	(4.9)	(10.3)
Employee related obligation	9.2	4.8	**(101.0)**	(5.3)	(11.2)
Short-term credit from banks	11.3	5.9	**(124.7)**	(6.6)	(13.9)
Forward	(3.5)	(1.8)	**(2.4)**	1.8	3.5
Options	(9.8)	(4.9)	**(1.6)**	3.5	7.2
Total	(19.0)	(9.6)	**58.1**	8.5	17.6

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	Millions$		Millions$	Millions$	
GBP/USD					
	Rise of 10%	Rise of 5%		Fall of 5%	Fall of 10%
Cash and cash equivalents	(0.1)	(0.0)	**0.6**	0.0	0.1
Marketable securities	0.0	0.0	**0.0**	0.0	0.0
Short-term investments	(0.2)	(0.1)	**1.8**	0.1	0.2
Other receivable	(1.3)	(0.7)	**14.6**	0.8	1.6
Inventories	(1.9)	1.0	**20.4**	1.1	2.3
Short-term credit from banks and other	0.1	0.1	**(1.5)**	(0.1)	(0.2)
Suppliers and other	0.8	0.4	**(9.1)**	(0.5)	(1.0)
Other payable	2.1	1.1	**(22.8)**	(1.2)	(2.5)
Employee related obligation	(0.1)	(0.1)	**1.5**	0.1	0.2
Total	(0.5)	(0.3)	**5.4**	0.3	0.6

	Profit (loss) from changes		**Fair value**	**Profit (loss) from changes**	
	Millions$		**Millions$**	**Millions$**	
JPY/USD					
Instrument Type	Rise of 10%	Rise of 5%		Fall of 5%	Fall of 10%
Cash and cash equivalents	(0.0)	(0.0)	**0.4**	0.0	0.0
Marketable securities	0.0	0.0	**0.0**	0.0	0.0
Short-term investments	0.0	0.0	**0.0**	0.0	0.0
Other receivable	(1.7)	(0.9)	**18.6**	1.0	2.1
Inventories	(0.9)	(0.5)	**10.3**	0.5	1.1
Associated companies	0.0	0.0	**0.0**	0.0	0.0
Long term deposits	(0.0)	(0.0)	**0.1**	0.0	0.0
Short-term credit from banks and other	0.1	0.1	**(1.2)**	(0.1)	(0.1)
Suppliers and other	0.3	0.1	**(3.0)**	(0.2)	(0.3)
Other payable	0.1	0.0	**(0.8)**	(0.0)	(0.1)
Employee related obligation	0.1	0.1	**(1.2)**	(0.1)	(0.1)
Forward	0.7	0.4	**0.1**	(0.4)	(0.9)
Option	0.9	0.4	**0.3**	(0.3)	(0.5)
Total	(0.5)	(0.3)	**23.6**	0.5	1.1

	Profit (loss) from changes		**Fair value**	**Profit (loss) from changes**	
	Millions$		**Millions$**	**Millions$**	
Real Brazil/USD	2.365	2.2575	2.15	2.0425	1.935
Instrument Type	Rise of 10%	Rise of 5%		Fall of 5%	Fall of 10%
Cash and cash equivalents	(0.2)	(0.1)	**2.2**	0.1	0.2
Marketable securities	0.0	0.0	**0.0**	0.0	0.0
Short-term investments	0.0	0.0	**0.0**	0.0	0.0
Other receivable	(0.6)	(0.3)	**6.5**	0.3	0.7
Inventories	(0.5)	(0.3)	**5.9**	0.3	0.7
Associated companies	(0.7)	(0.4)	**8.0**	0.4	0.9
Suppliers and other	0.2	0.1	**(2.7)**	(0.1)	(0.3)
Other payable	0.2	0.1	**(1.7)**	(0.1)	(0.2)
Total	(1.7)	(0.9)	**18.3**	1.0	2.0

Sensitivity analysis on changes in interest rates

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	Millions$		Millions$	Millions$	
Interest Libor variable	5.907	5.6385	5.37	5.1015	4.833
The kind of instrument	Rise of 10%	Rise of 5%		Fall of 5%	Fall of 10%
Loans at fixed interest	4.3	2.2	**(210.8)**	(2.2)	(4.3)
Loan at variable interest			**(497.5)**		
Collar transaction	0.6	0.3	**2.2**	(0.3)	(0.5)
Cap option	1.3	1.1	**2.1**	(0.3)	(0.6)
Swap transaction	(2.4)	(1.2)	**(2.7)**	1.2	2.4
Total	4.9	3.3	**(706.7)**	(0.2)	(1.9)

