

AVGOL INDUSTRIES 1953 LTD.

FINANCIAL STATEMENTS AS ON DECEMBER 31, 2010

U.S. Dollars

AVGOL INDUSTRIES 1953 LTD.

Financial Statements

Table of Contents

	<u>Page</u>
Auditors' Report to the Shareholders	2-3
<u>The Financial Statements in U.S. dollars</u>	
Consolidated statements of financial position	4
Consolidated statements of income	5
Consolidated statements of comprehensive income	6
Consolidated statements of changes in equity	7
Consolidated statements of cash flows	8-9
Notes to the consolidated financial statements	10-83

AVGOL INDUSTRIES 1953 LTD.**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

	Note	As on December 31	
		2010	2009
		USD thousands	USD thousands
<u>CURRENT ASSETS</u>			
Cash and cash equivalents		17,035	13,234
Trade receivables	4	40,681	30,622
Other accounts receivable and debit balances	5	11,999	13,413
Current income taxes receivable	32	3	425
Derivatives	10	5,163	3,691
Inventories	6	35,321	27,834
Total current assets		<u>110,202</u>	<u>89,219</u>
<u>NON-CURRENT ASSETS</u>			
Fixed assets, net	8,9	214,287	(*)189,714
Derivatives	10	14,156	13,442
Deferred tax assets	32	351	1,500
Intangible assets	19	1,468	-
Long-term debit balances	9,11	5,310	(*) 966
Total non-current assets		<u>235,572</u>	<u>205,622</u>
Total assets		<u>345,774</u>	<u>294,841</u>
<u>CURRENT LIABILITIES</u>			
Short-term credit from banking corporations and others	12	25,260	14,017
Current maturities of long-term bonds	16	18,381	17,327
Trade payables	13	37,541	23,548
Current income taxes payable	32	3,313	71
Other accounts payable and credit balances	14	6,056	6,643
Total current liabilities		<u>90,551</u>	<u>61,606</u>
<u>NON-CURRENT LIABILITIES</u>			
Long-term loans from banking corporations and others	15	66,623	46,081
Bonds	16	60,093	72,136
Employee benefit liabilities	18	276	465
Deferred tax liabilities	32	19,228	17,452
Total non-current liabilities		<u>146,220</u>	<u>136,134</u>
<u>EQUITY</u>			
Share capital	22	41	41
Share premium		51,678	51,637
Capital reserves		4,945	4,371
Surpluses		46,169	33,685
Equity attributable to equity holders of the parent company		102,833	89,734
Noncontrolling interests		6,170	7,367
Total equity		<u>109,003</u>	<u>97,101</u>
Total liabilities and equity		<u>345,774</u>	<u>294,841</u>

(*) after retrospective implementation of a change in accounting policy – see note 2.BB (1)

March 23, 2011

**Approval date of the
financial statements**

**Joshua Goldwasser
Chairman of the Board**

**Shlomo Liran
C.E.O.**

**Shachar Rachim
C.F.O.**

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

AVGOL INDUSTRIES 1953 LTD.**CONSOLIDATED STATEMENTS OF INCOME**

	Note	For the year ended December 31		
		2010	2009	2008
		USD thousands	USD thousands	USD thousands
Revenue from sales	24	277,528	211,250	254,213
Cost of sales	25	217,286	162,157	207,419
Gross profit		60,242	49,093	46,794
Research and development expenses	26	2,403	2,103	2,753
Selling and marketing expenses	27	13,840	10,681	12,776
Administrative and general expenses	28	8,464	7,154	5,357
Income from ordinary operations		35,535	29,155	25,908
Financing expenses	29	(9,073)	(8,086)	(8,912)
Financing income	30	548	253	1,651
Other income (expenses), net	31	829	576	(4,750)
Income before taxes on income		27,839	21,898	13,897
Taxes on income	32	(6,853)	(6,344)	(3,874)
Income for the year		20,986	15,554	10,023
Attributable to:				
Equity holders of the parent company		20,260	15,468	10,023
Non-controlling interests		726	86	-
		20,986	15,554	10,023
Net earnings per share (in USD)				
Basic earnings		0.068	0.052	0.034
Diluted earnings		0.068	0.052	0.034
Weighted average of the share capital used to calculate earnings per share				
Basic		297,853,595	297,853,595	297,853,595

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

AVGOL INDUSTRIES 1953 LTD.**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	For the year ended December 31		
	2 0 1 0	2 0 0 9	2 0 0 8
	USD thousands	USD thousands	USD thousands
Income for the year	20,986	15,554	10,023
Other comprehensive income:			
Gains (losses) from cash-flow hedges, net of tax	(784)	2,028	291
Gain from revaluation in respect of a step acquisition, net of tax	-	1,658	-
Translation differences in respect of foreign operations	1,730	(54)	122
Other comprehensive income for the year, net of tax	946	3,632	413
Total comprehensive income for the year	21,932	19,186	10,436
Attributable to:			
Equity holders of the parent company	20,861	19,076	10,436
Non-controlling interests	1,071	110	-
	21,932	19,186	10,436

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

AVGOL INDUSTRIES 1953 LTD.**STATEMENTS OF CHANGES IN EQUITY**

	Share capital	Share premium	Capital reserve for transactions with non-controlling interest	Capital reserve for translation differences of foreign operations	Capital reserve for cash-flow hedges	Revaluation reserve for step acquisition	Capital reserve for share-based payments	Surpluses	Total attributable to equity holders of the parent company	Non-controlling interests	Total equity
	אלפי דולר										
Balance as on January 1, 2008	41	50,989	-	350	-	-	-	25,194	76,574	-	76,574
Income for the year	-	-	-	-	-	-	-	10,023	10,023	-	10,023
Other comprehensive income for the year	-	-	-	122	291	-	-	-	413	-	413
Dividend paid	-	-	-	-	-	-	-	(10,000)	(10,000)	-	(10,000)
Tax benefit in respect of a share-based payment	-	9	-	-	-	-	-	-	9	-	9
Tax benefit in respect of issue expenses	-	339	-	-	-	-	-	-	339	-	339
Balance as on December 31, 2008	41	51,337	-	472	291	-	-	25,217	77,358	-	77,358
Movement in 2009:											
Income for the year	-	-	-	-	-	-	-	15,468	15,468	86	15,554
Other comprehensive income for the year	-	-	-	(78)	2,028	1,658	-	-	3,608	24	3,632
Dividend paid	-	-	-	-	-	-	-	(7,000)	(7,000)	-	(7,000)
Business combination achieved in stages	-	-	-	-	-	-	-	-	-	7,659	7,659
Acquisition of shares from non-controlling interest in a consolidated company	-	-	-	-	-	-	-	-	-	(402)	(402)
Tax benefit in respect of a share-based payment	-	100	-	-	-	-	-	-	100	-	100
Tax benefit in respect of issue expenses	-	200	-	-	-	-	-	-	200	-	200
Balance on December 31, 2009	41	51,637	-	394	2,319	1,658	-	33,685	89,734	7,367	97,101
Movement in 2010:											
Income for the year	-	-	-	-	-	-	-	20,260	20,260	726	20,986
Other comprehensive income for the year	-	-	-	1,385	(784)	-	-	-	601	345	946
Dividend paid	-	-	-	-	-	-	-	(8,000)	(8,000)	-	(8,000)
Transfer of a reserve for step acquisition to surpluses	-	-	-	-	-	(224)	-	224	-	-	-
Acquisition of shares from non-controlling interest in a consolidated company	-	-	(261)	-	-	-	-	-	(261)	(2,268)	(2,529)
Tax benefit in respect of a share-based payment	-	41	-	-	-	-	-	-	41	-	41
Share-based payment	-	-	-	-	-	-	458	-	458	-	458
Balance as on December 31, 2010	41	51,678	(261)	1,779	1,535	1,434	458	46,169	102,833	6,170	109,003

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

AVGOL INDUSTRIES 1953 LTD.**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	For the year ended December 31		
	2 0 1 0	2 0 0 9	2 0 0 8
	USD thousands	USD thousands	USD thousands
<u>Cash flows from operating activities</u>			
Income for the year according to Statement of Income	20,986	15,554	10,023
Adjustments to reconcile cash flows provided by operating activities (Appendix A)	14,879	18,052	(*)1,290
Net cash provided by operating activities	<u>35,865</u>	<u>33,606</u>	<u>(*)11,313</u>
<u>Cash flows from investment activities</u>			
Investment in fixed assets	(35,137)	(34,351)	(6,084)
Initial consolidation of subsidiary in China	-	70	-
Purchase of intangible assets	(1,468)	-	-
Proceeds from sale of fixed assets	-	130	17
Net cash used in investment activities	<u>(36,605)</u>	<u>(34,151)</u>	<u>(6,067)</u>
<u>Cash flows from financing activities</u>			
Increase (decrease) in short-term credit from banking corporations, net	4,701	(24,149)	22,789
Repayment of long-term loans from banking corporations	(18,463)	(10,547)	(14,357)
Receipt of long-term loans from banking corporations and others	45,000	30,000	-
Payment of liabilities to fixed asset suppliers	-	(174)	(5,758)
Proceeds from issue of bonds to public (net of issues expenses)	-	36,668	-
Proceeds from payment of derivatives	880	-	-
Repayment of bonds to the public	(16,327)	(16,401)	-
Expenses in obtaining long-term loans	-	(287)	-
Acquisition of shares from non-controlling interests	(2,931)	-	-
Dividend paid	(8,000)	(7,000)	(10,000)
Net cash, provided by (used in) financing activities	<u>4,860</u>	<u>8,110</u>	<u>(7,326)</u>
Increase (decrease) in cash and cash equivalents	4,120	7,565	(2,080)
Balance of cash and cash equivalents at the beginning of the year	13,234	5,722	7,663
Effect of exchange rate differences on cash balances held in foreign currency	(319)	(53)	139
Balance of cash and cash equivalents at the end of the year	<u>17,035</u>	<u>13,234</u>	<u>5,722</u>

(*) after retrospective implementation of a change in accounting policy – see note 2.BB (2)

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

AVGOL INDUSTRIES 1953 LTD.**APPENDICES TO THE CONSOLIDATED STATEMENTS OF CASH FLOWS****Appendix A – Adjustments required to present cash flows from operating activities**

	For the year ended December 31		
	2 0 1 0	2 0 0 9	2 0 0 8
	USD thousands	USD thousands	USD thousands
Expenses (income) not involving cash flows:			
Depreciation and amortization	15,739	13,148	11,462
Capital gain from sale of fixed assets	-	(2)	(4)
Reconciliation of assets and liabilities, net	4	4	2,094
Increase in deferred taxes, net	3,161	1,899	1,040
Increase (decrease) in liabilities for severance pay, net	(189)	(74)	157
Accrued financing expenses in respect of bonds	1,293	844	4,299
Increase in the fair value of derivatives at fair value through profit and loss	-	-	(3,234)
Payments relating to an attempt to acquire a company	-	-	(*) (4,729)
Share-based payments	458	-	-
Changes in asset and liability items, net:			
Decrease (increase) in trade receivables	(9,877)	7,024	1,398
Increase in other accounts receivable and debit balances	(2,149)	(7,257)	(5,666)
Decrease (increase) in inventories	(7,333)	3,017	(3,470)
Increase (decrease) in trade payables	10,743	132	(4,183)
Increase (decrease) in other accounts payable and credit balances	3,029	(683)	2,126
	<u>14,879</u>	<u>18,052</u>	<u>(*) 1,290</u>

	For the year ended December 31		
	2 0 1 0	2 0 0 9	2 0 0 8
	USD thousands	USD thousands	USD thousands
Interest paid	<u>7,155</u>	<u>7,852</u>	<u>7,399</u>
Taxes paid	<u>4,226</u>	<u>4,744</u>	<u>6,404</u>
Taxes received	<u>3,913</u>	<u>1,236</u>	<u>-</u>

(*) after retrospective implementation of a change in accounting policy – see note 2.BB (2)

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

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 – GENERAL

- A.** The Company is a holding company, which wholly owns Avgol Ltd. (hereinafter – “Avgol Israel”). The Company’s registered office is located in Tel-Aviv. The Company’s securities are listed for trading on the Tel-Aviv Stock Exchange.

The Company and its investee companies (hereinafter – “the Group”) engage in the manufacture, marketing and sale of nonwoven fabrics, which are used mainly for the manufacture of hygiene products (mainly disposable diapers for infants and adults, and feminine hygiene products), and for the manufacture of products used in diverse applications (agriculture, furniture and upholstery, construction, apparel, disposable towelettes and more). The Group sells mainly in North America, Europe, Eastern Europe and the Far East.

Correct to the approval date of the financial statements, the Group has 12 production lines, including an additional production line in China, which began operating during the reporting period. The total investment in the line was approximately USD 42 million.

B. Definitions:

- | | |
|---------------------------------------|--|
| The Company | – Avgol Industries 1953 Ltd. |
| The Group | – The Company and its consolidated companies. |
| Related Parties | – As defined in IAS 24. |
| Interested Parties | – As defined in the Securities Law, 5728 – 1968, including the Securities Regulations. |
| Controlling Shareholder | – As defined in the Securities Regulations (Annual Financial Statements), 5770 – 2010. |
| CPI | – Consumer Price Index, as published by the Israel Central Bureau of Statistics. |
| USD | – U.S. dollar. |
| EUR | – Currency of the European Union. |
| CNY | – Local currency in China – Yuan Renminbi. |
| RUB | – Local currency in Russia – rouble. |
| Consolidated Companies | – Companies that are controlled by the Company (as defined in IAS 27), directly or indirectly, whose accounts are fully consolidated with those of the Company. |
| Companies under Common Control | – Companies held by various entities that have a contractual arrangement for common control, and whose accounts are consolidated with those of the Company using the proportionate consolidation method. |
| Investee Companies | – Subsidiaries, including Companies under Common Control. |

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

A. Application of International Financial Reporting Standards (IFRS):

Declaration regarding application of IFRS

The Group's consolidated financial statements have been prepared in conformity with the International Financial Reporting Standards (hereinafter – "IFRS") and clarifications thereto, which were pronounced by the International Accounting Standards Board (IASB). The significant accounting policies specified hereunder were applied consistently in relation to all reporting periods presented in these consolidated financial statements, except for accounting policy amendments deriving from the application of the standards, amendments to standards and interpretations that came into effect at the time of the financial statements, as specified in note 2.BB.

B. These financial statements have been prepared in conformity with the Israeli Securities Regulations (Annual Financial Statements), 5770 – 2010 (hereinafter – "Financial Statements Regulations").

C. The Group's operating turnover period is 12 months.

D. Basis of preparation of the financial statements:

These financial statements have been prepared on the basis of the historic cost, except in relation to the following assets and liabilities –

- The following assets and liabilities are measured according to their fair value: derivatives.
- Inventories, which are stated at cost or net realizable value, whichever is lower.
- Fixed assets, which are stated at cost, less accumulated depreciation, or at the recoverable amount, whichever is lower.
- Employee benefit liabilities (see note 18).

E. Foreign currency:

(1) Functional currency and presentation currency

The financial statements of each of the companies of the Group are prepared in the currency that best reflects the principal economic environment in which each company operates (hereinafter – "Functional Currency"). For the purpose of consolidating the financial statements, the results and financial position of each of the companies of the Group are stated in USD, which is the Company's Functional Currency. The Company's consolidated financial statements are stated in USD. Regarding the currency exchange rates and the fluctuations in them during the reporting periods, see Note 2.AA hereunder.

(2) Translation of transactions in currencies other than the Functional Currency

When preparing the financial statements of each of the companies of the Group, transactions executed in currencies other than the Functional Currency of that company (hereinafter – "Foreign Currency") were recorded according to the exchange rates in effect on the transaction closing dates. At the end of the reporting period, monetary items quoted in Foreign Currency are translated according to the exchange rates in effect at that time; nonmonetary items measured at fair value and quoted in Foreign Currency are translated according to the exchange rates on the date the fair value was determined; nonmonetary items measured in terms of the historic cost are translated according to the exchange rates in effect when the transaction relative to that nonmonetary item was executed.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

E. Foreign currency: (continued)

(3) Method of recording exchange-rate differentials

Exchange rate differentials are recognized in the statement of income in the period in which they derived, except in the following instances:

- Exchange-rate differentials relating to assets under construction for the purpose of future manufacturing use, which are included in the cost of those assets when they refer to adjustment of the interest costs on credit in Foreign Currency.
- Exchange rate differentials in respect of transactions intended to hedge against particular Foreign Currency risks.
- Exchange rate differentials in respect of monetary items receivable or payable from a foreign operation (the settlement of which is not planned or expected to occur, and which, therefore, constitute part of the net investment in the foreign operation) are recognized in the statement of equity under the item “capital reserve for translation differences of foreign operations” and shall be recognized in the statement of income when the net investment in the foreign operation is realized.

(4) Translation of financial statements of Investee Companies whose Functional Currency is other than the USD

For the purpose of the presentation of the consolidated financial statements, assets and liabilities of foreign operations, including allocated excess costs, are stated according to the exchange rates in effect at the end of the reporting period. Income and expense items are translated according to the average of the exchange rates during the reporting period, unless significant fluctuations occurred in the exchange rates during that period. In such instance, these items are translated according to the exchange rates on the transaction closing dates, and the related translation differences are recognized in comprehensive income under “translation differences of foreign operations.” These translation differences are reclassified to profit and loss on disposal of the foreign operation in respect whereof the translation differences were created.

F. Cash and cash equivalents:

Cash and cash equivalents include deposits for withdrawal on demand and fixed-term deposits having no use restrictions, which were deposited for a period not exceeding three months from the date of deposit.

G. Consolidated financial statements:

(1) General

The consolidated financial statements of the Group include the financial statements of the Company and of entities controlled by the Company, whether directly or indirectly. Control is achieved when the Company has the power to govern the operating and financial policies of an Investee Company for the purpose of gleaning benefits from its operations.

The results of operations of subsidiaries acquired or sold during the reporting period are included in the Company’s consolidated statements of income as of the date on which control was achieved and ends when such control ceases, as the case may be.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

G. Consolidated financial statements: (continued)

(1) General (continued)

Financial statements of Consolidated Companies that are prepared other than according to the accounting policy of the Group are adjusted, prior to consolidation, to the accounting policy applied by the Group.

For the purpose of consolidation, all intercompany transactions, balances, income and expenses are completely eliminated.

(2) Non-controlling interest

The non-controlling interests' share in net assets (excluding goodwill) of consolidated subsidiaries is presented separately under the equity of the Group. The non-controlling interests include the total of these rights on the date of the business combination (see hereunder) as well as the noncontrolling interests' share in changes that occurred in the consolidated company's equity subsequent to the date of the business combination.

Losses of Consolidated Companies attributed to the non-controlling interests that exceed the non-controlling interests in the equity of the Consolidated Company are allocated to non-controlling interests, while disregarding the obligations and ability of those interests to invest additional sums in the Consolidated Company.

Results of transactions with non-controlling interests that relate to realization of a portion of the Group's investment in a Consolidated Company, while retaining control thereof, are allotted to equity attributable to equity holders of the parent company.

