



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, 2005

This Directors' Report of Israel Chemicals Ltd. ("ICL" or "the Company") is presented as part of the Periodic Report for 2005, and assumes that the reader has before him the other parts of the Periodic Report.

ICL operates in four 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 2005, ICL Industrial Products was the world's leading manufacturer of bromine, producing about 35% of total global production. During this year, ICL Industrial Products used about 75% 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. The pure acid is used in the manufacture of downstream products of high added value – phosphate salts, food additives, hygiene products, phosphorus derivatives and fire 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. Regarding the acquisition of the operations and assets of Astaris, see section 2.3 below.
- **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, even where administrative division and legal ownership do not fully correspond.

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 2005 and the fourth quarter of 2005 include the results of the operations purchased from Astaris on 4 November, 2005 – see section 3.3 below.

| | 2005 | | 2004 | | 10-12/2005 | | 10-12/2004 | |
|--|-------------|------------|-------------|------------|-------------|------------|-------------|------------|
| | \$ millions | % of sales | \$ millions | % of sales | \$ millions | % of sales | \$ millions | % of sales |
| Sales | 2,986.0 | 100.0 | 2,715.0 | 100.0 | 775.0 | 100.0 | 746.5 | 100.0 |
| Gross profit | 1,140.7 | 38.2 | 937.1 | 34.5 | 265.5 | 34.3 | 264.7 | 35.5 |
| Operating income | 561.3 | 18.8 | 354.4 | 13.1 | 113.5 | 14.6 | 100.9 | 13.5 |
| Pre-tax income | 514.3 | 17.2 | 309.5 | 11.4 | 75.3 | 9.7 | 82.2 | 11.0 |
| Net income before extraordinary operations | 426.0 | 14.3 | 226.1 | 8.3 | 101.1 | 13.0 | 75.4 | 10.1 |
| Net income | 422.2 | 14.1 | 250.5 | 9.2 | 82.0 | 10.6 | 81.8 | 11.0 |
| Cash flow from current operations | 490.9 | | 429.9 | | 152.2 | | 163.7 | |
| EBITDA ^(*) | 734.3 | 24.6 | 521.8 | 19.2 | 163.5 | 21.1 | 147.2 | 19.7 |
| Investments | | | | | | | | |
| Purchase of shares of consolidated companies | 273.3 | | - | | 265.7 | | - | |
| Property, plant and equipment, less grants | 147.8 | | 120.8 | | 35.4 | | 40.2 | |
| Total | 421.1 | | 120.8 | | 301.1 | | 40.2 | |

(*) Calculated as follows in millions of dollars:

| | <u>2005</u> | <u>2004</u> | <u>10-12/2005</u> | <u>10-12/2004</u> |
|--|--------------|--------------|-------------------|-------------------|
| Net income | 422.2 | 250.5 | 82.0 | 81.8 |
| Depreciation and amortization | 166.0 | 166.3 | 43.8 | 47.2 |
| Net financing expenses | 10.2 | 38.2 | 7.1 | 11.4 |
| Income tax | 101.8 | 59.2 | 2.5 | (0.4) |
| Minority share in profit (loss) of included companies, net | (9.1) | 0.1 | (9.1) | 0.6 |
| Extraordinary or one-time expenses | <u>43.2</u> | <u>7.5</u> | <u>37.2</u> | <u>6.6</u> |
| | <u>734.3</u> | <u>521.8</u> | <u>163.5</u> | <u>147.2</u> |

1.2 Results of operations for the period January – December 2005

Sales

Sales of the ICL Group in the reporting period amounted to approximately \$2,986 million, compared with approximately \$2,715 million last year, an increase of approximately 10%.

The increase in the Group's sales reflects an increase in turnover in all the segments of the Group's operations, mainly as a result of price rises of many of the Company's products, as well as the purchase of the operations of Astaris. Conversely, there was a decrease in the quantities sold of some products.

Below is a breakdown of sales by geographical region:

| Sales CIF | 2005 | | 2004 | |
|-------------------|-------------|-------|-------------|-------|
| | \$ millions | % | \$ millions | % |
| Israel | 215.1 | 7.2 | 209.0 | 7.7 |
| North America | 390.0 | 13.1 | 312.6 | 11.5 |
| South America | 309.1 | 10.4 | 332.2 | 12.2 |
| Europe | 1,228.6 | 41.1 | 1,186.5 | 43.7 |
| Asia | 704.8 | 23.6 | 549.9 | 20.3 |
| Rest of the world | 138.4 | 4.6 | 124.8 | 4.6 |
| Total | 2,986.0 | 100.0 | 2,715.0 | 100.0 |

The breakdown of sales in 2005 shows a considerable increase in sales in Asia, and in its part in total revenue, due mainly to the increase in revenue from sales of bromine, bromine compounds and potash. The increase in North America's part was influenced mainly by the additional sales of ICL Performance Products following the acquisition of Astaris's operations. In South America, the decrease in income was due mainly to a decrease in fertilizers sold in Brazil, following the drought on southern Brazil, the strengthening of the local currency and other factors which worsened the situation of the farmers. In all other target markets of the Company, revenue increased.

Gross Profit

Gross profit amounted to approximately \$1,140.7 million, an increase of 21.7% compared with last year. The gross profit margin out of sales turnover for the year reached 38.2%, compared with 34.5% last year.

The increase in revenues as described above and the ongoing efficiency measures contributed to a rise in gross profit, despite increases in the prices of energy and in the prices of some raw materials. The prices of land transportation also rose, due mainly to the rise in the price of diesel fuel in Israel.