Interest-hedging transactions – for hedging changes in variable interest rate (LIBOR) on dollar loans								
Nominal Value				Fair Value				
Up to one year		More than one year		Up to one year		More than one year		
Short	Long	Short	Long	Short	Long	Short	Long	
- 2,678				125,000				**Swap**
	3,975		346		480,000		36,000	**Caps**
	-25				350,000		16,000	**Floors**

6.7 Derivative Positions

Here are the details on this subject

Hedging transactions against the effects of changes in exchange rates of cash flows-in thousands dollars				
	Nominal Value Up to One Year		Fair Value Up to One Year	
	Long	Short	Long	Short
Direction of transaction in derivatives is Dollar purchase				
Currency: Euro/dollar in $"000s				
Setoff recognized for accounting	13,303		-790	
Setoff not recognized for accounting	20,000		-1,560	
Call Options				
Setoff recognized for accounting	87,884		-2,114	
Put Options				
Setoff recognized for accounting	97,916		547	
Currency: JPY/dollar in $"000s				
FORWARD				
Setoff recognized for accounting	8,111		71	
Call Options				
Setoff recognized for accounting	13,000		309	
Put Options				
Setoff recognized for accounting	13,000		-3	
Direction of transaction in derivatives is GBP purchase				
Currency: Euro/GBP in $"000s				
FORWARD				
Setoff recognized for accounting	7,920		343	
Currency: ILS/ USD in $"000s				
Call Options				
Setoff recognized for accounting		60,800		-1
Put Options				
Setoff recognized for accounting		38,000		1,613
Currency: ILS/Euro in $"000s				
Call Options				
Setoff recognized for accounting		8,363	-1	
Put Options				
Setoff recognized for accounting		8363	332	

7. ACCOUNTING ISSUES

7.1 Accounting and financial expertise

A directive of the Securities Authority from October 20, 2003 requires public companies to define the appropriate minimum number of directors having accounting and financial expertise and to disclose which directors serving in the company meet that requirement. The directives states that these directors should be those who do not fulfill another function in the company and who, because of their education, experience and qualifications, have a high level of expertise and understanding of matters concerning accounting, internal auditing and financial statements, to an extent that allows them a profound degree of understanding of the company's financial statements and to raise issues and questions in connection with the financial reporting of the company.

The Board of Directors of the Company decided to set the minimum number of such directors at three. Factually, as at the reporting date, eleven of the twelve members of the Board of Directors of the Company have accounting and financial expertise as that term is defined above.

The Board of Directors believes that this number enables it to fulfill the duties imposed upon it by law and its documents of incorporation, and particularly in relation to its responsibility to ascertain the financial condition of the Company and to draw up and approve the financial statements.

In making this determination, the Board of Directors took into consideration the size of the Company, the complexity of its operations, the range of risks to which the Company is exposed, the control system currently in place in the Company – both internal auditing and the auditing of the external auditors, the existence of boards of directors in the segments of operations of the Company having skilled and professional members, including outside directors, who examine the operations of each segment and ascertain that the segment is correctly described in the segment's reports and in the financial statements of the segment companies.

In assessing the accounting and financial expertise of the directors, considerations included their education, their managerial experience in public companies, the number of years they have served as directors in public companies and the extent of their knowledge of and proficiency in the following subjects: accounting and auditing issues that are typical of the sector in which the ICL Group operates, the role of the auditor, the duties imposed on him and the reciprocal relations between a reasonable director and the auditor, the processes involved in the preparation of financial statements according to the law and Company procedures, and the internal auditing system in the Company.

The Board of Directors of the Company believes, as at the date of this report, that eleven out of the twelve members of the board of the Company, have accounting and financial expertise as that term is defined above. A brief description follows:

Yossi Rosen has been Chairman of the Board of the Company since 1998, is CEO of the parent company – Israel Corporation Ltd., and a director in a number of public and private companies. Mr. Rosen has a B.A. in economics and political science and an MBA.

Avraham (Beiga) Shohat was Israel's Minister of Finance, a member of the Knesset Finance Committee and has held various other offices in the Government and the Knesset. He was and is a director in several public and private companies and has also served as a mayor.

Irit Izakson has served and currently serves on a number of boards of directors of public and private bodies, and for many years she held managerial positions in banks. Mrs. Izakson has a B.A. in economics and an M.A. in operations research.

Yaakov Dior is an outside director at ICL, and serves as a director in public and private companies. He has held senior positions in the banking system, including the management of two credit card companies and a commercial bank. Mr. Di'ur has a B.A. in economics and an MBA.

Amnon Sadeh is a director in a number of public and private companies. He has held senior managerial positions in a bank and in industrial and commercial companies, Mr. Sadeh has a B.A. in economics and political science.

Moshe Vidman serves and has served as a director of many public and private companies. In the past he was president & CEO of an industrial company and Deputy Accountant General at the Ministry of Finance. Mr. Vidman has a B.A. in economics and an MBA (major: finance).