In relation to transactions with non-controlling interests that relate to the acquisition of an additional portion of a Consolidated Company, subsequent to the date on which control was achieved, the purchase cost in excess of the carrying amount of the non-controlling interests on the acquisition date is allocated to equity attributable to equity holders of the parent company.

(3) Loss of control

Upon the loss of control of a Consolidated Company, the Company recognizes any gain or loss at the height of the difference between the aggregate value of the consideration received and the fair value of any retained investment in the former Consolidated Company, and the carrying amount of the assets, liabilities and non-controlling interests in the former Consolidated Company. The fair value of any retained investment in the former Consolidated Company is deemed the fair value at the time of the initial recognition of a financial asset, or cost at the time of the initial recognition of an Investee Company or an Entity under Common Control.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

H. Business combinations:

Acquisitions of operations and Consolidated Companies that constitute a business combination are accounted for by applying the acquisition method. The cost of the business combination is measured as the aggregate fair value (on the swap date) of the assets transferred, the liabilities incurred and the equity instruments issued by the Group in consideration for achieving control over the acquiree, the fair value of the Group's holdings of the acquiree prior to the business combination.

Transaction costs directly relating to the business combination are allocated to profit and loss as an expense when incurred.

The acquiree's identifiable assets, liabilities and contingent liabilities, which meet the criteria for recognition pursuant to IFRS 3 (Revised) – *Business Combinations*, are recognized at fair value on the acquisition date, except for noncurrent assets (or disposal groups) which are classified as being held for sale pursuant to IFRS 5 – *Noncurrent Assets Held for Sale and Discontinued Operations*, which are recognized and measured at fair value, less selling costs.

Goodwill deriving from the acquisition of a Consolidated Company is measured at the excess of the purchase price plus the fair value of non-controlling interests over the net fair value of the identifiable assets, liabilities and contingent liabilities of the Consolidated Company. If, subsequent to a revaluation, the Group's total rights in the net fair value of the identifiable assets, liabilities and contingent liabilities that had been recognized exceed the cost of the business combination, the excess is immediately recognized in profit and loss.

Non-controlling interests in the acquiree are initially measured on the date of the business combination according to their proportionate share of the fair value of the assets, including their share of the goodwill, the liabilities and the contingent liabilities of the acquiree.

Non-controlling interests, which do not confer present ownership interests, such as option warrants and equity components of bonds convertible into shares of the acquiree, are presented at their fair value, excluding share-based payments of the acquiree, which are measured on the date of the business combination.

Regarding the accounting policy for non-controlling interests, see clause G above.

A contingent consideration is classified as an equity instrument or as a financial liability in accordance with the provisions of IAS 32 – *Financial Instruments: Presentation*. If a component of the contingent consideration has been classified as a financial liability, subsequent changes in its fair value are allocated to profit and loss in subsequent periods. If the contingent consideration has been classified as an equity instrument, its value is not remeasured in subsequent periods.

In business combinations in which control is achieved subsequent to a number of acquisitions (acquisition in stages), the assets, liabilities and contingent liabilities of the acquiree are measured at fair value on the date that control is achieved, while allocating the difference between the carrying amount of the Company's holdings of the acquiree prior to the business combination and the fair value on the business combination date to the statement of income.

The non-controlling interests in the acquiree are initially measured on the date of the business combination according to their proportionate share of the net fair value of the recognized assets, liabilities and contingent liabilities.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

H. Business combinations: (continued)

This policy is relevant for business combinations that occurred up until December 31, 2009. As of 2010, the provisions of the Standard on this subject were revised.

Regarding the pronouncement of IFRS 3 (Revised) – *Business Combinations*, within the framework of the annual improvements project for 2010, see note 2.BB.

I. Rights in joint transactions and Entities under Common Control:

“Entities under Common Control” are the result of joint control arrangements, which involve the establishment of a separate entity containing rights for each of the partners.

The Group reports on its rights in Entities under Common Control by way of proportionate consolidation. Within the scope of the proportionate consolidation, the relative share of assets over which the Company has joint control, as well as the relative share of the liabilities for which the Company is jointly liable, are included in the Company’s statement of financial position. The statement of income includes the proportionate share of income and expenses over which the Company has common control.

Financial statements of Entities under Common Control, which are prepared other than in conformity with the accounting policies of the Group, are adjusted to the accounting policies of the Group, prior to inclusion in the Company’s financial statements.

Profits or losses generated from transactions being transacted between the Company and companies of the Group and an Entity under Joint Control are eliminated according to the Group’s holding ratio of the relevant entity.

J. Fixed assets:

A “fixed asset” is a tangible item, which is being held for use in manufacturing or for the supply of goods or services, or for renting to others, when use thereof for more than a single period is anticipated. The Company presents its fixed asset items using the cost model – fixed asset items are stated in the statement of financial position at cost, after deducting investment grants received, accumulated depreciation and accumulated impairment losses. The cost includes the asset’s purchase cost, as well as costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by the Management.

The cost of “qualifying assets” also includes credit costs that must be capitalized, as stated hereunder in Note 2.K.

Each component of a depreciable fixed-asset item with a cost that is significant relative to the total cost of the item is depreciated separately. Depreciation is calculated methodically using the straight-line method over the expected useful lifespan of the item’s components from the date that the asset was ready for its designated use, while taking into account the expected residual value at the end of its useful life.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS**

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)**J. Fixed assets:** (continued)

The useful life and depreciation rates used in calculating depreciation are as follows:

	<u>Useful lifespan</u>	<u>Depreciation rates</u>
Buildings and real estate	14-40 years	2.5%-7%
Machinery and equipment	12.5-17 years	6%-8%
Motor vehicles	6.66 years	15%
Office furniture and equipment (including computers)	3-17 years (mainly 3)	6%-33% (mainly 33%)
Leasehold Improvements – term of the lease plus an option	10 years	10%

The useful life, depreciation method and residual values of assets are reviewed by the Company's Management at the end of each fiscal year. Changes are accounted for prospectively as a change in accounting estimate.

A gain or loss resulting from a sale or retirement of an asset is determined according to the difference between the proceeds from its sale and the carrying amount of the asset and is allocated to profit and loss.

K. Credit costs:

Credit costs directly attributable to the purchase, construction or manufacture of qualifying assets, when their preparation for their intended use or sale requires a significant length of time, are capitalized to the cost of those assets until the date on which these assets are essentially ready for their intended use or sale. Exchange rate differentials in respect of loans denominated in a currency other than the Company's Functional Currency, are capitalized to the cost of those assets until the point that they are considered to correlate with the interest costs.

Income deriving from a temporary investment of specific credit received for the purpose of investing in qualifying assets, is cleared of credit costs qualifying for capitalization.

All other credit costs are recognized in the statement of income when incurred.

L. Impairment of tangible assets:

At the end of each reporting period, the Group examines the carrying amount of its tangible assets, excluding inventories, in order to ascertain whether there are indications that point to a possible impairment in respect of these assets. If such indications exist, the recoverable amount of the asset is estimated, in order to determine the amount of the loss created due to the impairment, if any. If it is not possible to estimate the recoverable amount of a single asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Joint assets are also allocated to the individual cash-generating units if a reasonable and consistent foundation can be identified for such an allocation.

If the joint assets cannot be allocated to the single cash-generating units on the said basis, the joint assets are allocated to the smallest categories of cash-generating units for which a reasonable and consistent foundation can be identified.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

L. Impairment of tangible assets: (continued)

A "recoverable amount" is the higher of the selling price of the asset, less costs of sale and value in use. When assessing value in use, the expected future cash flows are discounted to their present value, using a pretax discount rate that reflects the current market assessments regarding the time value of the cash, and the specific risks to the asset in respect whereof the future cash flow estimate was not adjusted.

If the carrying amount of a tangible asset (or of a cash-generating unit) is estimated as exceeding its recoverable amount, the carrying amount of the asset (or of the cash-generating unit) is reduced to its recoverable amount. Impairment losses are immediately recognized as an expense in profit and loss.

When a previously recognized impairment loss is reversed, the carrying amount of the asset (or of the cash-generating unit) is increased once again to its updated recoverable amount, but not to a sum exceeding the carrying amount of the asset (or of the cash-generating unit) that would have been determined had no impairment loss been recognized for the asset in previous periods. The reversal of an impairment loss is immediately recognized in the statement of income.

M. Inventories:

"Inventory" are assets being held for selling purposes during the ordinary course of business, or undergoing a manufacturing process for selling purposes or are materials being consumed during the manufacturing process or during the supply of the services.

Inventories are measured at the lower of cost or net realizable value. The cost of inventories includes all purchasing costs, direct labor costs, fixed and variable overhead costs and other costs incurred in bringing the inventories to their present location and condition.

"Net realizable value" represents the estimated selling price during the ordinary course of business, less the estimated costs of completion and an estimate of the costs required to execute sales.

The cost of inventories is determined as follows:

Raw materials, components
and packing supplies

– using the first-in, first-out method;

Finished goods

– at direct manufacturing cost, calculated on the basis of actual manufacturing costs, plus that portion relating to actual indirect manufacturing expenses, with the exception of finished goods from third parties, the cost of which is determined using the first-in, first-out method.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

N. Financial assets:

(1) General

Financial assets are recognized in the statement of financial position of the Group when the Group becomes a party to the contractual terms and conditions of the instrument. When an acquisition or sale of an investment is under a contract, the conditions of which require transfer of the investment within a timeframe acceptable by the related market, the investment is recognized or derecognized on the trading date (the date on which the Group undertook to purchase or sell the asset).

Investments in financial assets are initially recognized at fair value plus transaction costs, with the exception of those financial assets classified under the category of fair value through profit and loss, which are initially recognized at fair value.

Financial assets are classified under the categories specified hereunder. The classification under these categories depends on the nature and purpose of the holding of the held financial asset and is determined on the date of the initial recognition of the financial asset:

- Financial assets at fair value through profit and loss
- Loans and receivables

Regarding amendment IAS 39 – *Financial Instruments: Recognition and Measurement* and IFRS 7 – *Financial Instruments: Disclosures*, see note 2.BB hereunder.

Regarding the pronouncement of IFRS 9 – *Financial Instruments*, see note 2.BB hereunder.

(2) Financial assets at fair value through profit and loss

Financial assets are classified as “financial assets at fair value through profit and loss” when those assets are being held for trading purposes or when they are designated as financial assets at fair value through profit and loss.

A financial asset is classified as being held for trading purposes if:

- It was acquired principally for the purpose of selling in the near term; or
- It constitutes part of a portfolio of identified financial instruments that are managed together by the Group and for which there is evidence of a recent pattern of short-term profit taking; or
- It is a derivative other than a contract of financial guarantee or that is not intended and is not effective as a hedging instrument.

A financial asset, other than a financial asset being held for trading purposes, is classified as a financial asset at fair value through profit and loss at the time of initial recognition if:

- Such a classification eliminates or significantly reduces inconsistent recognition or measurement that would have occurred were it not for this classification; or

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

N. Financial assets: (continued)

(2) Financial assets at fair value through profit and loss (continued)

- The financial asset constitutes part of a group of financial assets or liabilities or both, when the management and performance thereof are assessed on the basis of fair value, according to the Group's documented risk management policy or investment strategy, and information about the group of financial instruments was forwarded within the scope of internal reports on this basis to key management personnel of the Group; or
- It constitutes part of a contract including one or more combined embedded derivatives and the entire combined contract (asset or liability) can be classified at fair value through profit and loss.
A financial asset at fair value through profit and loss is stated at fair value. Any gains or losses deriving from changes in the fair value, including those originating in changes in exchange rates, are recognized in the statement of income in the period in which the change occurred.

The net gain or loss recognized in profit and loss encompasses any dividend or interest that was generated in respect of the financial asset. Regarding the method for determining fair value, see Note 20.C.

(3) Loans and receivables

Trade receivables, deposits, loans and other receivables with fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. Loans and receivables are measured at amortized cost using the effective interest method, after deducting impairment, if any. Interest income is recognized under the effective interest method, except in respect of short-term receivables when the sums of interest in them that must be recognized are immaterial.

(4) Impairment of financial assets

Financial assets, with the exception of those classified as financial assets at fair value through profit and loss, are examined at the end of each reporting period in order to ascertain whether there are any indications of impairment. Such impairment arises when there is objective evidence that, as a result of one or more events that occurred after the initial recognition date of the financial asset, there has been an adverse impact on the estimated future cash flows of the investment.

In respect of all other financial instruments, indications of impairment could include:

- Significant financial difficulties of the issuer or the debtor;
- Default on current payments of principal or interest;
- Forecast that the debtor will be facing bankruptcy or debt restructuring;

Regarding financial assets stated at amortized cost, impairment is recognized at the height of the difference between the carrying amount of the financial assets and the present value of the estimated future cash flows from the financial assets, being discounted at their original effective interest rate.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

N. Financial assets: (continued)

(4) Impairment of financial assets (continued)

If, during a subsequent period, a loss from impairment of a financial asset is reduced, and that reduction objectively relates to an event that occurred after the impairment was recognized, then, in such instance, the previously recognized impairment is reversed, fully or partially, through the statement of income. Such reversal is limited in sum, so that the carrying amount of the investment in the asset on the date that the impairment loss is reversed shall not exceed the amortized cost of the asset that would have existed at that time had an impairment not been previously recognized.

The carrying amount of a financial asset is amortized in respect of the impairment loss in relation to all financial assets directly, with the exception of a loss from impairment of trade receivables and other receivables, which is allocated to an allowance account. The write-off of uncollectible customer debts is allocated to the allowance account. Collections during subsequent periods of sums previously written off are credited against the allowance account. The changes in the carrying amount of the allowance account in the report are allocated to profit and loss.

O. Financial liabilities and equity instruments issued by the Group:

(1) Classification as a financial liability or as an equity instrument

Nonderivative financial instruments are classified as a financial liability or as an equity instrument, depending upon the nature of the underlying contractual arrangements.

An “equity instrument” is any contract that evidences a residual interest in the Group’s assets after deducting all of its liabilities. Equity instruments issued by the Company are recorded according to the issue proceeds, after deducting expenses directly related to the issuance of these instruments.

Financial liabilities are stated and measured according to the following classification:

- Financial liabilities at fair value through profit and loss.
- Other financial liabilities.

Regarding the pronouncement of amendment IAS 32 – *Financial Instruments: Presentation*, and IAS 1: *Presentation of Financial Statements*, see note 2.BB(2) hereunder.

(2) Financial liabilities at fair value through profit and loss

A financial liability is classified at fair value through profit and loss if it is being held for trading purposes or has been designated as a financial liability at fair value through profit and loss.

The Group’s financial liabilities that are included in this category include options for the purchase of shares of the Company that are exercisable in a currency other than the Company’s Functional Currency.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

O. Financial liabilities and equity instruments issued by the Group: (continued)

(2) Financial liabilities at fair value through profit and loss (continued)

Financial liabilities at fair value through profit and loss are stated at fair value. Any gain or loss deriving from changes in the fair value is recognized in the statement of income. The net gain or loss that is recognized in the statement of income encompasses interest paid in respect of that financial liability. Transaction costs are allocated on their initial recognition date to the statement of income.

Regarding the method for determining fair value, see note 21.

Regarding amendment IFRS 7 – *Financial Instruments – Disclosures*, see note 2.BB(1).

(3) Other financial liabilities

Other financial liabilities are initially recognized at fair value after deducting transaction costs. Subsequent to the initial recognition date, other financial liabilities are measured at amortized cost using the effective interest rate.

The effective interest rate is a method for calculating the amortized cost of a financial liability and allocating interest expenses over the relevant period. The effective interest rate is the rate that precisely deducts the forecasted flow of the future cash flows over the anticipated lifespan of the financial liability to its carrying amount, or when appropriate, for a shorter period.

Regarding the handling of other, CPI-linked financial liabilities, see note 2.O.(4) hereunder.

(4) CPI-linked financial liabilities

The Group has CPI-linked financial liabilities that are not measured at fair value through profit and loss. In respect of these liabilities, the Company determines the effective interest rate as a real rate, plus linkage differentials according to the actual changes that occurred in the CPI up until the end of each reporting period.

On the date of the statement of financial position, the Group has such CPI-linked financial liabilities at the inclusive sum of approximately USD 78.5 million.

P. Derivatives and hedge accounting:

(1) General

The Group regularly examines its use of derivatives in order to manage its exposures to fluctuations in interest rates and foreign currency rates individually and on their merits. The Group purchases interest rate swap transactions and combined interest and foreign currency swap transactions.

Derivatives are initially recognized on the engagement date and at the end of every reporting period according to their fair value. Changes in the fair value of derivatives are allocated as a rule to the statement of income. The timing of the recognition of changes in the fair value of derivatives in profit and loss, which were intended for hedging purposes, when this hedge is effective and meets all criteria for determining hedge relationships, depends upon the nature and type of hedge.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

P. Derivatives and hedge accounting: (continued)

(2) Hedge accounting

The Group designates derivatives for hedging. The hedges are intended as cash flow hedges. On the date of the engagement in a hedge transaction, the Group documents the hedge relationships. The documentation includes identification of the hedging instrument, the hedge, the hedged item and the hedge strategy applied, and an examination of the extent of the strategy's conformity to the Group's overall policy. In addition, at the inception of the hedge relationship and throughout the term of each hedging relationship, the Group documents the extent of the hedge instrument's effectiveness in offsetting the exposure to changes in the cash flows attributable to the hedged risk.

The classification of hedge instruments in the statement of financial position is determined according to the remaining term of the hedge relationships at the end of the reporting period. If, at the end of the reporting period, the remaining term of the hedge relationships exceeds 12 months, the hedge instrument is classified in the statement of financial position as a noncurrent asset or liability. If, at the end of the reporting period, the remaining term of the hedge relationships does not exceed 12 months, the hedge instrument is classified in the statement of financial position as a current asset or liability.

The Group's hedging activity includes cash-flow hedge relationships in respect of CPI-linked shekel bonds, in respect of which the Group engaged in interest-rate and foreign currency swap transactions.

The effective portion of changes in the value of financial instruments designated as cash flow hedges is immediately recognized as other comprehensive income under the item "gain (loss) in respect of cash flow hedging," while any portion that is ineffective is recognized immediately in profit and loss.

Cash-flow hedge accounting is discontinued when the hedge instrument expires, is sold or is realized or when the hedge relationships are no longer meeting the hedge threshold conditions. Once the hedge accounting is discontinued, the sums allocated to other comprehensive income are allocated to the statement of income with the hedged item recorded in the statement of income.

Q. Revenue recognition:

Revenues are measured at the fair value of the proceeds received and/or of the proceeds that the Group is entitled to receive in respect of revenue from sales of goods during the ordinary course of business. The income is stated after deducting estimates of returns, discounts, etc.