Gross profit is after one-time expenses amounting to \$11.3 million which are non-cash expenses, in respect of impairment of the value of inventory of ICL Metallurgy, and from one-time expenses deriving from the accounting treatment of the acquisition of the Astaris operation. Eliminating these expenses, gross profit amounts to approximately \$1,152 million, an increase of 22.9% compared with last year.

Sales and Marketing Expenses

Expenses amounted to approximately \$443.3 million, a decrease of about 0.4% compared with last year. Despite the negative effects of the rise in the prices of oil on the costs of transportation as a whole, the marine transportation costs of ICL Fertilizers actually decreased compared with last year, as a result of a fall in the bulk transportation tariffs during the year compared to the tariffs in 2004.

General and Administrative Expenses

These expenses totaled \$105.8 million, an increase of about 0.1% compared with the same period last year.

Research and Development Expenses

R&D expenses (net of grants from the Chief Scientist) amounted to approximately \$30.3 million, a decrease of about \$1.8 million compared with last year.

Operating income

Operating income increased by \$207.0 million compared with last year, reaching \$561.3 million. The increase derived mainly from the sharp increase in gross profit as shown above. The percentage of operating income is 18.8%, compared with 13.1% last year.

Operating income, net of one-time expenses as described above, reached \$572.6 million, an increase of 61.6% compared with last year.

Financing Expenses

Financing expenses amounted to about \$10.2 million, compared with \$38.2 million last year, a decrease of about \$28 million.

During the reporting period, the Company recorded income of approximately \$20.0 million from exchange rate differentials. In addition, net financing expenses were influenced by a decrease of approximately \$287 million in the average balance of net financial liabilities in the period, compared with last year. The effect of the decrease in the average debt balance on financing expenses was partially offset by the rise in the average dollar interest rates for the period by approximately 1.4% (140 points).

Other Expenses, Net

Other expenses offset by other income amounted to approximately \$36.8 million. This item consists mainly of the effect of the provision for impairment of the value of assets of the magnesium company, expenses in respect of changes in actuarial assumptions in the pension plan of a consolidated overseas company, as well as amortization of goodwill. Last year, other expenses offset by other income were approximately \$6.7 million, and included as income capital gains from sales of the Company's holdings in SQM and in Negev Industrial Minerals Ltd. and the sale of real estate in Be'er Sheva. Last year's expenses included expenses in respect of the Company's portion in the flood damages in Sdom (the insurance deductible), production facility write-offs, early retirement plans, and changes in actuarial assumptions in an overseas pension plan.

Tax expenses

These expenses amounted to approximately \$101.8 million, compared with \$59.2 million last year. The tax rate on pre-tax income increased from 19.8% to approximately 20.0%

In June 2004 the Knesset enacted an amendment to the Income Tax Law ("the 2004 Amendment"), prescribing a gradual lowering of the corporate tax rate from 36% to 30%. In July 2005 the Knesset amended the Income Tax Ordinance ("the 2005 Amendment"), which revised the corporate tax rates a second time, effective from January 1, 2006, so that in 2006 the corporate tax rate will be 31%, in 2007 – 29%, in 2008 – 27%, in 2009 – 26%, and from 2010 onwards – 25%.

As a result of these amendments, the income tax expenses charged to the results of operations in 2005 and 2004 decreased by approximately \$29 million and \$14 million, respectively.

The low tax rate last year derived mainly from the utilization of losses in respect of which no deferred taxes were generated in the past, and from differences between the measurement basis for tax purposes and the measurement basis of the financial statements.

For further details, see also Note 17 to the financial statements.

Net Income

Net income amounted to approximately \$422.2 million, compared with \$250.5 million last year, an increase of 68.5%.

Net income before extraordinary operations amounted to approximately \$426.0 million, compared with \$226.1 million last year, an increase of 88.4%.

1.3 **Results of operations for the period October - December 2005**

Sales

Sales of ICL Group in the quarter amounted to \$775 million, compared with \$746.5 million last year, an increase of about 3.8%.

The increase in Group sales derived from price rises and the contribution of the acquisition of the Astaris operations (consolidated since November 2005), which were offset by smaller quantities sold, mainly of potash. The weakening of the euro against the dollar, which

adversely affected revenues in dollar terms, also contributed somewhat to the decrease in income from sales.

Below is a breakdown of sales by geographical area:

| | 10-12/2005 | | 10-12/2004 | |
|-------------------|-------------|-------|-------------|-------|
| | \$ millions | % | \$ millions | % |
| Israel | 53.3 | 6.9 | 66.7 | 8.9 |
| North America | 147.4 | 19.0 | 104.1 | 13.9 |
| South America | 61.8 | 8.0 | 65.1 | 8.7 |
| Europe | 282.1 | 36.4 | 307.8 | 41.3 |
| Asia | 189.2 | 24.4 | 167.7 | 22.5 |
| Rest of the world | 41.2 | 5.2 | 35.1 | 4.7 |
| Total | 775.0 | 100.0 | 746.5 | 100.0 |

During the quarter, sales increased, as did the share in total turnover of North America (where sales increased by about 38.1%), and Asia (about 12.8%). The increase in North America derived mainly from the acquisition of the Astaris operations, which was offset by a decrease in sales of specialty chemicals and magnesium, whereas sales in Asia saw an increase in sales of potash (mainly to India) and bromine and bromine compounds.