Avisar Paz is CFO of the parent company – Israel Corporation, and a director in a number of the Group's companies. Previously he was CFO and comptroller of another concern. Mr. Paz is a certified public accountant and has a B.A. in economics.

Haim Erez serves as a director in a number of public companies. From 1985 to 1996 he was CEO of ICL, and prior to that he was Chairman of ICL subsidiaries. Mr. Erez is research fellow in privatization and local government at the London School of Economics.

Victor Medina is a former CEO of United Mizrachi Bank. From 1990 to 1995 he served as ICL's Chairman of the Board, prior to which he was Director General at the Ministry of Finance and served in various senior positions at the Bank of Israel, including as a member of the bank's senior management, in charge of the Monetary department, its Foreign Currency Control department and its Credit department. Mr. Medina has a B.A. in economics and political science, and an M.A. in economics (finance and banking).

Nir Gilad, currently Deputy CEO of the parent company – Israel Corporation, was formerly the deputy CEO of Migdal Insurance Holdings and the CFO of Israel Aircraft Industries. He has also served in senior positions at the Ministry of Finance, the last of which was Accountant General. Mr. Gilad has a B.A. in economics and agricultural management, and an MBA (financing).

Yair Orgler is an outside director at ICL. He was professor of finance and banking, Dean of the Faculty of Management, and Deputy Rector of Tel Aviv University. Prof. Orgeller has published and edited numerous books in his field of specialization, as well as articles in scientific and professional journals. For about ten years, he was Chairman of the Board at the Tel Aviv Stock Exchange. Prof. Orgeller has an M.A. and Ph.D. in business administration, an M.A. in Industrial engineering and management, and is a graduate of the Technion in Industrial engineering and management. He founded Maalot – The Israel Securities Rating Co. Ltd., and was acting Chairman of the company. He was and is a director in a number of public companies.

Additional details about the corporations and their directors can be found in the Periodic Report. The directors with accounting and financing expertise also serve on some of the boards of directors of the private subsidiaries of ICL.

7.2 Critical accounting estimates

The preparation of the financial statements according to accepted accounting principles requires the Management of the Company to use estimates that influence the assets and liabilities in the balance sheet, the contingent liabilities and the Company's results in the reporting period. The Management bases the estimates on past experience and on additional factors which it believes to be relevant to the circumstances. These estimates are critical, since any change in them can affect the financial statements.

Pension liabilities

In calculating its pension liabilities, the Company uses various estimates. These include, among others, the interest rate for discounting of the Company's pension liability, the expected long-term yield in respect of the pension fund assets, the long-term growth forecast for wages and the forecast life expectancy of those entitled to the pension.

The estimated interest rate for discounting of the Company's pension liability is based on the yield of long-term debentures. The yield of the long-term debentures varies according to market conditions. As a result, the interest rate for discounting will vary and in consequence, the pension liability will also vary.

The estimated long-term yield in respect of the pension fund assets is based on the yield expected over time of the asset portfolio according to the composition of the pension fund assets. Changes in capital market conditions or in the composition of the pension fund asset portfolio can lead to changes in the estimated yield of the pension fund assets and consequently, to a change in the pension fund.

The estimated growth forecast for wages is based on the Company's forecast in light of past experience and actual labor agreements. This estimate might not tally with actual growth in wages.

The estimated life expectancy is based on the actuarial research papers published in every country. In practice, these this research is updated every few years, and accordingly, estimated life expectancy will also be adjusted.

In the past three years, the effects of changes in actuarial estimates were not material.

Environmental Matters

The ICL Group manufactures fertilizers and chemical products and is therefore exposed, in the ordinary course of its business, to liabilities and obligations arising from laws relating to the environment and related issues. The Group invests considerable amounts in complying with the requirements of the law. The Company records a liability in its books when such a liability is anticipated and can be estimated. The estimate of the liability is based mainly on experience, familiarity with the requirements of the law in the areas of Company operation, on estimates relating to claims pending against the Company, and on the opinion of legal advisers and other experts. As explained in Note 19 to the financial statements, there are several legal claims pending against the Company, the outcome of which could influence its business results.

Fixed assets

Fixed assets are depreciated by the straight line method, based on the estimated duration of their useful lives. There has been no change in the estimated duration of the assets in the past three years.

Standard 15 – Impairment of the value of assets

Under Standard 15, upon signs of a decrease in value, the Company examines whether the stated value of the asset in the Company's books is recoverable from the cash flow expected from that asset. The recoverable amount of the asset is determined at the higher of the net selling price of the assets and the present value of the cash flow expected from continued use of the asset, including the cash flow expected when the asset is taken out of service and realized in the future.

The circumstances likely to give rise to concern of impairment can be a change in regulation such in respect of the environment, a change in the rate of return, physical damage to facilities, termination of the operation of facilities, a change in the business environment, etc.