Revenue from sales of goods is recognized when all of the following conditions are met:

- The Group has transferred all significant risks and rewards deriving from ownership of the goods to the buyer;
- The Group no longer retains continuing managerial involvement at a level usually characteristic of ownership, and does not retain effective control over the goods sold;
- The sum of the revenues can be reliably measured;
- The economic benefits associated with the transaction are expected to flow to the Group; and
- The costs that were or shall be incurred in respect of the transaction can be reliably measured.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

R. Leases:

(1) General

The leasing arrangements are classified as finance leases when the contract terms transfer all of the significant risks and benefits deriving from ownership to the lessee. All other leases are classified as operating leases.

(2) Leasing of land by the Group

Finance leases

In finance lease transactions in which the Group leases assets from another entity, the Group recognizes the assets on the lease inception date at the lower of fair value or present value of the minimum lease payments. The liability for the transfer of the minimum lease payments to the lessor is presented in the statement of financial position as a financial liability in respect of leasing. In subsequent periods, current payments in respect of finance leasing are apportioned between the finance charge component and the liability component, in a manner obtaining a fixed interest rate calculated on the balance of the lease liability. The portion apportioned to the finance component is allocated to profit and loss, except in instances whereby the asset being leased is a qualifying asset, in respect of which credit costs are discounted (regarding the discounting of credit costs, see clause 2.K. above).

Land leases (other than investment real-estate, which is measured at fair value) from the Israel Lands Administration, the payment of which is rendered periodically, are classified as finance leases. On the lease inception date, the Group recognizes the “fixed assets” and recognizes the liability in respect of the finance lease according to the lower of the fair value of the land and the present value of the minimum lease payments. In subsequent periods, the liability is handled as stated above, and the land is amortized on a straight-line basis over the balance of the lease term, while including/disregarding a lease extension option.

Land leases (other than investment real-estate, which is measured at fair value) from the Israel Lands Administration, for which the lease fees were paid in full in advance, are classified as finance leases. The deferred lease payments that were paid on the lease inception date are recognized in the statement of financial position under the fixed assets item, and are amortized on a straight-line basis over the balance of the lease term, while including/disregarding a lease extension option.

Operating leases

Leasing fee expenses in respect of operating leases are recognized on a straight-line basis over the lease term. In lease arrangements in which leasing fees are not paid at the inception of the lease term, or reduced leasing fees are paid, and additional benefits are received from the lessor, the Group recognizes expenses on a straight-line basis over the lease term.

The Company's land leases in China are classified as operating leases. The deferred leasing payments paid at the inception of the lease are presented in the statement of financial position under “other receivables and long-term debit balances,” and are amortized on a straight-line basis over the balance of the lease term.

Regarding the amendment to IAS 17 – *Leases*, within the scope of the Annual Improvements Project for 2009, see note 2.BB.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

S. Government grants:

Government grants are recognized when there is reasonable assurance that the Group shall comply with the attached conditions and that the grants shall be received.

Government grants, whose principal condition is that the Group acquires, constructs or otherwise obtains noncurrent assets, are stated net of the carrying amount of the asset that is the subject of the grant. The sum of the grant is allocated to the statement of income on a reasonably methodical basis over the period of the useful lifespan of the related assets.

T. Provisions:

Provisions are recognized when the Group has a legal or constructive obligation as a result of a past event, in respect of which it is probable that an outflow of economic resources that can be reliably estimated will be required to settle the obligation.

The sum recognized as a provision reflects the Management's best estimate of the sum that shall be required to settle the obligation in the present on the date of the statement of financial position, while taking into account the risks and uncertainties involved in the obligation. When the provision is measured using forecasted cash flows for the purpose of settling the obligation, the carrying amount of the provision is the present value of the forecasted cash flows. Changes in respect of the time value are allocated to profit and loss.

When the entire sum or that portion that is required to settle the obligation in the present is expected to be indemnified by a third party, the Group recognizes the asset, in respect of the indemnification, up to the height of the recognized provision, only when it is virtually certain that the indemnification shall be received and can be reliably estimated.

U. Share-based payments:

Share-based payments to employees and to others providing similar services, which are settled using equity instruments of the Group, are measured at fair value on the granting date. On the granting date, the Group measures the fair value of the equity instruments being granted using a Black and Scholes model (regarding the method for measuring the fair value of share-based payments, see note 33). When the equity instruments being granted do not vest until those employees complete a defined period of service, fulfill performance criteria or meet a defined market condition, the Group recognizes the share-based payment arrangements in the financial statements over the vesting period against an increase in equity, under the item "capital reserve for share-based payments." At the end of each reporting period, the Group estimates the number of equity instruments that are expected to vest. Any change in estimate relative to previous periods is recognized in profit and loss over the remaining vesting period.

In share-based payment transactions being settled in cash, the Group measures the goods or services purchased and the liability incurred in respect of the share-based payments being settled in cash according to the fair value of the liability. Until this liability is settled, the Group remeasures the fair value of the liability on each reporting date and on the settlement date, with any changes in the fair value being recognized in the statement of income for that period.

The Company has a memorandum of understanding with a material customer (see note 24), which is being handled according to principles similar to the principles specified in IFRS 2 – *Share-Based Payments*.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

V. Taxes on income:

(1) General

The tax expenses on income include all current taxes, and the total change in the deferred tax balances, and excludes deferred taxes deriving from transactions directly allocated to equity, and business combination transactions.

(2) Current taxes

Current tax expenses are calculated based on the taxable income for tax purposes of the Company and Consolidated Companies during the reporting period. The taxable income differs from the income before taxes on income, due to the inclusion or exclusion of income and expense items that are taxable or deductible during different reporting periods, or which are not taxable or are deductible. Assets and liabilities in respect of current taxes were calculated based on the tax rates and tax laws enacted or substantively enacted by the date of the statement of financial position.

(3) Deferred taxes

Companies of the Group create deferred taxes in respect of temporary differences between the carrying amounts of assets and liabilities in the financial statements and the amounts attributed for tax purposes. The deferred tax balances (asset or liability) are computed according to the tax rates expected to apply when they are utilized, based on the tax rates and the tax laws that have been enacted or substantively enacted by the date of the statement of financial position. Deferred tax liabilities are usually recognized in respect of all temporary differences between the carrying amounts of assets and liabilities in the financial statements and the amounts attributed for tax purposes. Deferred tax liabilities are recognized in respect of all of the deductible temporary differences up to the sum that is expected to be taxable income, against which it shall be possible to utilize the deductible temporary difference.

When calculating deferred taxes, the taxes that would have applied in the event of disposal of investments in Investee Companies have not been taken into account, since the Group intends to retain and develop these investments. Furthermore, deferred taxes in respect of distributions of earnings by these Investee Companies have not been taken into account, since a resolution has been passed not to initiate a distribution of dividends in the foreseeable future that triggers a tax liability.

Deferred tax assets and liabilities are stated as an offset when an entity has a legally enforceable right to offset current tax assets against current tax liabilities, and when they relate to income taxes imposed by the same taxation authority, and the Group intends to settle the current tax assets and liabilities on a net basis.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

W. Employee benefits:

(1) Post-employment benefits

Expenses in respect of a defined benefit plan are allocated to the statement of income, or are capitalized to the cost of the asset according to the projected unit credit method, using actuarial assessments being performed at the end of each reporting period. The present value of the Group's obligation in respect of a defined benefit plan is determined based on discounted expected future cash flows in respect of the plan by reference to market yields of government bonds, which are denominated in the same currency as the benefits to be paid in respect of the plan, and have redemption periods nearly matching the forecasted settlement dates of the plan.

Actuarial profits and losses are allocated to the statement of income upon creation. The past service cost is immediately recognized in the Company's statements of income to the extent that the benefit vested. Past service costs that have not yet vested are amortized on a straight-line basis over the average vesting period until the vesting date.

The Group's liability in respect of a defined benefit plan, which is stated in the statement of financial position, includes the present value of the obligation in respect of a defined benefit less the fair value of the plan's assets.

(2) Short-term employee benefits

Short-term employee benefits are benefits payable during a period not exceeding 12 months after the end of the period when the service qualifying for the benefit was rendered.

Short-term employee benefits in the Group include the Group's liability in respect of vacation and bonus payments. These benefits are allocated to the statement of income as they arise. The benefits that the Group forecasts as payable are measured without discounting. The difference between the height of the short-term benefits to which an employee is entitled and the sum paid in respect thereof is recognized as an asset or as a liability.

X. Supplier discounts:

Current discounts and discounts received from suppliers at the end of the period, when the Group is under no obligation to comply with particular targets, are recognized in the financial statements upon executing the purchases that entitle the Group to the said discounts. Supplier discounts, for which the entitlement thereto is contingent upon the Group meeting particular targets, such as a minimum volume of annual purchases (quantitative or monetary), an increase in the volume of purchases compared with previous periods, etc., are recognized in the financial statements in proportion to the volume of purchases made by the Group from those suppliers during the reporting period that advance the Group towards achievement of those targets, provided that the Group expects to achieve the targets, and when the amount of the discounts can be reasonably estimated. An estimate of a meeting of targets is based, inter alia, on past experience and on the projected volume of purchases from the supplier during the remainder of the period.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES** (continued)**Y. Research and development expenses:**

An intangible asset arising from the Group's internal development activities is recognized only when the Group can demonstrate all of the following conditions:

- The technical feasibility of completing the asset so that it will be available for use or sale;
- The Group's intention to complete the asset and use or sell it;
- The Group's capability to complete the asset and use or sell it;
- There is an expectation that the asset shall generate future economic benefits;
- The availability of technical, financial and other resources for the Group to complete the development and to use or sell the asset;
- Costs during the development that are attributable to the asset can be reliably measured.

When an intangible asset created internally cannot be recognized, the development costs are allocated to the statement of income when incurred.

Z. Earnings per share:

The Company computes the sums of the base earnings per share in relation to profit or loss attributed to equity holders of the Company by dividing the profit or loss attributable to holders of the Company's ordinary shares (numerator) by the weighted average number of ordinary shares outstanding (denominator) during the reporting period. For the purpose of calculating the diluted earnings per share, the Company adjusts the profit or loss attributable to the holders of the ordinary shares and the weighted average of the number of shares outstanding in respect of the effects of all of the diluted potential ordinary shares.

AA. Exchange rates and linkage base:

- (1) CPI-linked balances are stated according to the last "known" CPI at the end of the reporting period (the index of the month preceding the month of the statement of financial position of each year) or according to the CPI in respect of the last month of the reporting period (the CPI of December of each year), depending upon the transaction conditions.
- (2) Balances in or linked to foreign currency are included in the financial statements according to the representative rates of exchange published by the Bank of Israel and in effect at the end of the reporting period.
- (3) Following are data on the CPI and the representative rates of exchange of the USD, the RUB, the EUR and the CNY:

Statements date	Representative exchange rate of USD				Consumer Price Index	
	In NIS	In EUR	In CNY	In RUB	"for" Points	"known" points
December 31, 2010	3.549	0.749	6.612	30.48	125.83	125.37
December 31, 2009	3.775	0.693	6.837	30.27	122.57	122.57
Rates of change:						
For the year ended:						
December 31, 2010	(5.98)	8.08	(3.29)	0.7	2.66	2.28
December 31, 2009	(0.7)	(3.5)	(0.3)	3.02	3.92	3.82
December 31, 2008	(1.14)	5.74	(6.29)	19.69	3.80	4.51

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES** (continued)**BB. New financial reporting standards and interpretations issued:****(1) New standards and new interpretations affecting the present period and/or previous reporting periods:**▪ **IAS 17 (amendment) – Leases**

IAS 17 – *Leases* was amended within the scope of the Annual Improvements Project for 2009.

The amendment to IAS 17 – *Leases* prescribes that land leases are to be classified as finance leases or as operating leases using the general principles prescribed in the standard, while taking into account that land normally has an indefinite economic life. The amendment removed the requirement to classify a lease of land as an operating lease when the title does not pass to the lessee at the end of the lease.

The amendment is being applied in relation to annual reporting periods commencing January 1, 2010.

The amendment is being applied retrospectively in relation to existing leases when the requisite information is available at the beginning of the lease. When the requisite information is not available, land leases are to be re-examined as on the amendment adoption date.

The Group has land (other than investment real-estate, which is measured at fair value) that was leased and leasing fees in respect thereof have been paid in full. As a result of the amendment, sums paid in respect of the aforesaid leases and presented in the financial statements as on December 31, 2009 under the prepaid expenses item in respect of an operating lease, are now presented under fixed assets.

Impact of the retrospective application on the statement of financial position for the current period and for previous periods

	As on December 31		As on
	2010	2009	January 1
	USD	USD	USD
	thousands	thousands	thousands
Increase in fixed assets	1,537	1,610	1,683
Decrease in long-term debit balances	(1,537)	(1,610)	(1,683)

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

BB. New financial reporting standards and interpretations issued: (continued)

(1) New standards and new interpretations affecting the present period and/or previous reporting periods: (continued)

▪ **IFRS 8 – *Operating Segments***

IFRS 8 – *Operating Segments* was amended within the scope of the Annual Improvements Project for 2009.

The amendment to IFRS 8 – *Operating Segments* prescribes that a disclosure must be given about the measurement of a segment's reportable assets only if this information is regularly supplied to the chief operating decision-maker.

The amendment is being applied retrospectively in relation to annual reporting periods commencing on or after January 1, 2010.

As of January 1, 2010, information about segment assets that was presented in the financial statements as on December 31, 2009 will no longer be presented in the financial statements, since this information is not reported to the chief operating decision-maker.

(2) New standards and new interpretations in effect having no material effect on the present period and/or on previous reporting periods:

The following new standards, interpretations and amendments, which came into effect this year, have no material effect on the present period and/or on preceding periods, but their coming into effect might affect future periods.

▪ **IFRS 3 (Revised) – *Business Combinations***

This new standard prescribes rules for the accounting handling of business combinations. The standard is being applied in relation to business combinations that took place on or after January 1, 2010.

▪ **IAS 27 (Revised) – *Consolidated and Separate Financial Statements***

The new standard prescribes rules for the accounting handling of consolidated and separate financial statements. The provisions of the standard apply to annual reporting periods commencing on or after January 1, 2010. The standard is being applied retrospectively, apart for a few exceptions, for which the provisions of the standard are being applied prospectively. In respect of an additional acquisition of the Group's holdings of Avgol China, the Group recognized the sum of USD 261 thousand during the period, which was allocated to equity, instead of to profit and loss, as it would have been recognized had the new standard not been adopted.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

BB. New financial reporting standards and interpretations issued: (continued)

(2) New standards and new interpretations in effect having no material effect on the present period and/or on previous reporting periods: (continued)

▪ **Amendment to IAS 39 – *Financial Instruments: Recognition and Measurement* (regarding designation of the exposure to inflationary risks as hedging items)**

The amendment prescribes, inter alia, that changes in cash flows deriving from exposure to inflationary risks may be designated as hedged items. Additionally, the amendment prescribes that the internal value, as opposed to the time value of purchased options qualifies to be used as a hedge instrument of a one-sided risk deriving from an anticipated transaction. The amendment is being applied retrospectively in relation to annual reporting periods commencing on or after January 1, 2010.

▪ **Amendment to IAS 7 – *Statements of Cash Flows***

The amendment to IAS 7 – *Statements of Cash Flows* clarifies that only exits leading to an asset being recognized in the statement of financial position are qualified to be classified as cash flows used in investment activities. The amendment is being applied retrospectively in relation to annual reporting periods commencing on or after January 1, 2010.

▪ **Amendment to IAS 1 – *Presentation of Financial Statements***

The amendment prescribes that items of other comprehensive income shall be presented in the statement of changes in equity or in the notes, according to the Company's accounting policy. The amendment shall be applied retrospectively.

(3) New standards and new interpretations announced that are not in effect and have not been adopted early by the Group, which are expected or may have an impact on future periods:

▪ **IFRS 9 – *Financial instruments***

- The change in the fair value of a financial liability designated upon initial recognition as at fair value through profit or loss that is attributable to changes in the credit risk of the liability is to be directly allocated to other comprehensive income, unless such allocation would create or increase an accounting mismatch in profit or loss.
- When a financial liability is repaid or cleared, the fair value amount is allocated to other comprehensive income not classified to profit and loss.
- All derivatives, whether assets or liabilities, are to be measured at fair value, including a derivative constituting a liability relating to an unquoted equity instrument when the fair value cannot be measured reliably.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

BB. New financial reporting standards and interpretations issued: (continued)

- (3) **New standards and new interpretations announced that are not in effect and have not been adopted early by the Group, which are expected or may have an impact on future periods:** (continued)

▪ **IFRS 9 – *Financial instruments*** (continued)

The provisions of the amendment apply by way of retrospective application, apart from exceptions as specified in the standard, in relation to annual reporting periods commencing on or after January 1, 2013. Early adoption is possible. Entities applying the standard by way of early adoption prior to January 1, 2012 are allowed to forgo retrospective application. Furthermore, subject to the transitional provisions of the standard, the provisions of the standard may be adopted early solely in relation to financial assets, without adopting the aforesaid provisions in relation to financial liabilities.

The Management of the Company is unable, at this stage, to assess the impact of application of the standard on its financial position and operating results.

NOTE 3 – CRITICAL ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS USED IN THE PREPARATION OF THE FINANCIAL STATEMENTS

A. General:

In the application of the Group's accounting policies described above in note 2, the Group's Management is required, in certain instances, to use considerable accounting judgment concerning estimates and assumptions relating to carrying amounts of assets and liabilities that are not necessary apparent from other sources. The estimates and associated assumptions are based on past experience and other factors considered relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed by the Management regularly. Revisions to accounting estimates are recognized only in the period in which the estimate was revised if the revision affects only that period, or are recognized in the said period and in future periods if the revision affects both current and future periods.

B. Key sources of estimates of uncertainty:

(1) **Taxes on income**

The Group is subject to the tax laws of a number of countries. Extensive judgment is required when determining the current tax liability of each of the companies of the Group.

(2) **Duration of the useful lifespan of fixed assets**

Each component of a depreciable fixed-asset item with a cost that is significant relative to the total cost of the item is depreciated separately. Depreciation is calculated methodically using the straight-line method over the expected useful lifespan of the item's components from the date that the asset was ready for its designated use, while taking into account the expected residual value at the end of its useful life.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 3 – CRITICAL ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS USED IN THE PREPARATION OF THE FINANCIAL STATEMENTS**

(continued)

B. Key sources of estimates of uncertainty: (continued)**(2) Duration of the useful lifespan of fixed assets (continued)**

Residual values, the depreciation method and the duration of the useful lifespan of the asset are determined according to the Group's judgment and accumulated experience. These data are reviewed by the Company's Management at the end of each fiscal year with changes in the revised estimate being handled prospectively.

(3) Employee benefits

The present value of the Company's liability for severance pay is based on a great deal of data, which are determined on the basis of an actuarial assessment, while making use of a great many assumptions, including of the discount rate. Changes in the actuarial assumptions are likely to affect the carrying amount of the Company's liabilities for severance pay. The Group estimates the discount rate once a year, based on the yield rate on government bonds. Other key assumptions are determined based on the data prevailing on the market, and on the basis of the Group's accumulated experience. For additional details about the assumptions used by the Group, see note 18.