The decrease in Europe was mainly the result of the weakening euro against the dollar, and a certain decrease in the sales of the fertilizer segment.

Gross Profit

Gross profit amounted to approximately \$265.5 million, similar to the gross profit last year (\$264.7 million).

Price rises, ongoing efficiency measures and the depreciation of the shekel against the dollar all contributed to the rise in gross profit. These effects were offset, however, mainly by the rise in energy prices, in the prices of some raw materials and a decrease in the production of some products.

Gross profit is after one-time expenses amounting to \$11.3 million which are non-cash expenses, in respect of impairment of the value of inventory of ICL Metallurgy, and from one-time expenses deriving from the accounting treatment of the acquisition of the Astaris operations. Eliminating these expenses, gross profit amounts to approximately \$276.8 million, an increase of 4.6% compared with the same period last year.

Sales and Marketing Expenses

These expenses amounted to approximately \$116.3 million, a decrease of about 7.1% compared with last year. The decrease was due mainly to a decrease in quantities sold of some products, as well as a decrease in the tariffs of bulk marine bulk transportation compared with the tariffs that prevailed in the fourth quarter of 2004.

Operating Income

Operating income amounted to approximately \$113.5 million, which is approximately 12.5% more than in the corresponding period last year. The percentage of operating income increased from 13.5% last year to 14.6% this year.

Operating income, net of one-time expenses as described above, reached \$124.8 million, an increase of 23.7% compared with the same period last year.

Financing Expenses

Financing expenses amounted to approximately \$7.1 million, compared with \$11.4 million last year.

During the reporting period, the Company recorded income of approximately \$3 million from exchange rate differentials. In addition, financing expenses were influenced by a decrease of approximately \$154 million in average net financial liabilities in the quarter compared with the same quarter in the prior year. The effect of the decrease in the average debt balance on financing expenses was partially offset by the rise in the average dollar interest rates for the period by approximately 1.5% (150 points).

Other Expenses, net

Other expenses, net, amounted to approximately \$31.2 million.

This item consists mainly of the effect of the write-off of assets in the magnesium company, expenses in respect of changes in actuarial assumptions in the pension plan of a consolidated overseas company and amortization of goodwill. Last year, other expenses, net, amounted to \$7.3 million and included, as revenues, capital gains from sales of the Company's holdings in SQM and in Negev Industrial Minerals Ltd. and from the sale of real estate in Be'er Sheva. Last year's expenses included expenses in respect of the Company's share in the flood damages in Sdom (the insurance deductible), production facility write-offs, early retirement plans, and changes in actuarial assumptions in an overseas pension plan.

Tax income/expenses

Tax expenses amounted to approximately \$2.5 million, comprising about 3.4% of pre-tax income. In the corresponding period in the prior year, the Company recorded a tax revenue of approximately \$0.4 million.

The low tax rate in the quarter derives mainly from taxable income at a zero tax rate in respect of "Approved Enterprises".

The tax income last year derived from a tax-exempt capital gain from the sale of a consolidated company, differences between the measurement basis for tax purposes and the measurement basis of the financial statements, and taxable income at zero percent in respect of "Approved Enterprises".

Net Income

Net income for the quarter amounts to approximately \$82.0 million, compared with approximately \$81.8 million last year.

Net income before extraordinary operations amounted to approximately \$101.1 million, compared with \$75.4 million in the same period last year, an increase of 34.1%.

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 by segment of operations | 2005 | | 2004 | | 10-12/2005 | | 10-12/2004 | |
|--|-------------|---------------------|-------------|---------------------|-------------|---------------------|-------------|---------------------|
| | \$ millions | % of total sales | \$ millions | % of total sales | \$ millions | % of total sales | \$ millions | % of total sales |
| ICL Fertilizers | 1,573.7 | 48.5 | 1,455.9 | 49.7 | 366.3 | 43.1 | 385.7 | 47.7 |
| ICL Industrial Products | 805.5 | 24.8 | 706.5 | 24.1 | 230.6 | 27.2 | 210.7 | 26.1 |
| ICL Performance Products | 677.0 | 20.9 | 582.5 | 19.9 | 206.0 | 24.3 | 153.1 | 18.9 |
| ICL Metallurgy | 102.8 | 3.2 | 88.2 | 3.0 | 21.4 | 2.5 | 23.1 | 2.9 |
| Others and setoffs | (173.0) | | (118.1) | - | (49.3) | - | (26.1) | - |
| Total | 2,986.0 | | 2,715.0 | | 775.0 | | 746.5 | |

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

| Operating income by segment of operations | 2005 | | 2004 | | 10-12/2005 | | 10-12/2004 | |
|---|-------|--------------------------|-------------|--------------------------|-------------|--------------------------|-------------|--------------------------|
| | 348.1 | % of segment sales | \$ millions | % of segment sales | \$ millions | % of segment sales | \$ millions | % of segment sales |
| ICL Fertilizers | 348.1 | 22.1 | 243.5 | 16.7 | 71.0 | 19.4 | 68.0 | 17.6 |
| ICL Industrial Products | 153.9 | 19.1 | 63.0 | 8.9 | 43.6 | 18.9 | 24.0 | 11.4 |
| ICL Performance Products | 55.0 | 8.1 | 47.0 | 8.1 | 4.9 | 2.4 | 8.9 | 5.8 |
| ICL Metallurgy | (9.0) | (8.7) | (3.3) | (3.7) | (9.5) | (44.5) | 0.2 | 0.7 |
| Others and setoffs | 13.3 | | 4.2 | - | 3.5 | | (0.2) | - |
| Total | 561.3 | 18.8 | 354.4 | 13.1 | 113.5 | 14.6 | 100.9 | 13.5 |

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 2005 amounted to approximately \$1,573.7 million, an increase of about 8.1% compared with last year. The increase in sales turnover derived mainly from higher prices for most of the segment's products, particularly potash, due to the ongoing rise in prices in the fertilizer market worldwide. The increase was partially offset by a decrease in quantities sold.