In calculating impairment, estimates are made for future cash flows, the growth forecast for the operation of the facility in the short term and the long term, and in the discount rate reflecting also the risk of the sector to which the activities belong. A change in these estimates or in actual results compared with the estimate, can influence the need for making such a write-off and as a consequence, the assets and results of the Company.

7.3 Effects of transition to international financial reporting standards:

In July 2006 the Israel Accounting Standards Board published Accounting Standard No. 29 – Adoption of international financial reporting standards (IFRS) ("the Standard"). The Standard provides that entities subject to the Securities Law, 5728-1968 and required to report according to the standards of that law, will prepare their financial statements according to the IFRS for periods commencing January 1, 2008. The Standard allows early adoption of IFRS, commencing from the financial statements to be published after July 31, 2006. First-time adoption of IFRS will include application of the provisions of IFRS1 – First-time Adoption of IFRS, for the transition. ICL has no plans to make early transition to IFRS.

Under the Standard, the Company must include, in a note to its financial statements as at December 31, 2007, the balance sheet data for December 31, 2007 and the statement of operations data for the year then ended, after application of the principles of recognition, measurement and statement of IFRS.

The management of the Company has appointed the CFO of the Company to be in charge of the process of adoption of the IFRS.

As part of the Company's preparation for transition to the application of IFRS, an action plan was presented to the Finance Committee of the Board of Directors of the Company, the main points of which are as follows:

- A seminar will be held for the relevant professionals in the Company and the Group's companies in Israel and abroad, for studying the new international standards, with particular focus on the differences between them and the standards applied today by the Company.
- A steering committee will be appointed, whose members will be representatives of the Company and the Group's companies, to manage and oversee application of the standards and to set an up-to-date policy for the Company based on IFRS.
- Mapping of the IFRS relevant to the Company, and an in-depth examination of their implications for the financial statements.
- Comprehensive examination of the main implications for the Company which can be expected to derive from the adoption of the IFRS.
- Quantitative analysis of the implications of adoption of the IFRS.
- Briefing of the Finance Committee with regard to the recommendations of the steering committee, approval of the Finance Committee and structuring of a new accounting policy accordingly.

  By December 31, 2006, the comprehensive examination of the implications for ICL of adoption of the IFRS was completed. The Company is currently carrying out the quantitative analysis of their adoption.

  Below is a description of the expected effects on the financial statements of the Company as a result of the transition to the IFRS, including changes that could occur in the Company's accounting policy following the transition:

- IAS 19 – Employee Benefits, sets the following accounting rules for recording a liability in respect of employee benefits:

  1. **Employee benefits after employment**

     Under the provisions of IAS 19, this liability is to be treated as a "defined benefit plan" if the actuarial saving and the investment risk remain in the hands of the Company.

     In order to estimate the liability in defined benefit plans, actuarial methods must be used which take into account the amount of the benefit payable to the employees for services they rendered in the present period and in past periods. Measurement of the liability is made on the basis of capitalized amounts, using actuarial assumptions (e.g. life expectancy, salary increment rates, etc.). The amount that will be recognized as a liability for a defined benefit will include the present value of the liability for a defined benefit at the end of the reporting period, plus actuarial gains (net of actuarial losses) not yet recognized and after deduction of the fair value of the plan's assets as defined in the standard.

     Actuarial gains and losses will be treated according to the accounting policy chosen by the Company when there is a number of an alternative. One alternative is the "corridor" method, whereby part of the actuarial gains/losses are deferred in the manner provided in the standard. The second alternative is immediate recognition of the actuarial gains/losses in the statement of operations, and the third alternative is immediate recognition of the actuarial gains/losses as part of the shareholders' equity.

     According to the provisions of an IASB opinion, financial statements will include a reserve for an employer's liability for employee severance benefits, retirement pay or pension, to be paid when the time comes, assuming that all the employees will retire on terms that entitle them to full compensation on the balance sheet date.

2. **Long-term and short-term employee benefits**

Under IAS 19, benefits for vacation pay and sick pay that can be accumulated and used (whether by redemption or by paid leave of absence) in excess of one year, are long-term employee benefits. The liability will be recognized on the basis of actuarial assessments and in capitalized amounts.

According to the provisions of the IASB opinion, these benefits were calculated assuming that all employees will exercise their right on the balance sheet date, without actuarial computations.

- IAS 39 – Financial Instruments: Recognition and Measurement

This standard sets rules for recognition in the sale of customer debt in a securitization transaction. The customer securitization transaction made by the Company is not in compliance with the terms of sale required for the decrease of financial assets. Therefore, the Company will state an asset in its financial statements – Customer balance and financial liability. IAS 39 also lays down rigid cumulative rules in hedging transactions (designation, documentation and expectation for high hedging effectiveness), for a transaction to be seen as a hedging transaction in accounting terms. In transactions seen as hedging transactions in accounting terms, the change in the fair value of the financial instrument designated for hedging will be charged to the statement of operations, with a corresponding charge of the changes in the fair value of the defined asset or liability relating to the hedged risk.