NOTE 4 – TRADE RECEIVABLES**A. Composition:**

	As on December 31	
	2010	2009
	USD	USD
	thousands	thousands
Open accounts	40,130	30,219
Revenues receivable from customers	563	-
Checks for collection	318	760
	<u>41,011</u>	<u>30,979</u>
Less – allowance for doubtful accounts	(330)	(357)
	<u>40,681</u>	<u>30,622</u>

The average credit period in sales of goods is 54 days. During this period, most customers are not charged interest.

The majority of the Company customers are long-standing regular customers. When accepting a new customer, the Company performs a process of examining and verifying financial soundness. The Company examines its customers' balances and the credit terms set for them on a weekly basis. Approximately 94% of the Group's customers conform to the credit term set for them (apart from deviations of an insignificant number of days), and they have been ranked as customers with high-quality credit ratings. For additional information regarding credit ratings and credit concentrations of the Group, see note 20.H.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 4 – TRADE RECEIVABLES** (continued)**A. Composition:** (continued)

The balance of the Group's trade receivables as on December 31, 2010 includes the sum of approximately USD 9,543 thousand (2009: USD 6,643 thousand), for which the payment due date has elapsed. However, based on the Group's past experience and on the credit quality of the debtors, the Group did not allocate an allowance for doubtful accounts in respect thereof, since, in its opinion, these sums are collectible. The Group does not hold sureties in respect of these debts.

B. Age of past due trade receivables, for which an allowance for doubtful accounts was not allocated:

	As on December 31	
	2010	2009
	USD thousands	USD thousands
Number of days		
0-30	7,011	1,874
31-60	1,278	1,047
61-90	301	1,153
More than 91 days	953	2,569
Total	9,543	6,643

C. Movement in the allowance for doubtful accounts:

	ליום 31 בדצמבר	
	2010	2009
	USD thousands	USD thousands
Balance at the beginning of the year	357	-
Loss from impairment in respect of trade receivables	-	357
Exchange-rate differentials	(27)	-
Sums recovered during the year	-	-
Balance at year end	330	357

NOTE 5 – OTHER ACCOUNTS RECEIVABLE AND DEBIT BALANCES**Composition:**

	As on December 31	
	2010	2009
	USD thousands	USD thousands
Government institutions	5,173	8,253
Income receivable	438	287
Prepaid expenses	550	769
Advances to suppliers	1,716	2,146
Prepaid commissions [see note 19.A(2)]	2,447	-
Other receivables	1,675	1,958
	11,999	13,413

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 6 – INVENTORIES****A. Composition:**

	As on December 31	
	2 0 1 0	2 0 0 9
	USD thousands	USD thousands
Raw materials, components and packing materials	15,513	13,600
Finished goods	19,808	12,837
	<u>35,321</u>	<u>26,437</u>
Payments on account of raw materials	-	1,397
	<u>35,321</u>	<u>27,834</u>

B. Additional information:

The total inventories recognized as an expense during the period under the cost of sales item totalled approximately USD 159,883 thousand in 2010 (2009: approximately USD 109,610 thousand; 2008: approximately USD 154,705 thousand).

During the reporting period, the Company wrote-down inventories at the sum of approximately USD 290 thousand in respect of slow-moving inventories, which was transferred for recycling or for which no use was made for more than 12 months.

NOTE 7 – INVESTMENT IN INVESTEE COMPANIES**A. Consolidated Companies:****Details about the Group's Consolidated Companies:**

Name of subsidiary	Place of domicile	Location of principal operations	Holding Ratio	Volume of the investment in the Investee Company		Remarks
				on December 31		
				2 0 1 0	2 0 0 9	
			%	USD thousands	USD thousands	
Directly held						
Avgol Ltd.	Israel	Israel	100	160,064	135,355	
Indirectly held						
Avgol America Inc.	USA	USA	100	-	-	(1)
Avgol Distribution Company Inc.	USA	USA	100	-	-	(2)
Avgol Rus LLC	Russia	Russia	100	-	-	(3)
Hubei Gold Dragon	China	China	80	-	-	(5)
Avgol Cyprus Limited	Cyprus	Cyprus	100	-	-	(4)

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 7 – INVESTMENT IN investee COMPANIES (continued)

A. Consolidated Companies: (continued)

- (1) In May 2001, Avgol Israel founded a wholly owned company in the United States (hereinafter – “Avgol America”). On June 22, 2001, Avgol America acquired, from a third party, the operations and assets of the vendor relating to a factory for the manufacture of nonwoven fabric that the vendor had founded in North Carolina, U.S.A., including the factory building and the land on which it stands, a production line for the manufacture of nonwoven fabric and all other ancillary equipment, and contracts that the vendor had signed in relation to the operations.
- (2) In November 2005, Avgol Distribution Company, Inc. (“Avgol Distribution”) was founded in the United States as a wholly owned company of Avgol America for the purpose of distributing the Group’s products in North America. Avgol Distribution began operating on January 1, 2006.
- (3) On February 28, 2006, Avgol Rus LLC (“Avgol Russia”) was founded in Russia as a wholly owned company of Avgol Israel, with the objective of building a factory for the manufacture of nonwoven fabric in Russia. On October 26, 2006, Avgol Russia engaged in an agreement with a third party under which Avgol Russia acquired buildings on an area of approximately 12,500 m² and real-estate rights to an area of approximately 42,000 m², located in the Tula district, about 200 km south of Moscow.
- (4) On October 6, 2008, Avgol Cyprus Limited (“Avgol Cyprus”) was founded in Cyprus as a wholly owned company of Avgol Israel, with the objective of coordinating the Group’s financing and investment activities. Avgol Cyprus was not active during 2010.
- (5) On July 21, 2004, Avgol Israel engaged in an agreement with a Chinese company for the establishment of a Chinese joint company (hereinafter – “the Company in China” or “the Chinese Company”), which is to be held in equal shares by the parties and shall be the owner of a factory for the manufacture of nonwoven fabric using the same technology as used by Avgol Israel.

Avgol Israel’s investment included: the sum of approximately USD 1.9 million invested opposite Avgol Israel’s undertaking to make available to the Company in China know-how and experience that Avgol Israel has in the manufacture of nonwoven fabric products; the sum of USD 2.2 million in cash; while the balance of Avgol Israel’s investment was effected by way of a transfer of raw materials and equipment. The Chinese partner’s share in the investment was by way of the transfer of equipment that the Chinese partner had purchased prior to the engagement with Avgol Israel.

The surplus on the net worth of the Company in China on the investment date, at the sum of approximately USD 0.6 million, was attributed in its entirety to the fixed assets owned by the Company in China.

The Company in China undertook to obtain commitments from the Chinese partner vis-à-vis a banking corporation in China, which financed a portion of the plant construction costs and the purchase of the production line.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 7 – INVESTMENT IN INVESTEE COMPANIES (continued)

A. Consolidated Companies: (continued)

(5) (continued)

On June 8, 2008, a loan agreement was signed between the Company in China and a banking corporation in China, which assigned the loan from the Chinese partner to the Chinese Company. The loan is repayable within a period of six years in monthly repayments according to the assignment agreement that was signed between the Company in China, Avgol Israel, the Chinese partner, a banking corporation in China and a Chinese government company, which guaranteed the loan. During 2008, Avgol Israel and the Chinese partner each injected an additional investment of CNY 12.5 million. The Chinese partner's investment was executed in cash and in the assumption of supplier debts; while Avgol Israel's investment was executed in cash and in the transfer of raw materials and equipment.

During 2008, the Group identified business opportunities in China and resolved to establish an additional production line in the factory of the Company in China (for details about the purchase of the production line from the German manufacturer, see note 9.B). Subsequently, amendments were made in the founders' agreement and in the Articles of Association of the Chinese Company, which, inter alia, include an increase in Avgol Israel's holding ratio in the Chinese Company, as specified hereunder.

At the end of the second quarter of 2009, Avgol Israel increased its holding ratio in the Chinese Company to a stake of 70%, by way of an investment at the sum of approximately USD 10 million (CNY 70 million) in cash. The Chinese Company is using the aforesaid investment for the purchase and establishment of the new production line in China. Within the scope of the said agreement, Avgol Israel received an option for an additional investment of CNY 4.55 million (approximately USD 0.7 million), which reflects a holding ratio of 2.6% of the Chinese Company. During October 2009, shares were transferred to Avgol Israel's ownership constituting 1.57%, such that, at the end of 2009, Avgol Israel held 71.6% of the Chinese Company. In March 2010, Avgol Israel exercised the option at the sum of CNY 1,802 million (approximately USD 0.3 million), for additional shares constituting 1.03% of the Chinese Company's share capital (hereinafter – **"the Additional Shares"**). After this exercise and the transfer of these shares to the Company's ownership, Avgol's holding rate increased to approximately 72.6% of the Chinese Company's share capital.

The consideration in respect of the shares that were transferred and the Additional Shares, was paid upon the consummation of the agreement for the increase in the Company's holdings to 80%. On March 23, 2010, the Company's Board of Directors approved Avgol's engagement in a memorandum of understandings with the Chinese Partner for the purchase of an additional quantity of shares of the Chinese Company. According to that prescribed in the memorandum of understandings, Avgol transferred the sum of approximately CNY 17.5 million (approximately USD 2.6 million) to the Chinese partner, on May 28, 2010, only after the Chinese partner had removed the attachment on its shares, and the shares that were supposed to be transferred to Avgol (which also include the Additional Shares, as defined above) were recorded under its name. This sum constitutes the consideration that Avgol was to pay for increasing its holdings in the Chinese Company to 80% (which also includes the payment at the sum of CNY 4.55 million for the shares that were transferred and the Additional Shares).

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 7 – INVESTMENTS IN INVESTEE COMPANIES** (continued)**A. Consolidated Companies:** (continued)**(5)** (continued)

As of the end of the second quarter of 2009, Avgol Israel ceased to consolidate the Chinese Company by proportionate consolidation, and began fully consolidating the Chinese Company and giving the noncontrolling interest its share according to the rate of its holdings.

Furthermore, the assets, liabilities and contingent liabilities of the Chinese Company were measured at fair value on the date that control was obtained; the difference between the fair value on the execution date of the acquisitions that preceded the business combination and their fair value on the business combination date were allocated to other comprehensive income under the item "gain (loss) in respect of step acquisitions."

Analysis of the assets and liabilities acquired, and the purchase price allocation as on June 30, 2009:

	HUBEI GOLD DRAGON		
	Carrying amount	Adjustment to fair value	Fair value at acquisition
	USD	USD	USD
	thousands	thousands	thousands
Current assets			
Cash and cash equivalents	244	-	244
Trade receivables	2,097	-	2,097
Other accounts receivable and debit balances	1,440	-	1,440
Inventories	3,537	240	3,777
Noncurrent assets			
Fixed assets	19,386	2,788	22,174
Long-term debit balances	323	615	938
Current liabilities			
Short-term credit from banking corporations and current maturities of long-term loans	(2,367)	-	(2,367)
Trade payables	(1,804)	-	(1,804)
Other accounts payable and credit balances	(665)	-	(665)
Noncurrent liabilities			
Long-term loans	(8,419)	-	(8,419)
Deferred taxes	-	(760)	(760)
	<u>13,772</u>	<u>2,883</u>	<u>16,655</u>
Noncontrolling interests in the acquisition			<u>(7,659)</u>
Capital reserve in respect of adjustment of the fair value of a business combination achieved in stages			<u>(1,658)</u>

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 7 – INVESTMENTS IN INVESTEE COMPANIES** (continued)**A. Consolidated Companies:** (continued)**(5)** (continued)

Furthermore, as a result of the increase in Avgol Israel's shareholding ratio as stated, amendments were made in the Chinese Company's Articles of Association, so that the ratio of directors on behalf of Avgol Israel on the Chinese Company's Board of Directors shall be 66%. Pursuant to the requirements of Chinese law, the Chinese Company's Articles of Association included a list of resolutions for which a unanimous approval of resolutions shall be required, such as: a change in the Chinese Company's registered share capital; a resolution regarding a merger or any other structural change in the Chinese Company, as well as an amendment to the Chinese Company's Articles of Association. The parties also prescribed in the Articles of Association a list of resolutions that may be passed by an ordinary majority of votes, provided that a representative of each of the parties is in the quorum of such Board of Directors meeting.

The Articles of Association also include various provisions regarding the relations between the parties as shareholders of the Chinese Company, including restrictions on share transfers [for five years after receiving approval from the Chinese authorities for the said amendments (correct to the approval date of this report, this approval has not yet been received), the parties shall not transfer shares without the consent of the other party, and subsequently, any transfer shall be subject to a right of first refusal, and, in the event of a transfer by the Chinese partner, Avgol Israel shall have a tag-along right]; provisions pertaining to the management of the Chinese Company's businesses, and the method of preparation of its financial statements. Provisions were also included relating to noncompetition, whereby: (a) the Chinese Company shall not sell its products outside of China (directly or indirectly); and (b) it shall not sell its products to companies in China that are subsidiaries of international companies constituting Avgol's customers, other than through Avgol.

B. Other investments in Consolidated Companies directly held by the Company:**Avgol Ltd.****The loan terms and conditions**

	Weighted annual interest rates	On December 31	
		2010	2009
	%	USD thousands	USD thousands
Loans at variable interest	LIBOR + 1.73	18,467	23,083
Loans at fixed interest	7.98-8.12	-	31,620
		18,467	54,703
Less – current maturities		(4,617)	(10,940)
		13,850	43,763

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS**

NOTE 8 – REAL-ESTATE RIGHTS**A. Composition:**

	on December 31	
	2 0 1 0	2 0 0 9
	USD	USD
	thousands	thousands
Land owned by the Company	1,289	1,289
Easement	872	910
Leasehold	1,537	1,610
	<u>3,698</u>	<u>3,809</u>

B. Presentation in the statement of financial position:

	on December 31	
	2 0 1 0	2 0 0 9
	USD	USD
	thousands	thousands
Under fixed assets item (see note 2.BB(1))	2,826	2,899
Under long-term debit balances item	872	910
	<u>3,698</u>	<u>3,809</u>

- C.** The statement of financial position as on December 31, 2010 includes land owned by Avgol America at the sum of approximately USD 0.7 million, an easement in China at the sum of approximately USD 0.9 million, land owned by Avgol Russia at the sum of approximately USD 0.6 million and a leasehold used by Avgol Israel at the sum of approximately USD 1.5 million.
- D.** The Company has not yet received a form 4 in respect of the factory building in Israel. The Company intends to complete the processes required in order to receive the said form during 2011.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 9 – FIXED ASSETS****A. Composition:**

	<u>Land and Buildings</u>	<u>Machinery and equipment</u>	<u>Motor Vehicles</u>	<u>Office furniture and equipment, including computers</u>	<u>Leasehold improvements</u>	<u>Total</u>
	USD thousands					
Cost:						
As on January 1, 2009	(*)41,735	195,915	505	3,711	259	(*)242,125
Acquisitions	261	34,336	128	518	-	35,243
Initial consolidation	1,902	13,715	41	321	-	15,979
Translation differentials	9	60	-	2	-	71
Disposals	-	(2)	(170)	(82)	-	(254)
Balance as on December 31, 2009	(*)43,907	244,024	504	4,470	259	(*)293,164
Acquisitions	1,806	35,858	52	479	-	38,195
Translation differentials	108	2,103	5	36	-	2,252
Disposals	-	-	(45)	-	-	(45)
Balance as on December 31, 2010	45,821	281,985	516	4,985	259	333,566
Accumulated depreciation:						
As on January 1, 2009	(*) 6,913	78,135	120	1,851	201	(*)87,220
Depreciation expenses	(*) 1,279	11,281	64	244	11	(*)12,879
Initial consolidation	239	3,240	13	111	-	3,603
Translation differentials	1	11	-	-	-	12
Disposals	-	(105)	(77)	(82)	-	(264)
Balance as on December 31, 2009	(*)8,432	92,562	120	2,124	212	(*)103,450
Depreciation expenses	1,312	13,817	56	322	11	15,518
Translation differentials	19	316	2	10	-	347
Disposals	-	-	(36)	-	-	(36)
Balance as on December 31, 2010	9,763	106,695	142	2,456	223	119,279
Amortized cost:						
As on December 31, 2010	36,058	175,290	374	2,529	36	214,287
As on December 31, 2009	(*)35,475	151,462	384	2,346	47	(*)189,714
The cost on December 31, 2010 includes:						
Payments on account of the purchase of fixed assets	-	15,002	-	-	-	15,002
Capitalized financing expenses	608	4,601	-	-	-	5,209
Deduction of investment grants received	-	(23,793)	-	-	-	(23,793)

(*) after retrospective application of a change in accounting policy – see note 2.BB(1).

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 9 – FIXED ASSETS (continued)

- B.** During 2008, the Group's Management resolved to establish a new production line in China (see note 7.A.) and to upgrade two of the production lines in Avgol America. For this purpose, the Company, Avgol Israel and companies under the control of Avgol Israel signed three purchase agreements with a German equipment manufacturer on December 24, 2008, under which the German manufacturer shall sell a new production line to the Chinese Company for the manufacture of nonwoven fabric, and shall sell upgrades for two existing production lines to Avgol America.

During 2009, the upgrades in the United States were completed – the cost of this investment totalled approximately USD 19 million.

In July 2010, the Company completed the establishment of the new line in China – the cost of this investment totalled approximately USD 42 million

In October 2010, the Company announced its intention to purchase two new production lines at an aggregate investment of approximately USD 80 million. One of the lines has been designated for installation at the Company's plant in the United States, while the designation of the second line has not yet been decided, as on the date of these statements.

The Company anticipates that these lines shall begin operating during the first half of 2012.

Regarding pledges in respect of fixed assets, see note 21.

C. Changes in estimates reported in previous reporting periods:

In January 2010, after completing the upgrades of the lines in the United States, the Group examined the time-frame during which it expects to continue using the upgraded lines, and the residual value expected at the end of their usage period.

The Group assesses that one of the lines that was upgraded shall continue to be used by the Group for an additional 15 years, and not for an additional nine years, which constitutes the balance of the years of amortization remaining for this line, due to the technological improvements added to the line during the said upgrading, which enable the Group to manufacture new products.

Concerning the residual value, the Group assesses that the said machines are not expected to have residual value.

As a result of that stated above, on January 1, 2010, the inclusive cost of approximately USD 29 million in respect of the said line is being amortized over a period of 15 years. The impact of that stated is a reduction of the annual depreciation expenses at the sum of approximately USD 800 thousand for each reporting year. The cost of sales for 2010 was reduced by the sum of approximately USD 800 thousand as stated, compared with the sums that would have been recognized had the estimate not been changed.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 10 DERIVATIVES****A. Composition:**

	Current assets		Noncurrent assets		Total	
	as on December 31		as on December 31		as on December 31	
	2010	2009	2010	2009	2010	2009
	USD thousands		USD thousands		USD thousands	
Derivatives designated as hedge items						
Swap transaction	4,986	3,609	13,670	13,143	18,656	16,752
IRS transaction	(400)	(179)	(1,097)	(654)	(1,497)	(833)
Swap and IRS combo transaction	577	261	1,583	953	2,160	1,214
	5,163	3,691	14,156	13,442	19,319	17,133

- B.** On January 21, 2007, the Company offered CPI-linked shekel bonds within the scope of a public offering of securities (see details above in note 16).