Operating income

Operating income in the segment amounted to approximately \$348.1 million, an increase of about 43% compared with 2004. The percentage of operating income out of sales was approximately 22.1%, compared with 16.7% last year.

The sharp increase derived mainly from the price rises described above. Conversely, an increase in various production costs, notably the costs of energy, moderated the positive effects of these price rises on operating income.

On average, bulk marine transportation prices were lower than last year. Nevertheless, the average cost of land transportation increased, mainly as a result of the rise in diesel fuel prices.

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 \$)

| | 2005 | 2004 | 10-12/2005 | 10-12/2004 |
|------------------|-------------|-------------|-------------------|-------------------|
| Revenue* | 1,064.1 | 932.3 | 247.2 | 264.2 |
| Operating income | 333.6 | 231.0 | 71.9 | 62.1 |

* Including revenue from inter-segment sales

The increase in sales revenue in 2005 compared with the prior year is the result of the ongoing rise in the prices of potash, which was offset by a decrease in quantities sold, particularly in the fourth quarter. The improvement in operating income, which increased in the reporting period by 44.4%, derives primarily from the rise in the selling prices.

Potash – Production and Sales (in thousands of tons)

| Thousands of tons | 2005 | 2004 | 10-12/2005 | 10-12/2004 |
|--|-------------|-------------|-------------------|-------------------|
| Production | 5,263 | 5,387 | 1,328 | 1,329 |
| Sales to external customers | 4,721 | 5,137 | 1,061 | 1,358 |
| Sales to internal customers | 252 | 280 | 58 | 56 |
| Total sales (including internal sales) | 4,973 | 5,417 | 1,119 | 1,414 |

Potash production in the fourth quarter of the year was at the same level as in the prior year, but cumulatively, a decrease of 124,000 tons was recorded compared with 2004. The lower cumulatively production is due to a decrease in production in Europe during the year, due, among other things, to production stoppages. Sales to external customers and for internal uses (mainly for the production of compound fertilizers) in the quarter were lower overall than in 2004 due to the decrease in sales in Brazil and Europe.

Brine percolation exists at one of the dikes of the evaporation ponds at the Dead Sea. After consultation with international experts, ICL Fertilizers has taken and is taking various maintenance actions to preserve the stability of the dike.

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 \$)

| Millions of dollars | 2005 | 2004 | 10-12/2005 | 10-12/2004 |
|----------------------------|-------------|-------------|-------------------|-------------------|
| Revenue* | 548.5 | 550.4 | 128.7 | 129.3 |
| Operating income | 15.4 | 12.9 | 0.3 | 6.0 |

* Including revenue from inter-segment sales.

Revenue in the quarter and in the whole of 2005 are similar to last year. The decrease in sales of fertilizers to Brazil was largely compensated by an increase in sales to other destination markets, and by a rise in the prices of most of the products compared with last year.

The increase in operating income for the year is the result of a rise in the selling prices, which was partially offset by an increase in the costs of energy and other inputs.

The decrease in operating income in the quarter derived mainly from a rise in the prices of inputs and energy, and a certain weakness in the prices of a few types of fertilizers.

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

| | 2005 | 2004 | 10-12/2005 | 10-12/2004 |
|------------------------------|-------------|-------------|-------------------|-------------------|
| <u>Phosphate rock</u> | | | | |
| Production | 3,236 | 3,290 | 686 | 981 |
| Sales* | 365 | 566 | 69 | 101 |
| <u>Fertilizers</u> | | | | |
| Production | 1,636 | 1,696 | 401 | 409 |
| Sales* | 1,671 | 1,664 | 403 | 323 |

* 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 decrease in production in the fourth quarter derived from the strategic change in the use of the different types of rock, which involved shutting down the calcining facility at the Zin site in the Negev.

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. In addition, sales of rock and phosphate fertilizers were adversely affected by the decrease in sales to Brazil, which was partially compensated by sales of fertilizers in Argentina and the U.S.A.

During the report period, ICL Fertilizers commenced the running-in of a plant at its site in Mishor Rotem, for the production of technical grade mono-ammonium phosphate (MAP), mainly for use as a soluble fertilizer.

2.2 ICL Industrial Products

Sales

Sales in this segment in the reporting period amounted to approximately \$805.5 million, an increase of about 14.0% compared with last year. The increase in sales 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.

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 during the year, which led to a decrease in quantities sold. The fourth quarter saw a recovery in the demand for flame retardants.

Revenue from inorganic bromine products increased for the period, particularly elementary bromine and clear brines, due mainly to the rise in demand for clear brines for the oil and gas industries, which was accompanied by a rise in prices.

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 in Europe and developing countries. Nevertheless, profitability of this product was not adversely affected.

In biocides for water treatment, revenue increased considerably as a result of greater quantities sold of bromine-based biocides and as a result of a rise in the prices of chlorine-based biocides following an anti-dumping levy imposed on imports to the U.S.A. from China and Spain.