The changes in fair value in respect of financial derivatives which do not meet the terms required for the application of hedging accounting, will be charged to the statement of operations.

All the existing hedging transactions in December 2006 must comply with the terms of designation, documentation and effectiveness if they are to be treated as hedging transactions under the IFRS. According to established practice in Israel, the terms for applying hedging accounting are simpler, and based mainly on economic criteria. In addition, in certain circumstances financial derivatives used for hedging are not reflected in the balance sheet.

- IAS 31 – Interests in Joint Ventures

In jointly controlled companies (50%), this standard allows treatment by way of proportionate consolidation or the equity method of accounting. Under current standards, the Company is required to treat jointly controlled companies (50%) by way of proportionate consolidation. If the Company decides to treat such companies by way of recording the investment on an equity basis, the amounts relating to the proportionately consolidated companies will be deducted from the asset and liability items of the Company and from its statement of operations and the statement of cash flows, and the results of their operations will be stated in one line in statement of operations and in one line in the balance sheet.

7.4 Fees of the auditing accountant

In 2006 the ICL Group recorded $3.54 million in expenses in respect of services received from KPMG for auditing services, audit-related services and tax advice.

8. INTERNAL AUDITING AND COMPLIANCE

8.1 The internal compliance plan and code of ethics

As part of the ICL Group, the Company maintains internal systems to ensure compliance with the provisions of relevant laws. The appropriate managers and office-holders of the Group's companies have been informed that their managerial responsibilities include ensuring compliance with by-laws of the company in which they serve. The matters are reviewed regularly by the managements and boards of directors of the various companies.

In the operational companies, committees have been set up by the boards of directors to cover issues such as ecology, safety and security, which convene regularly. Among other things, an internal compliance plan has been drafted and is applied for antitrust issues, the securities laws, and the prevention of sexual harassment. The boards of directors of ICL and of the segments receive quarterly reports about the various compliance plans. Group-wide centers of excellence are maintained and study days are held for appropriate managers and employees in these fields, and the application of the provisions of the law is monitored regularly.

At the beginning of 2006, ICL launched a code of ethics for the management level, which is designed to reflect the values of ICL and also to serve as a framework for the application and assimilation of compliance plans. As part of the assimilation process, training sessions were held for relevant managers and office-holders on the code of ethics. The code has been distributed to all the managers in the Company, who confirmed that they have received and read it and will act in accordance with its precepts. Assimilations have been carried out among target populations with the aim of applying it to all managers and employees upon completion of the process. For additional details, see Section 3.3 in the chapter "Description of the corporation's business" for 2006.

8.2 Internal audit

The ICL Group has an internal auditing system to ensure routine compliance with requirements of the law and good business management in the Group companies in Israel and abroad. Below are details about the internal auditor.

8.2.1 The name of the internal auditor in the corporation: Shlomo Ben-Shimol, CPA.

Mr. Ben-Shimol, a qualified internal auditor (CIA was appointed as internal auditor of the Group in May 2005.

Mr. Ben-Shimol meets the requirements of Section 146(b) of the Companies Law, meaning that he is not an interested party or officer in the Company, a relative of any of those, or the auditing accountant of the Company or acting on its behalf. He is also in compliance with Section 8 of the Internal Auditing Law, 5752-1992, and does not hold another position in addition to his position as internal auditor. The internal auditor confirmed to ICL that he does not hold another position that creates or is liable to create a conflict of interests with his position as internal auditor at ICL.

Mr. Ben-Shimol is a partner in the firm of Deloitte Breitman Almagor, and provides services on behalf of that firm. In addition, he provides internal auditing services in the subsidiary Dead Sea Magnesium. In the various segments, Company employees fulfill internal auditing functions under the professional guidance of Mr. Ben-Shimol.

8.2.2 Method of appointment: In 2006, the Board of Directors and its Audit Committee approved the appointment of the internal auditor after a round of interviews with a number of auditing firms, with particular attention to the professional qualifications of the candidate, his internal auditing experience overall and in industrial corporations and pubic companies in particular, *the international deployment of the Deloitte network and the data bases and means of auditing at its disposal on the subject of internal auditing,* as well as their impressions of the candidate and his team.