In 2007 and 2008, the Company executed swap and IRS transactions with a banking corporation in Israel, the aim being to hedge against the Company's existing currency and interest exposures (the Company's Functional Currency is the USD) in respect of shekel liabilities.

Current to 2009 and 2010, the liability is denominated in USD, bearing a fixed interest rate of 4.675%.

Up until November 25, 2008, the changes in the fair value of this transaction were allocated to the statement of income, under the "other financing" item, and this transaction did not meet the requisite criteria for being classified as a hedge transaction for accounting purposes.

Since November 25, 2008, this transaction has been meeting the requisite criteria for being classified as a hedge transaction, and therefore, as of that date, the effective portion of the changes in the value of the financial instruments designated as cash-flow hedges is recognized under "other comprehensive income" in the item "gain (loss) in respect of cash-flow hedges" while the ineffective portion is immediately recognized in profit and loss.

- C.** In June 2009, the Company offered CPI-linked shekel bonds within the scope of an offering of securities to the public and to private investors (see details in note 16).

On June 12, 2009, the Company executed a swap and IRS transaction with a banking corporation in Israel, the aim being to hedge against the Company's existing currency exposure (the Company's Functional Currency is the USD) in respect of shekel liabilities (currency exposure) and exposure deriving from changes in the CPI, as well as to fix the dollar interest rate prescribed in the swap transaction at a fixed annual interest rate of 8.12% per annum.

On April 19, 2010, the Company discontinued the hedge transaction on the shekel bonds issued in June 2009. As a result of that stated, the Company received the sum of USD 880 thousand from the banking corporation.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 10 DERIVATIVES** (continued)**C.** (continued)

On September 7, 2010, the Company executed a swap transaction with a banking corporation in Israel, the aim being to hedge against the Company's existing currency exposure (due to the discontinuance of the hedge transaction as stated above) on the bonds issued in June 2009 in respect of shekel liabilities (currency exposure) and the exposure deriving from changes in the CPI, as well as to fix the dollar interest rate prescribed in the swap transaction at a fixed annual dollar interest rate of 7.51% per annum.

This transaction meets the requisite criteria for being classified as a hedge transaction, and therefore, as of the execution date of that transaction, the effective portion of the changes in the value of financial instruments designated as cash-flow hedges is recognized under "other comprehensive income" in the item "gain (loss) in respect of cash-flow hedges" while the ineffective portion is immediately recognized in profit and loss.

D. In August 2009, the Company offered CPI-linked shekel bonds within the scope of a private offering.

On September 1, 2009, the Company executed a swap and IRS transaction with a banking corporation in Israel, the aim being to hedge against the Company's existing currency exposure (the Company's Functional Currency is the USD) in respect of shekel liabilities (currency exposure) and the exposure deriving from changes in the CPI, as well as to fix the dollar interest rate prescribed in the swap transaction at a fixed annual interest rate of 7.98% per annum.

This transaction meets the requisite criteria for being classified as a hedge transaction, and therefore, as of the execution date of that transaction, the effective portion of the changes in the value of the financial instruments designated as cash-flow hedges is recognized under "other comprehensive income" in the item "gain (loss) in respect of cash-flow hedges" while the ineffective portion is immediately recognized in profit and loss.

E. During the year, the sum of approximately USD 784 thousand (loss, net of the tax effect) was recognized under "other comprehensive income," in respect of effective cash-flow hedging against cash flow risks in respect of bonds issued by the Company.**NOTE 11 – LONG-TERM DEBIT BALANCES****Composition:**

	As on December 31	
	2010	2009
	USD	USD
	thousands	thousands
Prepaid expenses in respect of an operating lease (see note 8)	872	(*) 910
Prepaid commissions (see note 19.A(2))	2,085	-
Government institutions	2,303	-
Long-term deposits	50	56
	<u>5,310</u>	<u>(*) 966</u>

(*) After retrospective application of a change in accounting policy – see note 2.BB(1).

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 12 – SHORT-TERM CREDIT FROM BANKING CORPORATIONS AND OTHERS****A. Composition:**

	Interest rate	As on December 31	
		2010	2009
		USD thousands	USD thousands
Overdrafts at banks	(1)	–	263
Short-term loans from banking corporations	(2)	5,079	–
Current maturities of long-term loans from banking corporations and others	(3)	20,181	13,754
		<u>25,260</u>	<u>14,017</u>

(1) The balance as on December 31, 2009 is comprised mainly of dollar credit bearing interest at LIBOR + 1.8%.

(2) The balance as on December 31, 2010 derived from a short-term loan in CNY bearing variable interest (as on December 31, 2010, 4.86%) which was obtained during the fourth quarter of 2010 and is repayable during the first quarter of 2011.

(3) See note 15.

B. Financial criteria: see note 15.D.

NOTE 13 – TRADE PAYABLES**Composition:**

	on December 31	
	2010	2009
	USD thousands	USD thousands
Open accounts	37,104	23,193
Checks payable	437	355
	<u>37,541</u>	<u>23,548</u>

The average credit period given to the Group in respect of purchases of goods is 46 days, for which the Group pays no interest.

NOTE 14 – OTHER ACCOUNTS PAYABLE AND CREDIT BALANCES**Composition:**

	on December 31	
	2010	2009
	USD thousands	USD thousands
Employees and institutions in respect of wages	2,097	1,995
Commissions to agents	311	748
Interest payable	508	710
Expenses payable	2,606	2,241
Other payables	534	949
	<u>6,056</u>	<u>6,643</u>

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 15 – LONG-TERM LOANS FROM BANKING CORPORATIONS AND OTHERS****A. Composition:**

	Interest rate	on December 31	
		2010	2009
		USD thousands	USD thousands
In USD	(1)	79,447	50,769
In CNY	(2)	7,612	9,482
		<u>87,059</u>	<u>60,251</u>
Less – current maturities		(20,181)	(13,754)
Less – amortized balance of expenses in respect of a recruitment of long-term loans in Avgol America		(255)	(416)
		<u>66,623</u>	<u>46,081</u>

- (1) In respect of loans from banking corporations, bearing interest at LIBOR + 2% – 3.75%.
(2) Variable interest at 5.94%.

B. Repayment schedule:

	on December 31	
	2010	2009
	USD thousands	USD thousands
First year – current maturities	20,181	13,754
Second year	16,546	16,649
Third year	14,011	11,831
Fourth year	9,975	9,426
Fifth year and thereafter	26,346	8,591
	<u>66,878</u>	<u>46,497</u>
Total	<u>87,059</u>	<u>60,251</u>

C. Additional information about long-term loans:

- (1) On July 27, 2010, Avgol Israel obtained a loan at the sum of USD 30 million from a banking corporation in Israel (“the Loan”), which bears interest at LIBOR + 2.2%. The Loan is for a period of eight years and shall be repaid (principal and interest) on a quarterly basis throughout the Loan period. The Loan was given without collateral and/or financial covenants beyond those existing in respect of credit received from that same banking corporation.
- (2) During the reporting period, Avgol Israel effected an early repayment of the balance of the loan at the sum of USD 3.75 million obtained from the Mustang Mezzanine Fund (hereinafter – “Mustang”). Within the scope of the early repayment, Avgol Israel paid Mustang the sum of approximately USD 4,024 thousand. Against this payment, Mustang waived all its rights vis-à-vis the Company and vis-à-vis Avgol Ltd. by virtue of the original loan agreements.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 15 – LONG-TERM LOANS FROM BANKING CORPORATIONS AND OTHERS (continued)

C. Additional information about long-term loans: (continued)

- (3) In December, Avgol Israel obtained three loans at the sum of USD 5 million each from banking corporations. Following are details of the conditions of the aforesaid loans:
1. A loan from Bank Leumi le-Israel at the sum of USD 5 million, which was received on December 27, 2010. The loan is for a period of seven years and is repayable in 12 equal biannual payments commencing June 30, 2012. The loan bears interest at LIBOR + 2.4%.
 2. A loan from Bank Hapoalim at the sum of USD 5 million, which was received on December 29, 2010. The loan is for a period of eight years and is repayable in eight equal annual payments commencing December 29, 2011. The loan bears interest at LIBOR + 2.55%.
 3. A loan from Union Bank at the sum of USD 5 million, which was received on December 29, 2010. The loan is for a period of eight years and is repayable in 15 equal biannual payments commencing December 31, 2011. The loan bears interest at LIBOR + 2.4%.
- (4) Subsequent to the date of the statement of financial position, Avgol America refinanced its loans and obtained a loan of an additional USD 10 million. See note 38.C.

D. Financial covenants:

For the purpose of securing long-term loans and credit that companies of the Group received from banking corporations and others, the banking corporations and others stipulated that companies of the Group must comply with financial covenants, which have been amended from time to time within the scope of agreements and understandings.

Following is a description of the financial covenants applicable to the Group, correct to December 31, 2010:

- (1) Maintaining minimum equity of USD 65 million in the Company and minimum equity of USD 11.5 million in Avgol America, pursuant to the definition of "equity" in the agreements;
- (2) Maintaining a debt coverage ratio (as this term is defined in the agreement) of 1 to 1 in the Company in each six-month period;
- (3) The total of the loans to Avgol America shall not exceed 93% of the market value of Avgol America's fixed assets;
- (4) Equity – the ratio of tangible equity to total statement of financial position shall not diminish from 25% at any time.
- (5) The ratio obtained from dividing the EBITDA by the debt service plus the tax payments shall not diminish from 1. This ratio shall be examined every six months in relation to the four consecutive quarters preceding the date of the examination.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 15 – LONG-TERM LOANS FROM BANKING CORPORATIONS AND OTHERS (continued)

D. Financial covenants: (continued)

- (6) The ratio of debt to EBITDA – the ratio between the total of the Company's debts to the EBITDA shall not exceed 3.5, when, in relation to 2009 only, the ratio shall not exceed 4. For the purpose of examining this ratio, an examination shall be conducted every six months in relation to the four consecutive quarters preceding the date of the examination, except for 2009, when the examination shall be carried out once, according to the consolidated financial statements as on December 31, 2009.
- (7) The total annual EBITDA shall not diminish from USD 40,000,000 as reported in the Company's annual consolidated financial statements as on December 31, 2010.

In addition to the financial covenants referred to above, the Company must comply with additional covenants as prescribed in the agreements.

Correct to December 31, 2010, the Group is complying with all of the financial covenants applicable to it.

NOTE 16 – BONDS

A. Bond offering within the scope of an initial public offering of securities:

On January 18, 2007, the Company offered bonds (series A) to the public at a par value of NIS 244,350,000.

The bonds are repayable in six equal annual payments on December 31st of each of the years 2009 through 2014, and bear interest at the rate of 5.2% per annum, with payment on June 30 and December 31 of each of the years 2007 through 2014. The principal of the bonds and the interest are linked to the CPI published in respect of December 2006. The series A bonds are not secured by any lien.

B. Offering of bonds within the scope of an expansion of series A bonds that were offered in January 2007:

On June 9, 2009, the Company offered bonds (series A) to the public at a par value of NIS 81,797,000 within the scope of an expansion of series A pursuant to a shelf prospectus report dated May 26, 2009.

On June 14, 2009, the Company offered bonds (series A) at a par value of NIS 10,000,000 within the scope of an expansion of series A by way of a private allotment pursuant to a shelf prospectus dated May 26, 2009.

On August 31, 2009, the Company offered bonds (series A) at a par value of NIS 43,500,000 within the scope of an expansion of series A by way of a private allotment pursuant to a shelf prospectus dated May 26, 2009.

The bonds are repayable in six equal annual payments on December 31st of each of the years 2009 through 2014, and bear interest at the rate of 5.2% per annum, with payment on December 31, 2009 and on June 30 and December 31 of each of the years 2010 through 2014. The principal of the bonds and the interest are linked to the CPI published in respect of December 2006. The series A bonds are not secured by any lien.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 16 – BONDS** (continued)**C. Repayment dates:**

	on December 31	
	2 0 1 0	2 0 0 9
	USD	USD
	thousands	thousands
Current maturities	18,381	17,327
Second year	20,272	17,624
Third year	19,901	17,907
Fourth year	19,920	18,164
Fifth year	-	18,441
	<u>60,093</u>	<u>72,136</u>
	<u>78,474</u>	<u>89,463</u>

NOTE 17 – OPERATING LEASE ARRANGEMENTS

The Group engaged in operating lease arrangements for vehicles for periods of three years per vehicle. The Group does not have an option to purchase leased assets at the end of the lease term. Furthermore, the Group has rental agreements for offices in Tel-Aviv for a period of three years ending on August 31, 2012. Since the sums of the payments recognized as an expenditure are not of a significant volume, quantitative information in respect thereof was not included in this note.

NOTE 18 – EMPLOYEE BENEFITS**A. Composition:**

	on December 31	
	2 0 1 0	2 0 0 9
	USD	USD
	thousands	thousands
Post-employment benefits within the scope of defined benefit plans:		
Liability for severance pay and retirement compensation	<u>276</u>	<u>465</u>
Short-term employee benefits:		
Wages, salaries and social benefits	1,602	1,237
Benefits in respect of unused vacation time	495	467
Other	264	291
	<u>2,361</u>	<u>1,995</u>
Presentation in the statement of financial position:		
Liabilities in respect of employee benefits:		
Current	2,361	1,995
Noncurrent	276	465
	<u>2,637</u>	<u>2,460</u>

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 18 – EMPLOYEE BENEFITS (continued)

B. Post-employment benefits:

(1) Defined deposit plans

Avgol America and Avgol Distribution offer a benefits plan to employees, which may be redeemed without taxes upon reaching retirement age. The plan conforms with section 401K of the Internal Revenue Code. Avgol America and Avgol Distribution deposit funds to cover their liabilities in respect of this plan. The money paid and the liabilities that they cover are not presented in the financial statements, since they are not under the control and management of Avgol America and of Avgol Distribution.

There is no law in the United States making it compulsory for employers to deposit sums in respect of retirement for employees (if an employer chooses to contribute, it must do so without bias). The current deposits of Avgol America and of Avgol Distribution release them from any further obligation to employees, for whom the said sums were deposited. The Group shall not be under any legal or implicit obligation to pay any further payments if the plan shall not have sufficient assets in order to pay all of the employee's benefits relating to the employee's service during the current period and during previous periods.

The aggregate sum of the expenses recognized in the statement of income in respect of defined deposit plans during the year ended December 31, 2010, is a total of approximately USD 85 thousand (2009 – USD 80 thousand).

(2) Defined benefit plans

(a) General:

Liability in respect of retirement compensation and severance pay

The labor laws and the Severance Pay Law in Israel obligate the Company and a Consolidated Company in Israel to pay severance pay to an employee upon dismissal or retirement (including employees who leave their place of employ under other specific circumstances). The liability for the termination of employment relations is calculated in accordance with a valid employment agreement based on the employee's last salary, taking into account the number of years of his employment which, in the opinion of the Management, gives rise to the entitlement to receive severance pay.

The said liability was calculated using an actuarial assessment. The actuarial assessment was performed by Alan Dubin, a member of the Israel Association of Actuaries. The present value of the liability for a defined benefit and the related costs of current service and past services were measured using the projected unit credit method.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 18 – EMPLOYEE BENEFITS** (continued)**B. Post-employment benefits:** (continued)**(2) Defined benefit plans** (continued)**(b) The principal actuarial assumptions on the date of the statement of financial position:**

	on December 31	
	2 0 1 0	2 0 0 9
	%	%
Discount rates	4.6%	5.55%
Expected rates of return on the plan's assets	5.6%	3.20%
Expected (real) salary increase rates	2.5%	2%
Turnover and resignation rates	8%-23%	5-15%
Forecasted inflation rate	2.9%	2.63%
Nominal fixed interest rate	4.6%	5.55%

The mortality rates are not significant in the actuarial assessment of separation benefits. Compared with separation rates under which a separation benefit is payable, the mortality rates are immaterial. The actuary made use of rates in "Pension Circular 2007-3-6" of the Capital Market, Insurance and Savings Division of the Ministry of Finance.

No express use was made of a disability rate, since the assumption is that a portion of those leaving are leaving due to disability.

Until an examination of the existence or nonexistence of a deep market in high-quality corporate bonds is completed, the Group is using the appropriate discount rate for market yields on government bonds in Israel.

(c) Sums recognized in the statement of income in respect of defined benefit plans:

	For the year ended December 31	
	2 0 1 0	2 0 0 9
	USD	USD
	thousands	thousands
Current service cost	524	430
Interest cost	246	182
Expected return on the plan's assets	(241)	(130)
Actuarial gains	(173)	(17)
	<u>356</u>	<u>465</u>

The expenditure was included in the following items:

Cost of sales	230	302
Research and development expenses	20	31
Selling expenses	35	40
Administrative and general expenses	71	92
	<u>356</u>	<u>465</u>

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 18 – EMPLOYEE BENEFITS** (continued)**B. Post-employment benefits:** (continued)**(2) Defined benefit plans** (continued)**(d) Movement in the present value of the obligation in respect of a defined benefit plan:**

	For the year ended December 31	
	2010	2009
	USD thousands	USD thousands
Opening balance	4,345	3,744
Cost of current service	524	430
Interest cost	246	182
Actuarial losses (gains)	(73)	285
Benefits paid	(84)	(296)
Closing balance	<u>4,957</u>	<u>4,345</u>

(e) Movement in the fair value of the plan's assets:

	For the year ended December 31	
	2010	2009
	USD thousands	USD thousands
Opening balance	3,880	3,205
Expected return on the plan's assets	241	168
Actuarial gains	100	302
Deposits by the employer	554	497
Benefits paid	(217)	(253)
Transfer to providence fund	123	(39)
Closing balance	<u>4,681</u>	<u>3,880</u>

(f) Adjustment of the present value of the obligation in respect of the defined benefit plan and the fair value of the plan's assets to the assets and liabilities recognized in the statement of financial position:

	For the year ended December 31	
	2010	2009
	USD thousands	USD thousands
Present value of financed obligations	4,957	4,345
Fair value of the plans' assets, including rights to indemnification	(4,681)	(3,880)
	<u>276</u>	<u>465</u>

The inclusive expected rate of return is the weighted average of the expected yields of all types of assets comprising the plan's assets.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 18 – EMPLOYEE BENEFITS** (continued)**B. Post-employment benefits:** (continued)**(2) Defined benefit plans** (continued)**(g) Actual return on the plan's assets:**

	For the year ended December 31	
	2 0 1 0	2 0 0 9
	USD thousands	USD thousands
Expected return on the plan's assets	241	168
Actuarial gains	100	302
Actual return on the plan's assets	341	470

NOTE 19 – ENGAGEMENTS AND CONTINGENT LIABILITIES**A. Engagements:**

- (1) The Group has a principal supplier for raw materials at its various facilities around the world. Each year, the Group engages in an agreement with the supplier that prescribes the supply terms for the raw materials during that year, and mainly, the shipping method, the price formula for the raw materials, and a volume discount. The actual purchase of the products is done according to purchase orders issued by companies of the Group from time to time (as a clarification, the companies are under no obligation to purchase any quantity from the supplier, and the agreement solely regulates those purchases actually transacted by companies of the Group). Since the raw materials being purchased from this supplier are also purchased from a number of other suppliers, the Company Management believes that there is no dependence upon this supplier.
- (2) In 1995, Avgol Israel engaged in an agreement with an exclusive agent in North America, through which the majority of the Group's sales in America are transacted, specific sales in other territories, as well as all of the Group's sales to a principal customer (hereinafter – "Cleaver"). During the year ended December 31, 2010, approximately 77% of the Group's total sales were executed through Cleaver. In the last addendum to the agreement, which was signed between the parties in 2006, the terms and conditions of the continuation of the engagement with Cleaver from 2007 and thereafter were regulated, and, inter alia, it was agreed that if Avgol Israel shall terminate the agreement prior to 2015, it shall be required to pay compensation to the Exclusive Agent at the height of USD 4 million.