Revenue from magnesia products in 2005 was similar to 2004, where price rises were offset by a decrease in sales quantities (particularly due to the deliberate reduction of sales of sintered magnesia to the refractory industry).

Revenue from sales of chlorine-based products from the Dead Sea (Dead Sea salts) increased compared with last year, due mainly price rises.

Regarding discussion of the Montreal Protocol and the latest regulation, see section 4.2.15 in the chapter " Periodic Report -Description of Corporate Activity in 2005".

Operating income

Operating income in the segment for the reporting period was approximately \$153.9 million, an increase of about 144.5% compared with last year.

The increase stemmed mainly from a rise in the segment's selling prices and continued efficiency operations, and was partially offset by a rise in the costs of production and overheads. Particularly noteworthy in this regard was the rise in the prices of some raw materials and in energy prices.

2.3 ICL Performance Products

Sales

Sales in this segment amounted to approximately \$677.0 million, an increase of about 16.2% compared with last year. The increase in turnover derives from the first-time consolidation of the Astaris operations in the fourth quarter, a rise in selling prices, increased sales quantities of some of the segment's product lines, and the acquisition of Adicor in July 2005. Adicor manufactures and supplies additives for the Brazilian food industry.

Conversely, the relatively low growth rates in Europe, the surplus production in some of the segment's markets, and intensifying competition in relevant markets which led to smaller quantities sold of some products, are still inhibiting growth in some of the segment's areas of operation.

Operating income

Operating income in the segment amounted to \$55.0 million, about 16.9% higher than last year. The margin was approximately 8.1%, similar to last year.

The increase in revenues described above, along with improvement in some operations throughout the period and particularly in phosphate salts, contributed to the increase in income. Conversely, an increase in the costs of major production inputs, especially the rise in the prices of raw materials and energy, partially offset the improved income. The recording of expenses from the merger of the Astaris operations, part of them one-time expenses, had an adverse effect on operating income, particularly in the fourth quarter.

Acquisition of Astaris operations and assets

On 4 November, 2005, an asset deal was closed for the acquisition by a company from the ICL Group of most of the business activities and assets, including working capital, of Astaris LLC, an American corporation which is a joint venture owned in equal parts by Solutia Inc

and FMC Corporation (American public companies). The amount paid for the operations and assets of Astaris, including acquisition expenses, is \$266 million (of which, \$68 million was paid in consideration of working capital). The amount in respect of the working capital is not final, and will be finally determined according to a mechanism prescribed in the agreement.

Astaris was a leading manufacturer and marketer of phosphate salts, phosphoric acid of various grades (technical, electronic and food), and phosphorus-based chemicals in North and South America, for industrial uses and for fire retardants. Astaris was established in 2000 by a transfer of existing operations of the owners of the joint venture. It employed about 570 employees, and its plants are in the U.S.A. and Brazil. Astaris products are used in the food, detergent and pharmaceutical industries, in traditional industry and in the semiconductor and flat-screen industries.

The consideration was determined in negotiations. ICL financed the acquisition from its own resources and from existing credit lines, and the Company does not foresee additional material investments being required following the acquisition.

ICL intends to integrate the acquired assets into ICL Performance Products, as part of increasing the share of higher value-added downstream products manufactured by the Company, while utilizing economies of scale and a mutual sharing of technological and application know-how. Astaris products complement the principal products of ICL Performance Products, which are food additives of high added value. This integration of Astaris with ICL Performance Products is both on the geographical level and on the application level.

Below are the principal financial data of the operation and assets acquired:¹

| (In millions of \$) | 2004 | 2005 | For the period from 4 November to 31 December, 2005 |
|--|-------|-------|---|
| Income | 350.9 | 377.1 | 56.8 |
| Gross profit | 40.1 | 66.9 | 3.3 |
| Operating income | 13.8 | 15.4 | (4.7) |
| Operating income before one-time expenses | 13.8 | 20.7 | 0.6 |

Gross profit and operating income of the operations acquired from Astaris for 2005 and for the period from 4 November to 31 December, 2005, are after non-cash one-time expenses, deriving from the accounting treatment of the acquisition, which amount to \$5.3 million. Regarding the expenses for the period November-December, we note also that since December is a month with partial activity due to the holiday season overseas, activity in that period is not representative of annual activity.

2.4 **ICL Metallurgy**

Sales

Sales in this segment amounted to approximately \$102.8 million, an increase of about 16.6% compared with last year.

The increase in sales derived mainly from a rise in selling prices of the various types of magnesium. In the third quarter there was a slightly downward trend in prices, which continued into the fourth quarter.

¹ The financial data for 2004 were derived from the audited financial statements of Astaris. The data were drawn up without the expenses of the operations not acquired and the liabilities not transferred. Financial data for 2005 (proforma) were drawn up to reflect the business operations and assets acquired for the entire year, and were derived from the financial statements of Astaris up to the date of the acquisition and from the audited results of the acquired operation.

Operating loss

The operating loss in the segment amounted to approximately \$9.0 million, compared with a loss of \$3.3 million last year. The increase in the loss derives mainly from a rise in the prices of some production inputs, and particularly from costs of energy and materials. In addition, amortization of the value of inventory due to falling prices as mentioned above, increased the loss in the fourth quarter.

Regarding the provision for impairment of the value of the assets of ICL Metallurgy, see section 4.4.1.b. of in the chapter "Periodic Report -Description of Corporate Activity in 2005".