8.2.3 The organizational superior of the internal auditor: The Chairman of the Board of the Company.

8.2.4 The work plan: The Company and its subsidiaries in Israel and abroad have a multi-year plan for the years up to 2008and a detailed annual work plan. As part of the multi-year plan, in 2005-2006 a risk analysis survey was carried out in two parts, and served as the basis for the annual plan. Dozens of managers from headquarters and the subsidiaries in Israel and abroad participated in the survey. The survey included definition of the main processes at the level of the organization and the business units in Israel and abroad, risk exposures were characterized and an assessment was made of the level of exposure to those risks. The results of the survey served as the basis for determining priorities for the internal auditing of the subjects that will be examined in the coming years. The risk analysis and its results were discussed by the management of the Company and by the Audit Committee.

The planning of the work plan took into account the results of the risk survey, the requests of the management at ICL and in the segments for certain subjects to be audited, and the remarks and requests of the Audit Committee. The plan, which also considered subjects audited in the past and those to be audited in the future, was approved by the Audit Committee and then by the Board of Directors.

The work plan gives the internal auditor discretion to add to it. In accordance with accepted practice in the Group, the auditor is requiring to report on deviations from the plan, giving explanations and reasons. The Audit Committee monitors the implementation of the plan.

In 2006, there were no material purchases or sales of operations made, nor any extraordinary transactions as defined in Section 270 of the Companies Law. The auditor was involved in deciding on procedures for the auditing of ordinary transactions with parties with a personal interest and with controlling shareholders, and for the identification of related parties and interested parties for ascertaining grant of the approvals required by law.

8.2.5 **<u>Auditing abroad or of investee corporations</u>**

The internal audit plan encompasses also the corporations which are material holdings of the Company, in Israel and abroad.

8.2.6 **<u>Scope</u>**

The hours invested in internal auditing in the Group in 2006 are as follows:

In the corporation itself		1,000
In investee corporations	In Israel	10.360
	Outside Israel	2,890
Total		**14,250**

The hours invested in the investee companies were mostly of the internal audit employees of those companies, and the remainders were outsourced.

The number of hours invested is derived from the work plan as approved by the Audit Committee at ICL, and from ad hoc tasks imposed on the internal audit staff by the chairman of the boards of each of the companies in the Group.

8.2.7 **<u>Implementing the audit</u>**

Internal auditing is carried out according to accepted professional standards in the field, professional directives and briefings published by the Chamber of Internal Auditors.

As part of the annual audit plan, the internal auditor exercises quality control for reviewing the auditing work processes of the auditors in the Internal Audit unit. In accordance with Professional Directive 14 of the Israel Chamber of Internal Auditors, the internal auditor maintains a quality assurance program which includes self-audit and external audit of the Internal Audit unit.

The Board of Directors believes, based on the notice of the internal auditor that the internal auditing work is carried out in accordance with the accepted professional standards for internal auditing.

8.2.8 **<u>Access to information</u>**

The internal audit staffs are given free, constant and direct access to the information systems of ICL, including the investee corporations and including financial and other data, both in Israel and abroad.

8.2.9 **The internal auditor's reports**

The reports of the internal auditor are submitted regularly in writing throughout the year. In 2006, 85 reports were submitted at ICL and the subsidiaries. The reports are submitted to the chairman and members of the Audit Committee, the Management of ICL and the audited units. The reports of the auditors in investee companies are submitted to the CEO of the subsidiary, the chairman of the audit committee of the subsidiary and to the management of the audited unit. The auditor briefs the Chairman of the Board, the Audit Committee of ICL and the CEO of ICL on the findings of the audits.

In 2006, the Audit Committee convened eight times at Company headquarters – in January, March, May-August and November. In addition, the internal auditor meets regularly with the Chairman of the Board, the chairman of the Audit Committee, the CEO of the Group and the senior management of the Group.

In addition to the above, in 2006 the audit committees of the subsidiaries met 16 times. Meetings of the Audit Committee in the subsidiaries take place regularly throughout the year. The auditing officer in each segment also holds periodic meetings with the internal auditor, the chairman of the board of the subsidiary, the chairman of the audit committee of the subsidiary, the CEO of the subsidiary and the senior management of the Company.

8.2.10 **Board of Directors' assessment of the work of the internal auditor**

The Board of Directors believes, based on the confirmation of the internal auditor and on a comparison with similar companies in Israel and around the world, that the scope of the internal audit work, the continuity of action and the work plan of the internal auditor at headquarters and of the auditors in the investee units, are sufficient in the circumstances, and can achieve of the purpose of internal auditing in the Group. Once a year, the Audit Committee, together with the Group's Management and the internal auditor, examine the scope of the internal audit work.

8.2.11 **Remuneration**

The total financial remuneration paid for the internal auditor and his staff at ICL headquarters amounts to $72,000. In addition, $83,000 was paid for auditing services for the segments. In the opinion of the Board of Directors, the remuneration paid to the internal auditor is reasonable. It does not affect the exercise of his professional discretion.