At the beginning of 2010, the Company signed an agreement that prescribed a maximum of USD 5.43 million that shall be paid to the agent in respect of commissions in 2010. In light of the sales transacted by the Company in 2010, the said prescribed maximum sum was paid to the agent.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 19 – ENGAGEMENTS AND CONTINGENT LIABILITIES (continued)

A. Engagements: (continued)

(2) (continued)

Within the scope of the Company's policy to integrate the Company's external distribution services within the Company, on December 22, 2010, an agreement was signed between Avgol and Cleaver for the acquisition of assets from Cleaver and for an amendment of the original agency agreement (hereinafter – "the Amending Agreement"). Furthermore, Cleaver and its shareholders undertook noncompetition and nonsolicitation of customers and/or employees of the Group for the period from the signing date of the Amending Agreement until December 31, 2015. In consideration, inter alia, for the said assets, for the update of the conditions of the original agency agreement and for the noncompetition and nonsolicitation undertaking of Cleaver and its shareholders as stated, Avgol paid the sum of USD 7 million to Cleaver on the signing date of the Agreement. Out of the said total, the sum of USD 1 million was immediately allocated to marketing expenses, and the sum of approximately UD 1.5 million was attributed to intangible assets, which represents Cleaver's undertaking of noncompetition and nonsolicitation of customers as stated above. The balance of the consideration, at the sum of approximately USD 4.5 million, was split between the balance of short-term receivables and long-term debit balances.

The Amending Agreement with Cleaver further prescribes that, during a period of two years after the signing date of the Amending Agreement (hereinafter – "the Period of the Additional Services"), Cleaver shall assist the Company with the integration of the sales and distribution system into the Company's operations, and shall continue to provide the Company with the distribution services that it provided to the Company prior to the signing of the Amending Agreement. Cleaver shall be entitled to a commission in consideration of all services that Cleaver shall provide to the Company during the Period of the Additional Services. The relations between the parties shall terminate upon the expiry of the Period of the Additional Services, and Cleaver shall not be entitled to any commission and/or compensation and/or other payment as a result. Furthermore, the Company reserved its right to employ Cleaver's employees as employees of the Company upon the expiry of the Period of the Additional Services.

The arrangements by virtue of the Amending Agreement as specified above are replacing the previous arrangements that had applied between the parties by virtue of the original agency agreement, including the various amendments thereto, and shall supersede them.

- (3)** On January 8, 2010, Avgol Israel and Avgol China (hereinafter jointly – "Avgol") engaged in a master agreement with a material customer of the Group for the supply of a variety of nonwoven fabric products in the Far East.

Pursuant to this agreement, Avgol shall supply various types of products to the customer, at varying volumes for a period of three years commencing January 1, 2010.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 19 – ENGAGEMENTS AND CONTINGENT LIABILITIES** (continued)**B. Contingent liabilities:**

The Company and its Consolidated Companies are a party (as a plaintiff or a defendant) from time to time during the ordinary course of their businesses, to legal proceedings or to proceedings that are liable to develop into legal proceedings.

Correct to December 31, 2010, there are no lawsuits against companies of the Group.

NOTE 20 – FINANCIAL INSTRUMENTS**A. Capital management policy:**

The Group manages its capital so as to ensure that entities of the Group shall be able to continue doing business as a “going concern,” while improving the return on shareholders’ equity, this, by sustaining an optimal capital to debt ratio.

The structure of the Company’s capital is comprised of indebtedness, which includes the loans described in notes 15 and 16, cash and cash equivalents and equity, which includes issued share capital, capital reserves and balances of surpluses, as described in the statement of changes in equity.

B. Significant accounting policies:

Details about the significant accounting policies and adopted methodologies, including recognition criteria, the measurement basis, and the basis by which income and expenses were recognized relative to each category of financial assets, financial liabilities and equity instruments, are presented in note 2.

C. Categories of financial instruments:

	As on December 31	
	2 0 1 0	2 0 0 9
	USD	USD
	thousands	thousands
Financial assets:		
Fair value through profit or loss:		
Derivatives designated as hedge instruments	<u>19,319</u>	<u>17,133</u>
Trade receivables and other accounts receivable (including cash and cash equivalents)	<u>64,653</u>	<u>50,040 (*)</u>
Financial liabilities:		
Financial liabilities measured at amortized cost	<u>78,474</u>	<u>89,463</u>
Loans from banking corporations and others	<u>91,883</u>	<u>60,098</u>

(*) reclassified

On the report date, there are no significant concentrations of credit risks relating to loans and accounts receivable designated at fair value through profit and loss. The carrying amount presented above represents the Group’s maximum exposure to credit risk in relation to such loans and accounts receivable.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 20 – FINANCIAL INSTRUMENTS (continued)

D. Financial risk management objectives:

The Group's finance department provides services to the business operations, enables access to local and international financial markets, and oversees and manages the financial risks pertaining to the Group's activities using internal reports, which analyze the extent of the exposure to risks by degree and severity. These risks include market risks (including currency risks, fair-value risks in respect of interest rates, price risks and cash flow risks in respect of interest rates), credit risks and liquidity risks.

The Group reduces the impact of the aforesaid risks by using derivatives in order to hedge the exposures to risks. The use of derivatives is performed by the C.F.O. of the Company, according to the Group's Board-approved policies, which prescribe principles in relation to: the management of currency risks, interest-rate risks, credit risks, the use of derivatives and nonderivative financial instruments and the investment of surplus liquidity. The compliance with this policy and the levels of exposure are reviewed by the internal auditors on a continuous basis.

E. Market risks:

The Group's operations expose it mainly to the financial risks of fluctuations in foreign-currency exchange rates (see subclause g. hereunder), fluctuations in interest rates (see subclause h. hereunder) and changes in raw materials prices (see subclause f. hereunder). The Group holds a variety of derivatives in order to manage its market-risk exposures, which include:

- Forward contracts for foreign-currency swaps in order to hedge against the currency risk deriving from the issue of shekel bonds;
- Interest-rate swap contracts to reduce the risk deriving from rises in interest rates;
- Contracts with customers in which a selling-price-adjustment mechanism is defined to address changes in raw materials prices, in order to reduce the risk deriving from changes in raw materials prices.

During the reporting period, no change occurred in the exposure to market risks or in the way the Group manages or measures these risks.

F. Price risk deriving from changes in raw materials prices:

The Group is exposed to changes in prices of raw materials being purchased from various suppliers in Europe, the United States, the Far East and in Israel. As a rule, the Group's agreements with its customers include clauses addressing updates to the selling prices according to changes in the costs of the raw materials. Nonetheless, such updating is done only on a quarterly basis, and therefore, a permanent rise in the price of raw materials creates exposure to the Group and erodes its profitability. On the other hand, a persistent decline in raw materials prices may improve the Group's profitability.

G. Currency risk:

Due to its international operations, the Group is exposed to fluctuations in the exchange rates of various currencies relative to the USD (the Company's Functional Currency), mainly the EUR, CNY and RUB, since there is no full overlap between the currency in which the Group generates its income and that of its expenses. Nonetheless, since there is a currency overlap between the Group's expenses and its income, even if only a partial overlap, according to the Group's assessment, the impact of the fluctuations in the exchange rates on the Group's profitability is not anticipated to be material.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 20 – FINANCIAL INSTRUMENTS** (continued)**G. Currency risk:** (continued)

During 2009, no change occurred in the exposure to currency risk or in the manner by which the Group manages or measures the risk.

For information about the carrying amounts of the Group's monetary assets and liabilities, which are denominated in foreign currency, see note 20.L.

Analysis of sensitivity to foreign currency

The Group's operations are conducted mainly in USD, with the Group being exposed mainly to NIS and EUR (the Company also faces lesser currency exposures to the CNY and the RUB).

The following table shows the sensitivity to a rise or fall of 5% in the relevant exchange rate. This sensitivity analysis includes existing balances of monetary items denominated in foreign currency, as well as external loans denominated in a currency other than that of the lender or the borrower, and adjusts the translation thereof at the end of the period to a 5% change in the foreign currency exchange rates.

When the USD strengthens relative to the NIS by 5%, a positive number in the table indicates a rise in profit or an increase in equity. On the other hand, when the USD weakens by 5% relative to the NIS, a negative number in the table indicates a loss or reduction of equity.

When the USD strengthens by 5% relative to the EUR, a negative number in the table indicates a loss or a reduction of equity. On the other hand, when the USD weakens by 5% relative to the EUR, a positive number in the table indicates a rise in profit or an increase in equity.

The impact of a 5% rise in the USD versus the other currencies prior to the tax effect:

	NIS impact		EUR impact		CNY impact	
	on December 31		on December 31		on December 31	
	2010	2009	2010	2009	2010	2009
	USD	USD	USD	USD	USD	USD
	thousands	thousands	thousands	thousands	thousands	thousands
Gain (loss)	<u>(59)</u>	<u>(56)</u>	<u>145</u>	<u>435</u>	<u>245</u>	<u>261</u>

H. Interest risk:

The Group is exposed to interest risk, because companies of the Group lend and borrow mainly at variable interest rates. The Group frequently examines the need to engage in interest-rate swap transactions. The Group ensures that it maintains an optimal hedge strategy by adapting the Group's loan mix, or, alternatively, by protecting its interest expenses by interest-rate swap forward contracts.

The Group's exposure to interest rates on financial assets and liabilities is described in this section. Regarding liquidity risk management, see hereunder in this note.

Since the Company recruited additional long-term loans at grace interest rates during the year, its exposure to interest at LIBOR increased.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 20 – FINANCIAL INSTRUMENTS (continued)

H. Interest risk: (continued)

Analysis of sensitivity to interest rates

The sensitivity analysis was determined on the basis of the exposure to fluctuations in the interest rates on short-term and long-term loans on the date of the statement of financial position. The sensitivity analysis regarding liabilities bearing variable interest was prepared under the assumption that the balance of the liability on the date of the statement of financial position remained throughout the report year. The Company's Management has no way of estimating the anticipated fluctuations in future interest rates.

For the purpose of reporting about interest-rate risks, a 10% rise or fall compared with the existing interest rate was used.

Assuming that the interest rates would be rising by 10% compared with the interest rate on the date of the statement of financial position, while the rest of the parameters stay constant, the pre-tax impact would be as follows:

- The Group's profit for the year ended December 31, 2010 would be reduced by USD 311 thousand (2009: reduced by USD 227 thousand). This change derives mainly from the Group's exposure to interest rates in relation to its loans bearing variable interest.

I. Management of credit risks:

Credit risk relates to a risk that the counter party might not fulfill its contractual obligations and cause a financial loss to the Group. The Group implements a policy of executing transactions with parties having good credit ratings, when appropriate, as a means of reducing the risk of financial losses due to defaults.

Balances in respect of trade receivables of the Group include a large number of customers scattered over a variety of geographical regions. An extensive credit assessment is performed every two weeks in relation to the financial status of accounts receivable.

The Group has no exposure to a specific credit risk of any single third party or any category of third parties having similar characteristics. The Group defines third parties as having similar characteristics if they are related entities. The credit risk in respect of liquid sums and derivatives is limited, since the counter-parties to these balances are banks with high credit ratings assigned by an international credit rating agency.

For an analysis of the aging of financial assets in arrears on the report date, see note 4.B above.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 20 – FINANCIAL INSTRUMENTS** (continued)**I. Management of credit risks:** (continued)

The following table shows sums of the credit framework and the sums in the statement of financial position pertaining to the principal customer (more than 10%) on the date of the statement of financial position, using the Standard and Poor's credit rating.

Debtor	Location	Rating	on December 31, 2010		on December 31, 2009	
			Credit frame	Carrying amount	Credit frame	Carrying amount
			USD millions		USD millions	
Procter & Gamble	Global	AA-/stable (1)	**	13.6	20	8.1
Kimberly-Clark	Global	AA-/stable (1)	**	16.2	*	*

(1) Standard and Poor's rating

(*) In 2009 the sales to this customer did not exceed 10% of the total sales.

(**) A credit frame was not set.

J. Management of liquidity risks:

The final responsibility for managing liquidity risk is that of the Board of Directors, which formulates a suitable work plan for managing liquidity risk in relation to the Management's requirements for financing and liquidity in the short term, mid term and in the long term. The Group manages its liquidity risk by banking means and loans, through continuous monitoring of the actual and forecasted cash flows and by adjusting the vesting characteristics of financial assets and liabilities. The Company examines the liquidity risks within the framework of a designated finance committee, and liquidity risk management is one of the topics on its agenda.

Interest and liquidity risk tables**(1) Financial liabilities not constituting derivatives**

The following tables specify the remaining contractual maturity dates of the Group in respect of financial liabilities, which do not constitute derivatives. The tables were prepared based on the undiscounted cash flows of the financial liabilities based on the earliest date on which the Group might be required to repay them. The table includes flows both in respect of interest and in respect of principal on long-term loans only.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 20 – FINANCIAL INSTRUMENTS** (continued)**J. Management of liquidity risks:** (continued)

	Average effective interest rate %	Up to one month	1 – 3 months	More than 3 months to one year	1 – 5 years	More than 5 years	Total
		USD thousands					
2010							
Interest-bearing instruments:							
Variable interest	3.26%	3,501	174	18,841	55,188	18,811	96,515
Fixed interest	5.86%	-	-	17,420	53,553	-	70,973
		<u>3,501</u>	<u>174</u>	<u>36,261</u>	<u>108,741</u>	<u>18,811</u>	<u>167,488</u>
2009							
Interest-bearing instruments:							
Variable interest	4.59%	189	5,618	10,676	49,344	2,382	68,209
Fixed interest	6.02%	-	-	20,788	75,475	-	96,263
		<u>189</u>	<u>5,618</u>	<u>31,464</u>	<u>124,819</u>	<u>2,382</u>	<u>164,472</u>

The Group expects to be able to pay its other liabilities from its operating cash flows and from redemption of its financial assets. The Company has unutilized credit frameworks that may be used by the Company in instances where it needs additional sources of financing.

(2) Financial liabilities constituting derivatives

The following table specifies the Group's liquidity analysis regarding its derivatives. The table was prepared based on the cash payments/receipts relating to financial instruments designated as hedge items. When the sum for payment or receipt is not fixed, the reported sum was determined based on the forecasted interest rates as described by the existing interest yield curve at the end of the reporting period.

	Average effective interest rate %	Up to one month	1 – 3 months	More than 3 months to one year	1 – 5 years	More than 5 years	Total
		USD thousands					
2010							
Interest-bearing instruments:							
Fixed interest	5.86%	-	-	5,163	14,156	-	19,319
2009							
Interest-bearing instruments:							
Fixed interest	6.02%	-	-	3,691	13,442	-	17,133

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 20 – FINANCIAL INSTRUMENTS** (continued)**K. Fair value of financial instruments:**

Financial instruments that are not stated in the statement of financial position at fair value:

Apart from that specified in the table hereunder, the Group believes that the carrying amounts of the financial assets and liabilities presented at amortized cost in the financial statements approximate their carrying amounts:

	Carrying amount		Fair value	
	on December 31		on December 31	
	2010	2009	2010	2009
	USD	USD	USD	USD
	thousands	thousands	thousands	thousands
Financial liabilities				
Bonds	78,474	89,463	86,883	98,616

- (1) The fair value is based on prices quoted in an active market at the end of the reporting period.

Financial instruments presented in the statement of financial position at fair value:

For the purpose of measuring the fair value of the financial instruments, the Group classifies the financial instruments being measured in the statement of financial position according to their fair value, according to a fair-value hierarchy that includes the following three levels:

Level 1: quoted prices (unadjusted) in active markets for identical financial assets and liabilities.

Level 2: inputs other than quoted prices included in level 1, which are observable directly (i.e., prices) or indirectly (input deriving from prices), in relation to financial assets and liabilities.

Level 3: inputs on financial assets and liabilities that are not based on observable market data.