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

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

In the reporting period, the net financial liabilities of the Group increased, and at the end of the period those liabilities amounted to \$600.0 million, up by \$31 million. The increase derives from the cost of acquiring the assets and operations of Astaris as described above, for \$266 million.

The Group's sources of financing are primarily long- and short-term loans from Israeli and international banks. On 4 March, 2005 the ICL Group completed an issue of \$125 million non-listed debentures to institutional investors abroad, for a period of 5 to 10 years (with an average repayment period of eight years), at a fixed average interest of 5.40%.

After completing the issue, ICL floated the interest rate of approximately \$ 100 million of these debentures by means of swaps. The floating interest generated by the swaps was between LIBOR + 0.7% (for 5 years) and LIBOR + 1.05% (for 10 years).

At the beginning of August 2005 a \$250 million syndication transaction was signed with 16 international banks (\$100 million loan + \$150 million long term credit facility) for a period of 5 years (bullet) and at LIBOR + 0.6% interest.

Cash flow

ICL's cash flow from ordinary operations in 2005 amounted to \$490.9 million, compared with \$429.9 million last year, an increase of approximately \$61 million. These amounts, plus the increase of approximately \$31 million in net debt as described above, were the principal sources of financing investments in fixed assets, the acquisition of Astaris and dividend payments.

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 \$500 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 asked in relation to the coverage offered does not justify purchasing this insurance. The company has ascertained that 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, allowing direct access to the international reinsurance market and the possibility of taking 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 retention in the following insurances: property, product liability and third party, credit, employers' liability in an overseas subsidiary, marine cargo and ecology. For ecology, the retention is \$5 million per occurrence and for all other insurances together there is also a limit on maximum annual exposure – in property insurance that limit is \$15 million and in the other insurances – \$2 million or less.

4. INVESTMENTS

In the reporting period, investments in property, plant and equipment net of investment grants amounted to approximately \$147.8 million, compared with investments in property, plant and equipment less grants amounting to \$120.8 million last year.

5. HUMAN RESOURCES

The total number of employees at ICL Group as at December 31, 2005 is 9,236, compared with 8,546 on December 31, 2004. The increase is mainly in the ICL Performance Products segment, due to the acquisition of the Astaris operations in the U.S.A. and Brazil, as well as other acquisitions in Brazil in the field of food additives.

Under a collective agreement signed in 1978 with the employees of the subsidiary Dead Sea Works ("DSW") of the ICL Fertilizers segment, an arrangement was made which regulates the early retirement of workers at the Sdom plant. Following the decision of the National Labor Court declaring that arrangement void, DSW negotiated with the Workers' Committee, as a result of which a collective agreement was signed on July 19, 2005, granting DSW workers in the Sdom plant to whom it applies, a right to early retirement from the age of 60, provided certain conditions are met.

6. MARKET RISK EXPOSURE AND MANAGEMENT

- 6.1 The CFO of ICL is responsible for managing the market risks to which ICL is exposed.
- 6.2 Regarding ICL's operations and its business environment as described in the preface to this report, ICL is exposed to the following principal 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. The ICL Group protects some marine transportation prices by means of long-term contracts. As at the date of this report, ICL does not hedge fuel oil prices.

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 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 in dollar of the consolidated overseas companies which use a functional currency other than the dollar do expose those companies to fluctuations in dollar exchange rates vis-à-vis the functional currency in which they operate.

ICL's exposure as aforesaid is measured after deduction of expenses in the sale currency and after deduction of surplus income over expenses in dollars of those companies whose measurement currency is not the dollar. ICL's policy is to hedge a considerable portion of this exposure by way of various financial instruments, including derivatives.

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. ICL does not hedge against this temporary exposure.

- 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 greater volume than the other currency exposures. ICL decides whether and to what extent to hedge this exposure in accordance with market conditions and forecasts of exchange rate developments.
- 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. ICL does not hedge against this exposure.
- 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. The Company does not hedge against this exposure.
- B.5. ICL has monetary assets and liabilities in non-dollar currencies or in currencies which are not linked to the dollar, which are adjusted compared with the 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 currencies create exposure. The Company's policy is to hedge against (most of) this exposure by means of financial instruments, including derivatives.
- 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. The Company does not hedge against this exposure.

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, 2005, ICL has cap options to secure a LIBOR interest ceiling of 3% – 4%, which cover, as at December 31, 2005 and December 31, 2004, a notional amount of \$130 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, 2005, the options cover a notional amount of \$376 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 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.
- 6.4 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. The finance committees of ICL's companies receive quarterly reports for discussion of the quarterly results, as a control device for application of the policy and for its revision if necessary. The managements of the companies apply the policy with reference to actual developments and to expectations in the various markets.
- 6.5 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 results of the hedging transactions on existing assets and liabilities and on solid commitments for the results of the assets and liabilities which they protect. The financial results of all other hedging transactions are charged to financing expenses.