9. Social-Community Involvement of the ICL Group

ICL focuses its community engagement in the towns and development areas in the Negev – Dimona, Yeruham, Arad and Be’er Sheva, and in the north of Israel – Kiryat Ata and Haifa, where most of the employees of the companies in the Group live, in recognition of the need to be involved in and to support the needs of the community, cooperation and enrichment of residents, and mutually, of employees.

ICL’s efforts are mainly in the Negev, for disabled children, women and children at risk, populations in socioeconomic distress and those with special medical needs. The financial contribution of the ICL Group in 2006 amounted to approximately NIS 10.1 million (about $2.3 million) – 20% more than in 2005. This does not include the hours of work volunteered by employees, sometimes at the expense of their work-time, particularly activities in clubs,(see below), Some of the projects in which ICL, its managers, employees and their children, as well as ICL pensioners, are involved, are described below:

9.1 Adoption of a network of clubs for children at risk

In 2001, the Boards of Directors of the Israel Corporation and ICL formulated a strategic plan for the Group’s social and community involvement. The main project is the “adoption” of a network of clubs for children aged 3 – 16 who are at risk. At the end of December 2005, the Board of Directors of the Company extended the project for another five years, and increased its budget allocation by about 40%, in response to the ever-increasing numbers of clubs serving hundreds of children.

Pursuant to the resolution, the companies undertook to assist for another five years in the development and upkeep of the clubs, both by material means (money and equipment), and with educational and value content by means of active and close contact of ICL employees and retirees and their participation in club activities. Each of the principal ICL companies adopted a specific town in the Negev or the north of the country, and each production facility or department of each company adopted one of the clubs in the company's adopted town. The connection is on a warm, personal basis, and employees act as tutors, friends and leaders and represent the warm parental figure that these children often lack. These clubs are a therapeutic framework, a model for the organized home and functional family, intended for children aged 6 – 13. The children who attend these clubs are defined as being at risk, whose parents are unable to look after them during the day for various reasons – financial, violence, neglect, dysfunction, and so on.

The number of clubs adopted by ICL companies has grown steadily from the six "pilot" clubs adopted in 2001 in Yeruham, Be'er Sheva, Dimona, Arad, Kiryat Ata and Haifa, which are near ICL plants, to 50 clubs at the end of 2006, as well as a new model of club for older children. In this context, ICL is also adopting the Be'er Sheva branch of the Down's syndrome Children's Association, as well as "warm homes" for youth in distress in Be'er Sheva, Dimona and Arad.

The active contribution includes work by teams of employees – repairs in the club buildings, environmental development, donations of computers, domestic appliances, games and books, as well as enrichment activities, hikes, and activities on holidays and vacations.

This year, during which the number of clubs adopted increased gradually to 50, ICL companies donated about NIS 1.1 million directly to the clubs, compared with NIS 1.24 last year (the decrease derives from the fact that in 2005, the funds were also used for purchasing equipment to expand activities, while in 2006 most of the budget was allocated for financing day-to-day activities). In addition, thousands of volunteer hours were donated by employees, some at ICL's expense and some in the employees' own time.

9.2 <u>Initiatives and response to various issues</u>

Another important contribution of ICL this year was participation in the life-saving drug fund of the Israel Corporation Group, ICL, Zim Integrated Shipping Services Ltd. and Mr. Sami Ofer, in the amount of about NIS 35 million. ICL's part is NIS 5 million, half of which was expended in 2005, NIS 1.8 million in 2006,with the balance to be paid in 2007.

In December 2005 and January 2006 the boards of directors of ICL and the parent company – Israel Corporation, approved donations of NIS 1 million (ICL) and NIS 1.5 million (Israel Corporation) to "Alut" for the construction of a permanent home for autistic adults and teenagers in Be'er Sheva. Construction of the home was started in 2006.

Another contribution in 2005 – of about half a million shekels, was to Soroka Hospital in the Be'er Sheva, which serves the residents of the entire Negev region, among them ICL employees, plants, families and the community in which the Group's companies operate. For the past ten years, once a year, the donation collected is used for the construction, development and equipping of one of the hospital's departments. In the summer months, the children of employees assist in various activities and tasks in the hospital, in clubs and in other community activities, in cooperation with the municipalities. The children are paid by ICL companies.

ICL companies exchange the holiday gifts (New Year and Passover) traditionally distributed to colleagues and others, for food parcels and gift vouchers which they donate to needy families in the Negev, and distribute parcels, in cooperation with the "Haim" society, to children with cancer who are hospitalized or in the daily care of the Soroka Medical Center in Be'er Sheva.