Financial assets at fair value:

	on December 31, 2010			
	Level 1	Level 2	Level 3	Total
	USD	USD	USD	USD
	thousands	thousands	thousands	thousands
Financial assets at fair value through comprehensive income:				
Swap and IRS transaction	-	19,319	-	19,319

	on December 31, 2009			
	Level 1	Level 2	Level 3	Total
	USD	USD	USD	USD
	thousands	thousands	thousands	thousands
Financial assets at fair value through comprehensive income:				
Swap and IRS transaction	-	17,133	-	17,133

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 20 – FINANCIAL INSTRUMENTS** (continued)**L. Linkage terms of monetary assets and liabilities:**

	as on December 31, 2010				Total
	In or linked to USD	In NIS	In or linked to EUR	In or linked to other foreign currency	
	USD thousands				
Assets:					
Cash and cash equivalents	12,034	1,003	2,218	1,780	17,035
Trade receivables	23,129	3,896	8,250	5,406	40,681
Short-term derivatives	5,163	-	-	-	4,360
Other accounts receivable and debit balances	709	465	148	3,038	6,807
Long-term derivatives	14,156	-	-	-	14,156
Long-term debit balances	-	50	-	-	50
	<u>55,191</u>	<u>5,414</u>	<u>10,616</u>	<u>10,224</u>	<u>81,445</u>
Liabilities:					
Short-term credit from banking corporations and current maturities of long- term liabilities from banking corporations and others	17,913	-	-	7,347	25,260
Current maturities of long- term bonds, net	18,381	-	-	-	18,381
Trade payables	25,665	2,064	7,620	2,192	37,541
Other accounts payable and credit balances	2,496	2,113	99	667	5,375
Long-term loans from banking corporations and others (after deducting current maturities)	61,279	-	-	5,343	66,622
Long-term bonds, net (*)	60,093	-	-	-	60,093
	<u>185,827</u>	<u>4,177</u>	<u>7,719</u>	<u>15,549</u>	<u>213,272</u>
Financial assets less financial liabilities (financial liabilities less financial assets)	<u>(130,636)</u>	<u>1,237</u>	<u>2,897</u>	<u>(5,325)</u>	<u>(131,827)</u>

(*) The Company engaged in hedging with derivatives in order to convert the bond principal to principal denominated in USD.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 20 – FINANCIAL INSTRUMENTS** (continued)**L. Linkage terms of monetary assets and liabilities:** (continued)

	as on December 31, 2009				
	In or linked to USD	In NIS	In or linked to EUR	In or linked to other foreign currency	Total
	USD thousands				
Assets:					
Cash and cash equivalents	8,545	534	2,908	1,247	13,234
Trade receivables	18,628	3,911	5,135	2,948	30,622
Short-term derivatives	3,691	-	-	-	3,691
Other accounts receivable and debit balances	915	360	2,337	2,571	6,183
Derivatives	13,442	-	-	-	13,442
Long-term debit balances	-	56	-	-	56
	<u>45,221</u>	<u>4,861</u>	<u>10,380</u>	<u>6,766</u>	<u>67,228</u>
Liabilities:					
Short-term credit from banking corporations and current maturities of long- term liabilities from banking corporations and others	11,896	-	-	2,121	14,017
Current maturities of long- term bonds, net	17,327	-	-	-	17,327
Trade payables	18,994	1,954	1,603	997	23,548
Other accounts payable and credit balances	2,923	1,735	79	1,041	5,778
Long-term loans from banking corporations and others (after deducting current maturities)	38,720	-	-	7,361	46,081
Long-term bonds, net	72,136	-	-	-	72,136
	<u>161,996</u>	<u>3,689</u>	<u>1,682</u>	<u>11,520</u>	<u>178,887</u>
Financial assets less financial liabilities (financial liabilities less financial assets)	<u>(116,775)</u>	<u>1,172</u>	<u>8,698</u>	<u>(4,754)</u>	<u>(111,659)</u>

NOTE 21 – GUARANTEES, SURETIES AND LIENS

As a means to secure credit that the Group received from banking corporations, which totalled approximately USD 91.8 million on December 31, 2010, the Group registered a fixed and floating unlimited lien on all of the Group's assets (including shares of the companies of the Group). All shares of Avgol Israel and the share certificates in respect thereof were registered and pledged in favor of a banking corporation in Israel and are additionally pledged in favor of another banking corporation in Israel.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS**

NOTE 21 – GUARANTEES, SURETIES AND LIENS (continued)

To secure the fulfillment of the conditions prescribed in relation to investment grants that Avgol Israel received (see note 32), Avgol Israel registered a floating lien unlimited in sum in favor of the State of Israel, including on all machinery, equipment, tools, instruments and real estate and related insurance rights.

Israeli and American banking corporations also have specific liens on shares and assets of Avgol America and there are cross guarantees between these banks and banks in Israel, which constitute a guarantee of the Israeli Company's assets on the American company's assets.

A banking corporation in China also has liens on the first production line of the Company in China.

NOTE 22 – SHARE CAPITAL**A. The share capital is comprised as follows:**

Ordinary shares of NIS 0.0001 nominal par value each –

	on December 31, 2010 and 2009	
	Registered	Issued and paid-up
Ordinary shares	<u>5,000,000,000</u>	<u>297,853,595</u>

B. On December 28, 2006, the Company's Board of Directors adopted a dividend distribution policy whereby at least 50% of the Company's profits shall be distributed annually as dividends to the Company's shareholders, subject to the statutory provisions and the Company's cash flow needs.

NOTE 23 – DIVIDENDS

On April 19, 2010, the Company paid a dividend at the sum of USD 8,000 thousand (USD 0.027 per share). On April 13, 2009, the Company paid a dividend at the sum of USD 7,000 thousand (USD 0.024 per share). On April 16, 2008, the Company paid a dividend at the sum of USD 10,000 thousand (USD 0.034 per share) to the holders of ordinary shares.

Regarding the declaration of a dividend distribution subsequent to the end of the reporting period, see note 38.A.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 24 – SALES REVENUE**

- A. The segmentation of sales by principal customers (customers with which the transaction turnover exceeds 10% of the operating turnover):

	For the year ended December 31		
	2 0 1 0	2 0 0 9	2 0 0 8
	USD	USD	USD
	thousands	thousands	thousands
Procter & Gamble (P&G)	119,084	91,998	100,244
Kimberly-Clark (KC)	53,901	*	*

(*) The Group's sales to the customer KC in 2008-2009 did not exceed 10% of the sales turnover in those years.

B. Memorandum of understandings with a material customer:

On March 4, 2008, Avgol Israel (hereinafter jointly with its related companies – "Avgol") engaged in a memorandum of understandings with the Procter & Gamble Company (hereinafter – "P&G"), which is a material customer of the Group.

P&G declared in the memorandum of understandings that it intends on reducing the number of suppliers with whom it does business and increasing the volume of its purchases from suppliers with whom it shall continue to do business, including the Group.

Pursuant to the Memorandum of Understandings, P&G shall be rewarded each year in respect of its purchases from the Group, in the form of a discount, with the height of the discount deriving from the volume of P&G's purchases from the Group in the relevant year and from the rise in the Company's value. The annual discount to which P&G shall be entitled in respect of each of the above components is expected to range between USD 0-2.5 million, depending upon the Company's valuation figures, and P&G's purchasing quantities as specified in the memorandum of understandings. The granting of the discounts is conditional, inter alia, upon the minimum purchase quantities defined in the memorandum of understandings.

NOTE 25 – COST OF SALES**Composition:**

	For the year ended December 31		
	2 0 1 0	2 0 0 9	2 0 0 8
	USD	USD	USD
	thousands	thousands	thousands
Use of materials	166,854	107,683	155,753
Wages and benefits	15,461	14,183	14,725
Electricity, municipal tax and other taxes	13,436	12,393	13,449
Maintenance and insurance	8,284	8,464	6,830
Shipping	4,918	4,109	6,174
Depreciation	15,191	12,689	10,963
Other expenses	113	709	573
	<u>224,257</u>	<u>160,230</u>	<u>208,467</u>
Decrease (increase) in finished goods inventories	(6,971)	1,927	(1,048)
	<u>217,286</u>	<u>162,157</u>	<u>207,419</u>

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 26 – RESEARCH AND DEVELOPMENT EXPENSES****Composition:**

	For the year ended December 31		
	2010	2009	2008
	USD thousands	USD thousands	USD thousands
Wages and benefits	1,066	882	997
Materials	1,227	967	1,563
Professional consulting	9	59	39
Other expenses	101	195	154
	<u>2,403</u>	<u>2,103</u>	<u>2,753</u>

NOTE 27 – SELLING AND MARKETING EXPENSES**Composition:**

	For the year ended December 31		
	2010	2009	2008
	USD thousands	USD thousands	USD thousands
Wages and benefits	1,107	1,117	997
Commissions to agents	5,498	4,812	6,384
Storage and shipping	5,430	4,008	4,547
Travel abroad	441	476	279
Payments for marketing agreement (see note 19.A(2))	1,000	-	-
Other expenses	364	268	569
	<u>13,840</u>	<u>10,681</u>	<u>12,776</u>

NOTE 28 – ADMINISTRATIVE AND GENERAL EXPENSES**Composition:**

	For the year ended December 31		
	2010	2009	2008
	USD thousands	USD thousands	USD thousands
Wages and benefits	3,946	2,950	2,347
Doubtful and bad debts	88	357	(150)
Professional services	2,192	1,816	1,234
Rent and maintenance	941	864	1,016
Depreciation and amortization	390	349	338
Other expenses	907	818	572
	<u>8,464</u>	<u>7,154</u>	<u>5,357</u>

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 29 – FINANCING EXPENSES****Composition**

	For the year ended December 31		
	2010	2009	2008
	USD thousands	USD thousands	USD thousands
Expenses in respect of short-term credit from banking corporations	489	757	812
Expenses in respect of long-term loans from banking corporations and others	2,837	2,665	2,817
Financing expenses in respect of long-term bonds	5,776	5,298	5,533
Other expenses	595	-	252
Less – interest capitalized to qualifying assets during the reporting period (1)	(624)	(634)	(502)
	<u>9,073</u>	<u>8,086</u>	<u>8,912</u>

(1) See note 10.A.

NOTE 30 – FINANCING INCOME**Composition:**

	For the year ended December 31		
	2010	2009	2008
	USD thousands	USD thousands	USD thousands
Interest income from short-term deposits	140	97	58
Gain from fair-value changes and disposals of derivatives	-	-	1,055
Other income	408	156	537
	<u>548</u>	<u>253</u>	<u>1,651</u>

NOTE 31 – OTHER INCOME (EXPENSES), NET**Composition:**

	For the year ended December 31		
	2010	2009	2008
	USD thousands	USD thousands	USD thousands
Capital gain from the sale of fixed assets	-	2	4
Expenses relating to an attempted acquisition of a company (1)	-	-	(4,729)
Other income due to a contract cancellation (2)	-	566	-
Property tax rebates (3)	585	-	-
Other income (expenses), net	244	8	(25)
	<u>829</u>	<u>576</u>	<u>(4,750)</u>

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 31 – OTHER INCOME (EXPENSES), NET (continued)

- (1) Negotiations for the acquisition of a company: at the beginning of 2008, the Company conducted negotiations in connection with the acquisition of all shares of Fiberweb Plc, a UK company engaging in the manufacture of nonwoven fabric for the hygiene and industrial sectors, whose shares are traded on the London Stock Exchange (hereinafter – “Fiberweb”). The due diligence costs in connection with this acquisition totalled approximately USD 4.7 million during 2008. Subsequent to the due diligence process and in light of other macro-economic considerations that arose during that period, the Company decided not to submit an offer for the acquisition of Fiberweb’s shares.
- (2) On July 4, 2007, the subsidiary, Avgol Russia, engaged in an agreement with a Russian company for the sale of a portion of the grounds of the factory and various infrastructure. The agreement specified that Avgol Russia shall prepare energy and water infrastructure for the Russian company, and shall transfer the ownership of a portion of the land to the Russian company for the consideration of approximately USD 1,200 thousand. The agreement also specified that, if the agreement shall be cancelled, the Russian company shall pay a penalty to Avgol Russia at the sum of approximately USD 565 thousand. On May 13, 2009, the agreement was cancelled by the Russian company. Avgol Russia received the sum of USD 565 thousand.
- (3) Pursuant to the local laws of the area where the Russian subsidiary’s plant is located, rebates were received at the sum of approximately USD 585 thousand, for local property tax payments that the subsidiary had paid in 2009.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 32 – TAXES ON INCOME****A. Balances of deferred taxes:**

The composition of the deferred tax liabilities (assets) is specified hereunder:

	In respect of				Total USD thousands
	In respect of depreciable fixed assets USD thousands	carry- forward losses USD thousands	allowances		
			for employee benefits USD thousands	In respect of other timing differences USD thousands	
Balance on January 1, 2009	22,552	(11,100)	(135)	1,366	12,683
Movement in 2009					
Recognized in profit and loss	2,421	(787)	(10)	806	2,430
Change in the tax rate	(351)	-	61	(243)	(533)
Initial consolidation	-	-	-	760	760
Translation differences	-	-	-	4	4
Recognized in other comprehensive income	-	-	-	608	608
Balance on December 31, 2009	<u>24,622</u>	<u>(11,887)</u>	<u>(84)</u>	<u>3,301</u>	<u>15,952</u>
Movement in 2010					
Recognized in profit and loss	301	3,533	101	472	4,407
Change in the tax rate	(1,950)	-	(33)	709	(1,274)
Translation differences	17	-	-	-	17
Recognized in other comprehensive income	-	-	-	(225)	(225)
Balance on December 31, 2010	<u>22,990</u>	<u>(8,354)</u>	<u>(16)</u>	<u>4,257</u>	<u>18,877</u>

B. Presentation in the statement of financial position:

	As on December 31	
	2010	2009
	USD thousands	USD thousands
Noncurrent assets – deferred tax assets	(351)	(1,500)
Noncurrent liabilities – deferred tax liabilities	19,228	17,452
Deferred tax liabilities	<u>18,877</u>	<u>15,952</u>

C. Sums for which deferred tax assets were not recognized:

	As on December 31	
	2010	2009
	USD thousands	USD thousands
Business losses for tax purposes	-	1,029
Capital losses for tax purposes	410	385
Total	<u>410</u>	<u>1,414</u>

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 32 – TAXES ON INCOME** (continued)**C. Sums for which deferred tax assets were not recognized:** (continued)

Pursuant to the existing tax laws in Russia, carry-forward losses for tax purposes may be utilized for 10 years after the date they were created.

Pursuant to the existing tax laws in China, carry-forward losses for tax purposes may be utilized for five years after the date they were created.

Pursuant to the existing tax laws in the United States, carry-forward losses for tax purposes may be utilized for 20 years after the date they were created.

Pursuant to the existing tax laws in Israel, there is no expiration date for utilizing carry-forward losses for tax purposes and for utilizing the deductible temporary differences.

D. Income taxes directly recognized in equity and in other comprehensive income:

	For the year ended December 31	
	2010	2009
	USD thousands	USD thousands
<u>Current taxes</u>		
In respect of share realization expenses	41	100
In respect of issue expenses	-	200
	41	300

<u>Deferred taxes</u>		
Revaluations of financial instruments handled under cash flow hedge accounting	225	(608)
	225	(608)
Total income taxes recognized in equity	266	(308)

E. Income tax expenses recognized in the statement of income:

	For the year ended December 31		
	2010	2009	2008
	USD thousands	USD thousands	USD thousands
<u>Current taxes</u>			
Current tax expenses	3,309	4,465	3,723
Tax expenses (income) in respect of previous years	(433)	(18)	(889)
Total current taxes	2,876	4,447	2,837

<u>Deferred taxes</u>			
Deferred tax expenses in respect of the creation and reversal of temporary differences	3,977	1,897	1,040
Total deferred taxes	3,977	1,897	1,040

Total income tax expenses	6,853	6,344	3,874

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 32 – TAXES ON INCOME (continued)

F. Additional information:

- (1) On February 26, 2008, the Income Tax Law (Adjustments for Inflation) (Amendment no. 20) (Restriction of the Application Period), 5768 – 2008 (hereinafter – “the Amendment”) was passed during the third reading by the *Knesset*, under which the application of the Adjustments for Inflation Law shall cease in the 2007 tax year, and the provisions of the law shall no longer apply as of the 2008 tax year, with the exception of transitional provisions whose objective is to prevent distortions in the tax calculations.

Pursuant to the Amendment, as of the 2008 tax year, an adjustment of income for tax purposes to a real measurement basis shall no longer be calculated. Furthermore, sums of depreciation on fixed assets and sums of carry-forward losses for tax purposes shall no longer be linked to the CPI, in such manner that these sums shall be adjusted up until the CPI of the end of the 2007 tax year, and thereafter, the linkage to the CPI shall cease.

- (2) **Benefits pursuant to the provisions of the Law for the Encouragement of Capital Investments, 5719 – 1959**

Pursuant to the provisions of the Law for the Encouragement of Capital Investments, 5719 – 1959 (“the Law”), Avgol Israel is entitled to various tax benefits by virtue of its status as an “approved enterprise,” which was awarded to Avgol Israel’s plant. In accordance with the Law, Avgol Israel received investment grants at the inclusive sum of USD 23.8 million from the State of Israel, pursuant to a number of approved plans that were approved for Avgol. According to the Law, when calculating the depreciation for tax purposes, the grant is deducted from the cost of the investment.

According to the Law, Avgol Israel is entitled to a variety of tax benefits in respect of the taxable income attributed to each plan, for a period of seven to ten years after the initial year in which taxable income was first generated to Avgol Israel according to each plan separately, all provided that 12 years have not yet elapsed since the year the plan began being implemented or within 14 years of the date that the approval for these benefits was received, whichever is earlier. The Law grants a reduced tax rate of 25% to the approved plans, and, in relation to a plan approved on July 9, 1998, a two-year tax exemption (provided that no dividend is distributed) and the remaining five years at the reduced tax rate of 25%.

Correct to the date of the statement of financial position, the benefit period in respect of these plans has ended.

In October 2006, Avgol Israel received approval from the tax authorities (tax ruling agreement) that the expansion executed at its plant in Israel from 2003 through 2005 is deemed a “beneficiary enterprise,” as this term is defined in section 51 of the Law. Pursuant to the provisions of the Law and this approval, Avgol Israel is entitled to a tax exemption for a period of ten years commencing in 2005 on its taxable income deriving from the beneficiary enterprise.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 32 – TAXES ON INCOME (continued)

F. Additional information: (continued)

(2) Benefits pursuant to the provisions of the Law for the Encouragement of Capital Investments, 5719 – 1959 (continued)

On November 16, 2008, Amendment number 65 of the Law was promulgated; pursuant to that stated in the amendment, Avgol Israel chose to deem the expansion executed at its plant in Israel from 2002 through 2004 a beneficiary enterprise, and thus, shall be entitled to a tax exemption for a period of ten years commencing in 2004 on its taxable income deriving from the beneficiary enterprise, in lieu of the elective year of 2005, which was approved as stated above. Avgol Israel also chose to deem the expansion executed at its plant in Israel from 2005 through 2006 an additional beneficiary enterprise, and thus, shall be entitled to a tax exemption for a period of ten years commencing in 2006 on its taxable income deriving from the additional beneficiary enterprise.

Pursuant to the Law, the tax exemption in respect of the income attributed to the approved plans and the beneficiary enterprises (hereinafter – “the Exempt Income”) is conditional upon no dividend being distributed from them. In the event of a distribution of the Exempt Income as a dividend, the tax exemption shall be rescinded and Avgol Israel shall be charged tax at the rate of 25%.

Income other than within the framework of the approved enterprises or beneficiary enterprises, as described above, shall be taxed at the statutory tax rate for companies in Israel.

Avgol Israel received investment grants from the State of Israel pursuant to the Law for the Encouragement of Capital Investments, 5719 – 1959. If Avgol Israel shall not comply with the conditions relating to the receipt of these grants, it will be required to return the grant sums, in whole or in part, plus interest and linkage differentials from the date the grants were received. According to the assessment of the Company’s Management, Avgol Israel is complying with the conditions it undertook in the approval certificates.

(3) Tax assessments

The Company files its tax report jointly with Avgol Israel.

In January 2008, a tax assessment and collection agreement was signed between the Company and the Israel Tax Authorities for the tax years 2002 through 2005.

Pursuant to the agreement reached, the Company and Avgol Israel paid an additional tax liability at the sum of approximately USD 3.3 million (not including interest and linkage).

During 2009, an audit was performed by the Internal Revenue Service in the United States (hereinafter – “the IRS”) of Avgol America and of Avgol Distribution in relation to the 2007 tax year. In October 2009, a document was received from the IRS whereby the audit was completed.

Final tax assessments were issued to an Investee Company in Russia up until 2009. Final tax assessments have not yet been issued to an Investee Company in China.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 32 – TAXES ON INCOME (continued)

F. Additional information: (continued)

(4) Legislative amendment regarding the corporate tax rate

On July 23, 2009, the Law for Economic Efficiency (Amended Legislation for Implementing the Economic Plan for 2009 and 2010), 5769 – 2009 was passed in Israel (hereinafter – “the Economic Arrangements Law”). Pursuant to the Economic Arrangements Law, the tax rates of 26% and 25% imposed in Israeli companies in 2009 and 2010, respectively, shall be gradually reduced as of the 2011 tax year, for which tax at the rate of 24% shall be imposed and until the 2016 tax year, for which the corporate tax rate shall be 18%.