6.6 Linkage Base Report

Hereunder the linkage terms of monetary balances:

Composition as at December 31, 2005 (in thousands of dollars)

| | Dollar-linked | Non-dollar currency (mainly euro)* | CPI-linked | Unlinked | Non-monetary | Total |
|--|---------------|---------------------------------------|------------|----------|--------------|--------------------------|
| Assets: | | | | | | |
| | | | | | | <u>In shekels</u> |
| Current (including the current portion of long-term assets) | 393,937 | 183,155 | 7,107 | 88,375 | 714,778 | 1,387,352 |
| Non-current | 504 | 16,069 | 13,272 | 4,477 | 1,918,749 | 1,953,071 |
| Liabilities: | | | | | | |
| Current (including the current portion of long-term liabilities) | 384,561 | 256,875 | - | 255,536 | 158 | 897,130 |
| Long term | 381,853 | 230,825 | 5,857 | 138,435 | 1,686,323 | 2,443,293 |
| Total balance-sheet balance, net | 371,973 | 288,476 | 14,522 | 301,119 | 947,046 | |

* Including autonomous units reporting in euros whose euro liabilities do not generate exposure.

6.7 Derivative Positions

Here are the details on this subject

| Hedging transactions against the effects of changes in exchange rates on cash flows – In thousands of dollars | | | | | | | | |
|--|---|--------------|---------------------------|--------------|--------------------------------------|--------------|---------------------------|--------------|
| | Nominal Value Up to One Year | | | | Fair Value Up to One Year | | | |
| | Long | | Short | | Long | | Short | |
| <u>Direction of transaction in derivatives is dollar purchase.</u> | | | | | | | | |
| Currency: Euro/dollar in \$ '000s | | | | | | | | |
| <u>FORWARD</u> | | | | | | | | |
| Setoff recognized for accounting | 12,300 | | | | -50 | | | |
| Setoff not recognized for accounting | 28,000 | | | | 487 | | | |
| <u>Put Options</u> | | | | | | | | |
| Setoff recognized for accounting | 87,680 | | 22,634 | | 3,700 | | -1,250 | |
| <u>Call Options</u> | | | | | | | | |
| Setoff recognized for accounting | 88,880 | | 22,664 | | -711 | | 86 | |
| Currency: JPY/dollar in \$ 000s | | | | | | | | |
| <u>FORWARD</u> | | | | | | | | |
| Setoff recognized for accounting | | | | | | | | |
| <u>Put Options</u> | | | | | | | | |
| Setoff recognized for accounting | 10,100 | | | | 428 | | | |
| <u>Call Options</u> | | | | | | | | |
| Setoff recognized for accounting | 10,100 | | | | -40 | | | |
| Currency: GBP/dollar in \$ 000s | | | | | | | | |
| <u>FORWARD</u> | | | | | | | | |
| Setoff recognized for accounting | | | | | | | | |
| <u>Put Options</u> | | | | | | | | |
| Setoff recognized for accounting | 2,800 | | | | 169 | | | |
| <u>Call Options</u> | | | | | | | | |
| Setoff recognized for accounting | 2,800 | | | | 13 | | | |
| <u>Direction of transaction in the derivatives is purchase of GBP</u> | | | | | | | | |
| Currency: GBP/euro in \$ 000s | | | | | | | | |
| <u>FORWARD</u> | | | | | | | | |
| Setoff recognized for accounting | 6,294 | | | | 215 | | | |
| Currency: Shekel/dollar in \$ 000s | | | | | | | | |
| <u>Put Options</u> | | | | | | | | |
| Setoff recognized for accounting | | | 175,880 | | | | -901 | |
| <u>Call Options</u> | | | | | | | | |
| Setoff not recognized for accounting | | | 112,750 | | | | 1,368 | |
| 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 | |
| | Long | Short | Long | Short | Long | Short | Long | Short |
| Swap | | | | 106,000 | | | | -1,633 |
| Caps | 26,000 | | 480,000 | | | | 5,111 | |
| Floors | 26,000 | | 350,000 | | | | -88 | |

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 directive 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.

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 a skilled and professional member, 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 of the twelve members of the board of the Company, ten 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 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 Di'ur 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 Widman 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. Widman has a B.A. in economics and an MBA (major: finance).

Avishar 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 1995 to 1998 he was CEO of ICL, and prior to that he was Chairman of an ICL subsidiary.

Ben-Zion Rabinovitz is an outside director of ICL. He serves and has served as a director of many public and private companies and public corporations. He has held managerial and advisory positions in various holding companies in Israel and abroad. Mr. Rabinovitz has a B.Sc. in chemistry and physics and an MBA (major: financing and operations research).

Gilad Shavit, currently Deputy CEO of the parent company – Israel Corporation, was formerly the CEO of a company controlled by the parent company. He has held managerial positions in a public company and at ICL. Mr. Shavit has a B.A. in economics and an MBA.

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 commitments

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.

The environment

The ICL Group manufactures fertilizers and chemical products and is therefore exposed, in the normal 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 foreseen 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.

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 Fees of the auditing accountant

In 2005 the ICL Group recorded the following expenses in respect of auditing services, services associated with the audit and tax advice services: Kesselman & Kesselman, CPA – \$1,542 thousand, Somech Haikin, CPA – \$2,025 thousand. For other services in 2005 the Group recorded the following amounts: Kesselman & Kesselman, CPA – \$802 thousand, and Somech Haikin, CPA – \$22 thousand. These other services included advice and due diligence in connection with acquisitions.

7.4 Peer review

On July 28, 2005, a directive was published by the Securities Authority requiring public companies to disclose grant of consent for the performance of a "peer review", the purpose of which, according to the directive, is to commence a process of monitoring the performance of auditing accountants and compliance with the requisite procedures during their auditing work. The rationale behind the directive is the enhancement of the capital market. The Board of Directors of the Company, on the recommendation of its Management, approved the Company's participation in the peer review.

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.

ICL recently 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.

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.