During 2006, the Company provided aid amounting to about NIS 500,000 for the residents of the north during and after the recent war there. Among the actions taken were the distribution of food parcels to residents in shelters, parcels of clothing and candies for soldiers, and taking residents of the north and from Sderot and settlements along the Gaza Strip, on rest and relaxation outings in Eshkol Park. These activities were undertaken in cooperation with the Nature and Parks Authority. Many other initiatives were undertaken by the employees of the Group's companies and unions, including food parcels, games and equipment for the residents in the north.

ICL has also contributed both money and money equivalents to various support organizations operating in the south of the country. These include the "Haim" society for children with cancer and their families, "Al-Sam" in Be'er Sheva, "Nitzan" for children with learning difficulties, the Bat Dor Dance Company for children in Be'er Sheva, the Arad branch of the Cancer Association, equipment for "Yad Sarah" in Be'er Sheva, food parcels for the needy in Be'er Sheva, Dimona, Arad and Yeruham at holiday times, "B'Terem" – a road safety organization, an aid fund for new immigrants in the Negev, and other associations and activities operating in the towns and communities of ICL employees in the Negev and of the Bedouin population in the region. Together with the Committee for the Welfare of Soldiers, ICL Group also adopts a number of army units and bases, where they hold joint activities for the well-being of soldiers.

ICL continues its support of the Be'er Sheva branch of “Inbal”, a support center for children who are victims of sexual abuse. ICL has undertaken to donate $50,000 per year for five years, to the financing of Inbal’s activities. ICL also initiated the opening of a branch of “Yated” in the south, an organization for children with Down’s syndrome, and undertook to donate $30,000 per year for another three years for its operation (up from its $20,000 donation last year). Employees and managers of ICL companies are actively involved in public bodies in the community at Yeruham, Be’er Sheva, Dimona and Arad. ICL pensioners are also involved in Youth Club activities, Yated and other voluntary bodies.

10. EVENTS DURING THE PERIOD

10.1 A a special general meeting on January 26, 2006 resolved to appoint Irit Izakson and Avraham (Beiga) Shohat as additional directors in the Company. At the annual general meeting of the shareholders of the Company on April 23, 2006, it was decided, among other things, to re-appoint Yossi Rosen, Gilad Shavit, Haim Erez, Muhammad Dahleh, Moshe Vidman, Noga Yatziv, Avisar Paz, Amnon Sadeh, Avraham (Beiga) Shohat and Irit Izakson as directors of the Company, and to retain the services of the outside directors. On May 9, 2006, Gilad Shavit ceased to serve as director in the Company, and on May 28, 2006 Nir Gilad was appointed to replace him. On August 30, 2006 the term of office of outside director Ben-Zion Rabinovitz ended. Muhammad Dahleh, a director, gave notice of his resignation, effective August 31, 2006. At a special general meeting of the shareholders on September 5, 2006, Yair Orgeller was appointed as an outside director, the term of office of outside director Yaakov Dior was extended for a second term, and Victor Medina was elected as a director in the Company.

10.2 On March 27, 2006, the Company decided on a reward plan for senior managers – see section 5.2E in the Periodic Report - Description of Corporate Activity.

10.3 On May 9, 2006 the Company distributed a dividend on approximately $90 million, and on September 19, 2006 the Company distributed a dividend of approximately $90 million.

10.4 On November 5, 2006, Dan Mesika gave notice of his resignation as CEO of Dead Sea Magnesium, and he has been replaced by Arye Sodek. On November 1, 2006, Asher Rappoport was appointed VP Human Resouerces.10.5 On September 18, 2006, a subsidiary of I.D.E. Technologies Ltd. ("IDE"), a desalination company, received notice from the Government of Israel, informing it that it had won the tender for the design, financing, erection and operations by the BOT method, of a sea water desalination facility in the Hadera area, for the production of 100 million cu.m. per year. The shareholders in the subsidiary are IDE and a company from the Housing and Construction Holdings Ltd. Group, with equal holdings. IDE is jointly controlled by ICL and the Delek Group. The framework agreement for erection of the facility was signed between the Company and the subsidiary on November 23, 2006.

11. EVENTS AFTER THE BALANCE SHEET DATE

11.1 On January 28, 2007, the Company decided on a reward plan for senior managers – see section 5.2E above, in the section Description of Corporate Activity.

11.2 On March 27, 2007 the Board of Directors of the Company decided to distribute the net profit of the company for 2006 as a dividend, taking into account the dividend of $90 million which was distributed on September 19th, 2006 as a distribution of part of the year's profits. Correspondingly, a dividend in the amount of 283.9 million dollars will be distributed on April 25th, 2007 (283.4 million dollars, net of the share accruing to a consolidated company).

The Board of Directors of ICL wishes to thank ICL's management, as well as the employees and managers of the various companies, for their dedicated and skilled contribution to the development of ICL and the achievement of its business results.

March 27, 2007

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Akiva Mozes	Yossi Rosen
CEO	Chairman of the Board