- a. **The name of the internal auditor in the corporation:** Shlomo Ben-Shimol, CPA.
Mr. Ben-Shimol is a qualified internal auditor (CIA) of the International Internal Auditors Association, an auditing partner in Breitman Almagor & Co. – Deloitte, a member of the Israel Association of Internal Auditors. He was appointed as internal auditor of the Group in May 2005. The internal auditor provides internal auditing services by outsourcing on behalf of Breitman Almagor & Co. – Deloitte.
- b. **Scope of work of the internal auditor:** The internal audit function of the Group comprises 10 annual positions (including about 2 outsourced annual positions). In addition, occasional internal auditing tasks are undertaken by outsourcing (including in other countries), which are supervised by the internal auditors of the Group.
- c. **The considerations in determining the annual and multi-year internal audit plan:**
As part of the strategic plan of the internal audit, a review was carried out in 2005 for analysis of the risks which served as the basis for an annual and multi-year plan for the years up to 2008 inclusive. Dozens of senior managers at Group headquarters and in the segments participated in the review, which defined important processes at the organization level, characterized risk exposure and gave assessments for levels of exposure to those risks. Based on the results of the risk analysis, priorities were determined for the internal audit of subjects that would be examined in the Group in the coming years. The risk analysis review and its results were discussed in the Audit Committee, which then approved the subjects listed in the annual and multi-year work plan.

Regarding corporations which are material holdings of the Company: The internal audit plan encompasses corporations which are material holdings of the Group.
- d. **The professional standards which guide the internal auditing work:** The internal auditor's notice states that internal audits are carried out in accordance with accepted professional internal auditing standards, professional directives and briefings as approved and published by the Israel Association of Internal Auditors. In addition, internal auditing work is carried out on the basis of service standards prescribed by global Deloitte firm.
- e. **The organizational superior of the internal auditor:** The Chairman of the Board of the Company.
- f. **Dates for submitting internal audit reports:** In 2005 the audit committees of the Company and the segments convened 17 times to discuss audit reports. The internal auditor attended meetings of ICL's audit committee on August 22, November 21 and December 16, 2005.
- g. **The scope, character and continuity of the activity and the work plan of the internal auditor:** The Board of Directors believes that the scope of the internal audit work, the continuity of action and the work plan of the internal auditor, are sufficient in the circumstances, and can realize 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.
- h. **Free access for the internal audit:** The internal audit staff is given free, constant and direct access to the information systems of the corporation, including financial and other data.

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- i. **The number of reports written in the group during the financial year:** During 2005, 97 reports were distributed in the Group's segments and headquarters.

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 2005 amounted to approximately NIS 8.4 million (about NIS 1.8 million) – 30% more than in 2004. 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, to 33 clubs at the end of 2005, 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.

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 33, ICL companies donated about NIS 1.24 million directly to the clubs, compared with NIS 735,000 last year, as well as thousands of volunteer hours donated by employees.

9.2 Initiatives and response to various issues

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 and the other half will be paid in 2006.

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. The announcement of the construction of the home was made in February 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. 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.

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, "Aluaha" for the Bedouin population in the Negev which assists in medical matters, the Bat Dor Dance Company for children in Be'er Sheva, the scout movement in Dimona, 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 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 The annual general meeting of the shareholders of the Company on May 30, 2005 resolved, among other things, to re-appoint Yossi Rosen, Haim Erez, Moshe Vidman, Muhammad Dahleh, Noga Yatziv, Avisar Paz and Amnon Sadeh as directors of the Company, and to retain the services of the outside directors. On February 6, 2006, Idan Ofer ceased to serve as director in the Company, and on the same day, the Board of Directors of ICL appointed Gilad Shavit to replace him. At a special meeting of the shareholders on January 26, 2006, Irit Izakson and Avraham (Beiga) Shohat were appointed as additional directors in the Group.
- 10.2 On May 1, 2005, Shlomo Ben-Shimol, CPA, a partner in Breitman Almagor Deloitte and internal auditor in various companies, took up his position as internal auditor of the Company.
- 10.3 On March 28, 2005, the Company decided on a reward plan for senior managers – see section 5. 2 in the "Periodic Report -Description of Corporate Activity in 2005.
- 10.4 On April 20, 2005 the Company distributed a dividend on approximately \$35.7 million, and on September 21, 2005 the Company distributed a dividend of approximately \$59.7 million.
- 10.5 Regarding acquisition of the Astaris operation and assets – see section 2.3 above.

10.6 On August 4, 2005 the desalination plant in Ashkelon started operation. The plant was erected by V.I.D. under a BOT agreement with the State of Israel for the erection and operation of a facility that will supply 100 million cubic meters of water per year for 25 years.

V.I.D. is owned by I.D.E. Technologies (50%) and other partners. I.D.E. is jointly controlled by ICL and the Delek Group.

11. EVENTS AFTER THE BALANCE SHEET DATE

11.1 On January 25, 2006, a special meeting of the shareholders resolved to appoint KPMG Somech Haikin & Co. as joint auditing accountants for 2005, together with PwC Kesselman & Kesselman.

11.2 On March 27, 2006 the Company decided on a reward plan for senior managers – see section 5.2 in the "Periodic Report -Description of Corporate Activity in 2005.

11.3 On March 27, 2006 the Company decided on the distribution of a dividend of approximately 90 million dollars. The dividend will be distributed on May 9, 2006.

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, 2006

Akiva Mozes
CEO

Yossi Rosen
Chairman of the Board