As a result of that stated above, in 2009, the Company recorded tax income of approximately USD 533 thousand in respect of the effect of application of the Economic Arrangements Law on the deferred taxes.

On December 29, 2010, the *Knesset* passed the Law for Economic Policy for the years 2011-2012 (Amended Legislation), 5771 – 2011, which was promulgated on January 6, 2011. Within the scope of the Law for Economic Policy, the Law for the Encouragement of Capital Investments, 5719 – 1959 was amended (hereinafter – “the Amendment to the Law”). Pursuant to the Amendment to the Law, the various tax tracks were eliminated and flat tax rates were applied to the Company’s entire production turnover. The affixed tax rates are: in 2011-2012 – 15% (in development zone A – 10%); in 2013-2014 – 12.5% (in development zone A – 7%); and as of 2015 – 12% (in development zone A – 6%). The provisions of the Amendment to the Law came into effect as of January 1, 2011. The Company may choose whether to apply the Amendment to the Law and to waive the balance of the benefits to which it is entitled by virtue of the Law prior to the Amendment.

The Company expects to apply the provisions of the Law for the purpose of calculating its taxable income as of the 2011 tax year. Based on the Company’s forecast specified above, the Company recognized deferred tax income of approximately USD 1.2 million in 2010.

(5) Tax rates in Consolidated Companies

- (a) Avgol America’s federal corporate tax rate is 34% (the tax rate rises to 35% on income for tax purposes exceeding USD 10 million per annum). In addition, Avgol America is liable for state taxes at various rates (depending upon the state in which the goods are sold), with this sum deemed an expense for the purpose of the federal tax. A dividend distribution from Avgol America is subject to a final withholding tax at the rate of 12.5%, pursuant to the tax treaty between Israel and the United States. As a result of that stated above, the weighted tax rate applicable to income in the United States being transferred to Israel is approximately 38%.
- (b) The tax rate that applies to the subsidiary in China is 12.5% for 2010 and 2011, and 25% thereafter; no additional tax is imposed on a dividend distribution.
- (c) The corporate tax rate in Russia is 20%. Pursuant to the tax treaty between Israel and Russia, dividends, interest and royalties payable by a company that is a resident of Russia to a resident of Israel is liable for withholding tax in Russia at the rate of 10%.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 32 – TAXES ON INCOME (continued)****G. The effective tax:**

The difference between the tax sum calculated on income according to the ordinary tax rates and the total provision for taxes is explained hereunder:

	For the year ended December 31		
	2 0 1 0	2 0 0 9	2 0 0 8
	USD	USD	USD
	thousands	thousands	thousands
Income before taxes on income	27,839	21,898	13,897
Statutory tax rate	25%	26%	27%
Computed tax	6,959	5,693	3,752
Tax addition (savings) in respect of:			
Unrecognized expenses	1,190	20	1,364
Adjustment in respect of a tax rate in the Company with approved enterprises, net	-	(185)	(129)
Losses and benefits for tax purposes for which deferred taxes were not calculated	-	(193)	(309)
Difference in the tax rate applicable to income of Consolidated Companies abroad	231	787	832
Taxes in respect of previous years	(223)	(54)	(889)
Adjustments due to amendments to the tax laws	(1,362)	(533)	-
Other allowances, net	58	809	(747)
	<u>(106)</u>	<u>651</u>	<u>122</u>
	<u>6,853</u>	<u>6,344</u>	<u>3,874</u>

NOTE 33 – SHARE-BASED PAYMENT**A. Details of option warrant allotment plans to functionaries in the Company:**

On March 21, 2010 and March 23, 2010, the Company's Audit Committee and Board of Directors, respectively, approved the appointment and terms of employ of Mr. Shlomo Liran, as the new C.E.O. of the Company, as of April 18, 2010. The engagement with the C.E.O. is for an indefinite term. The conditions of the new C.E.O.'s incumbency include a gross monthly salary of NIS 100 thousand linked to the CPI, an annual bonus to be determined by the Company's Board of Directors in respect of 2010 and an annual bonus in respect of his incumbency in the coming years (2011 and thereafter) to be determined according to a mechanism to be set by the Company's Board of Directors on the approval date of the annual budget for each relevant year. Furthermore, the C.E.O.'s employment terms include his entitlement to an allotment of options in a capital gains track as follows: 5,212,437 options, constituting 1.75% of the Company's issued and paid-up share capital (not fully diluted), which are exercisable for 5,212,437 ordinary shares of the Company. The exercise price of each option warrant is NIS 2.5 per share. The options shall vest in four tranches as follows: (1) the first tranche, of 2,382,829 options, shall vest at the end of two years of employment; (2) the second tranche, of 1,191,414 options, shall vest at the end of an additional year; i.e., after the completion of three years of employ; (3) the third tranche, of 1,191,414 options, shall vest at the end of an additional year; i.e., after the completion of four years of employ; (4) the fourth tranche, of 446,780 options, shall vest at the end of ten additional months; i.e., after the completion of four years and ten months of employ. Furthermore, the C.E.O. is entitled to 744,634 options exercisable for 744,634 ordinary shares of the Company, constituting 0.25% of the Company's issued and paid-up share capital (not fully diluted) at an exercise price of NIS 3 per share.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 33 – SHARE-BASED PAYMENT** (continued)**A. Details of option warrant allotment plans to functionaries in the Company:** (continued)

These options shall vest after the completion of four years and ten months of employ since the first day of his employ. Furthermore, subject to the approval of the Company's Board of Directors, after having held a deliberation of the matter during the second half of the fifth year of the C.E.O.'s employ, and at the sole discretion of the Board of Directors, the C.E.O. shall be entitled, to the extent that the Board of Directors shall so decide, to an additional allotment of 1,489,268 options exercisable for 1,489,268 ordinary shares of the Company, constituting 0.5% of the Company's issued and paid-up share capital (not fully diluted). This allotment shall be carried out, to the extent that the Company's Board of Directors shall so decide, subsequent to the completion of four years and ten months of employ since the first day of the C.E.O.'s employ. These options, if allotted, shall be exercisable immediately upon the allotment thereof, and at an exercise price of NIS 3 per share. The exercise price of the options is subject to adjustments in respect of a dividend distribution.

The undertaking to allot options to the new C.E.O. was contingent upon the adoption of an options plan by the Company's Board of Directors. On May 23, 2010, such a plan was adopted.

On May 23, 2010, the Company's Board of Directors resolved to allot 523,568 options to the Company's C.F.O. at the exercise price of NIS 2.4 per share, subject to adjustments, which are exercisable for five years after the allotment date and with a gradual vesting mechanism of four tranches during four years.

The implied cost of the benefit in the option warrants allotted to the C.E.O. and C.F.O. as stated, based on their fair value on the date of the granting thereof, is estimated at the sum of approximately USD 2.1 million. This sum shall be allocated to the statement of income over the vesting period.

B. Estimate of the fair value of the option warrants:

The fair value of the options warrants granted as stated above has been estimated using the binomial model. Within this scope, the Company took into account the impact of the conditions not constituting vesting conditions on the fair value of the equity instruments being granted.

The parameters used when applying the model are as follows:

Component	Plan 1	Plan 2
Average share price (in NIS)	2.25	2.22
Exercise price (in NIS)	2.5	2.4
Expected volatility (*)	48%	48%
Lifespan of the option warrants (in years) (*)	1-5	4
Risk-free interest rate	2.24%-4.18%	2.16%-4%
Expected dividend rate	0%	0%

(*) The expected volatility was determined on the basis of the historical volatility of the share prices of the Company and of other companies in the Group. The average lifespan of the option warrants was determined based on the Management's forecast of the period that the employees shall hold the option warrants granted to them, considering their positions in the Company and the Company's past experience relating to employees leaving.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 33 – SHARE-BASED PAYMENT** (continued)**C. Exercises of option warrants during the reporting period:**

No option warrants were exercised during the reporting period.

D. Details about the impact of share-based payment transactions on the profit or loss of companies of the Group for the period and on the financial position:

	For the year ended December 31		
	2010	2009	2008
	USD	USD	USD
	thousands	thousands	thousands
The portion of the expenditure settled in cash	-	-	-
The portion of the expenditure cleared with equity instruments of the Company	458	-	-
Total value in the books in respect of a liability for a share-based payment	-	-	-

E. Additional details regarding option warrants granted to employees:

	As on December 31, 2010		As on December 31, 2009	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Option warrants granted to employees that were:				
Outstanding at the beginning of the period	-	-	-	-
Granted	6,457,071	2.4	-	-
Forfeited	-	-	-	-
Exercised	-	-	-	-
Expired	-	-	-	-
Outstanding at the end of the year	6,457,071	2.4	-	-
Exercisable at the end of the year	-	-	-	-

NOTE 34 – TRANSACTIONS OTHER THAN IN CASH

A. During 2010, the Group capitalized financing expenses to fixed assets at the sum of USD 624 thousand.

B. During 2010, the Group purchased fixed assets at the sum of approximately USD 4.1 million with suppliers' credit for a period exceeding three months. During 2009, the Group purchased equipment at the sum of USD 1,033 thousand with suppliers' credit for a period exceeding three months.

C. During 2009, the Group capitalized financing expenses to fixed assets at the sum of USD 634 thousand.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 35 – INFORMATION BY GEOGRAPHICAL SEGMENTS**

The Group operates in a number of principal geographical regions:

For the year ended December 31, 2010

	Israel	North America	Europe	China	Others	Total
	USD	USD	USD	USD	USD	USD
	thousands	thousands	thousands	thousands	thousands	thousands
Revenue from external customers by customer location	12,995	137,050	74,079	30,124	23,280	277,528
Location of noncurrent assets	25,280	92,490	35,898	61,490	-	215,158

For the year ended December 31, 2009

	Israel	North America	Europe	China	Others	Total
	USD	USD	USD	USD	USD	USD
	thousands	thousands	thousands	thousands	thousands	thousands
Revenue from external customers by customer location	11,466	111,649	65,725	12,112	10,296	211,250
Location of noncurrent assets	24,085	87,503	37,737	41,299	-	190,624

For the year ended December 31, 2008

	Israel	North America	Europe	China	Others	Total
	USD	USD	USD	USD	USD	USD
	thousands	thousands	thousands	thousands	thousands	thousands
Revenue from external customers by customer location	12,260	161,194	57,488	7,402	15,869	254,213
Location of noncurrent assets	31,645	74,653	39,411	9,363	-	155,072

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 36 – INTERESTED PARTIES AND RELATED PARTIES****A. Balances with interested parties and related parties:**

	on December 31	
	2 0 1 0	2 0 0 9
	USD	USD
	thousands	thousands
<u>Interested parties</u>		
Under current liabilities –		
Trade payables	14,354	2,679
Other payables and credit balances	580	886
Under long-term liabilities –		
Employee benefits	158	106

B. Transactions with interested parties and related parties:

	For the year ended December 31	
	2 0 1 0	2 0 0 9
	USD	USD
	thousands	thousands
<u>Related parties</u>		
Purchases of raw materials	49,161	28,047
Other	526	8

During its ordinary course of business, Avgol Israel purchases raw materials from a related party (a company indirectly held at 30.72% by Israel Petrochemical Enterprises Ltd., the controlling shareholder of the Company). All of the purchases are transacted at market conditions and according to purchase orders issued by Avgol Israel from time to time. In March 2008, the Company's Audit Committee and Board of Directors approved Avgol Israel's engagement in a master agreement with the related party to regulate purchases of the raw material, polypropylene (hereinafter – "the Raw Material") for the years 2008-2010 ("the Master Agreement"). Pursuant to the Master Agreement, the Raw Material shall be purchased according to the general selling conditions between the related party and all of its customers, as they shall be from time to time. The Master Agreement shall be for a period of three years as of January 1, 2008, whereby the parties shall engage in an annual agreement each year, under which the engagement terms and conditions shall be prescribed specifically for the relevant year, including the annual quantity being purchased, a mechanism for setting and updating prices, payment terms, etc. Pursuant to the Master Agreement, Avgol Israel undertook that for 2008, it shall purchase a quantity of 17 thousand tons of the Raw Material from the related party (with a variance of up to 10%), with the prices of the Raw Material being determined according to the mechanism agreed upon between the parties. In light of the fact that at issue is a transaction with a controlling shareholder of the Company, which therefore, has a personal interest in the agreement, the Master Agreement was approved by the Company's General Meeting.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 36 – INTERESTED PARTIES AND RELATED PARTIES** (continued)**B. Transactions with interested parties and related parties:** (continued)

On March 17, 2009, the Audit Committee and Board of Directors approved the renewal of the agreement for 2009. Pursuant to the agreement, Avgol undertook to purchase a quantity of approximately 23 thousand tons of the Raw Material (with a variance of up to 10%) from the related party, with the prices of the Raw Material being determined according to the mechanism agreed upon between the parties.

On January 28, 2010, the Audit Committee and Board of Directors approved the renewal of the agreement for 2010. Pursuant to the agreement, Avgol undertook to purchase a quantity of 30 thousand tons of the Raw Material (with a variance of up to 10%) from the related party, with the prices of the Raw Material being determined according to the mechanism agreed upon between the parties.

Regarding an agreement with a related party signed subsequent to the reporting period, see note 39.B.

C. Remuneration of key management staff:

	For the year ended December 31		
	2010	2009	2008
	USD thousands	USD thousands	USD thousands
Short-term benefits	2,277	1,672	1,395
Share-based payments	458	-	-
Post-employment benefits	284	42	81
	<u>3,019</u>	<u>1,714</u>	<u>1,476</u>

* In 2010, the Company reorganized its structure, under which additional employees were subordinated directly to the Company's C.E.O. and thus became senior officeholders as of the second half of the year.

D. Benefits to interested parties:

	For the year ended December 31		
	2010	2009	2008
	USD thousands	USD thousands	USD thousands
Wages and benefits to interested parties employed by the Company	2,115	1,423	1,058
Number of people to whom the benefit applies	4	4	4
Remuneration of directors not employed by the Company	121	97	87
Number of people to whom the benefit applies	4	4	4

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 36 – INTERESTED PARTIES AND RELATED PARTIES (continued)

- E.** On December 28, 2006, addenda to the employment agreements of two interested parties who are officeholders in the Company were signed. Pursuant to the addenda to these employment agreements, the Company shall pay an annual bonus to each of the these two interested parties at the sum equivalent to one half of one percent (0.5%) of the Company's annual net profit, which shall be paid to them within 30 days of the signing date of the Company's financial statements. (One of the interested parties' entitlement to a bonus expired at the end of 2009).
- F.** On December 9, 2009, after having received the approval of the Company's Audit Committee, the Company's Board of Directors resolved to approve the severance conditions of the outgoing Company C.E.O., Mr. Nir Peleg, who is also a director and controlling shareholder of the Company (hereinafter – "Mr. Peleg"), in relation to his stepping down from office as the Company's C.E.O. consensually as of December 9, 2009, as well as approval of an engagement with him in an agreement appointing him as a consultant to the Company's C.E.O. for the receipt of consulting services for a term up until August 15, 2013, pursuant to the conditions formulated in the agreement in principle between him and the Company dated December 9, 2009 (hereinafter – "the Consulting Agreement").

Pursuant to the resolution, in consideration for the consulting services and conclusion of Mr. Peleg's term of office as the Company's C.E.O., the Company shall pay a monthly payment to Mr. Peleg, against an invoice and not constituting employment relations, during the period between December 10, 2009 and August 15, 2011, at the sum of NIS 103 thousand, linked to the CPI; i.e., at the cost of employment of Mr. Peleg as the Company's C.E.O. during his incumbency. During the period between August 16, 2011 and August 15, 2013, the Company shall pay Mr. Peleg a monthly sum equivalent to the last monthly remuneration that Mr. Peleg shall receive during the initial period. It was further agreed that 50% of the total consideration in respect of the second period, as stated above, shall be given in exchange for an undertaking of noncompetition with the Company, which exceeds that prescribed in Mr. Peleg's employment agreement as the Company's C.E.O. Furthermore, the Company sold the company car that Mr. Peleg had used during his term of office as C.E.O. to Mr. Peleg, fully grossing up the sale cost. The cost of this benefit to the Company is NIS 420 thousand. Furthermore, Mr. Peleg shall be entitled to reimbursement in respect of use of the car during the period of the consulting agreement.

Within the scope of his services as a consultant, Mr. Peleg shall provide services to the Company as a consultant to the Company's C.E.O., and within this framework, Mr. Peleg shall be available to the Company's C.E.O. to the extent that the C.E.O. shall require. No appointment percentage or hours of work were defined, however, Mr. Peleg undertook to make himself fully available according to the Company C.E.O.'s requirements from time to time.

During the reporting period, the Company recorded the full value of the consulting services component in the statement of income at the sum of approximately USD 126 thousand, in light of the fact that the Company is no longer availing itself of the consulting services of Mr. Nir Peleg.

Subsequent to the approvals of the above transaction by the Company's Audit Committee and Board of Directors, on January 28, 2010, the Company's General Meeting approved the above resolution, as is required pursuant to the Companies Law, and the transaction took effect retroactively as of December 9, 2009.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 36 – INTERESTED PARTIES AND RELATED PARTIES** (continued)

- G. On July 13, 2010, within the framework of an Extraordinary General Meeting for the approval of a transaction with a controlling shareholder, the Company's General Meeting approved a retroactive amendment to the employment agreement of April 18, 2010 of Mr. Achai Bonneh, who holds office as the Vice Chairman of the Board of Directors, and who is one of the controlling shareholders of the Company.

Mr. Achai Bonneh's salary was updated in the amendment to his employment agreement, from some USD 18 thousand per month to about USD 23 thousand per month.

The mechanism for the annual bonus to which Mr. Achai Bonneh is entitled by virtue of his employment agreement was also updated, in the following manner:

If the Company's annual net profit (hereinafter – "the Net Profit") shall be lower than USD 10 million, Mr. Achai Bonneh shall not be entitled to a bonus; if the Net Profit shall be higher than USD 10 million, Mr. Achai Bonneh shall be entitled to a bonus at the rate of 0.5% of the total Net Profit; if the Net Profit shall be higher than USD 25 million, Mr. Achai Bonneh shall be entitled to a bonus at the rate of 1% of the total Net Profit. Furthermore, a one-time bonus at the sum of approximately USD 100 thousand was approved in respect of the period during which Mr. Achai Bonneh held office as the acting C.E.O. of the Company, and in respect of his contribution to the forging of the transaction with the Chinese partner in the Chinese subsidiary.

Following is the impact of the conditions of the new employment agreement as specified above:

(1) Impact on the Net Profit for the year

	For the year ended December 31		
	2010	2009	2008
	USD	USD	USD
	thousands	thousands	thousands
Net profit for the year attributed to the owners of the parent company as reported according to the previous agreement	20,260	15,468	10,023
Wage of the Vice Chairman of the Board according to the previous agreement up until April 18, 2010	364	255	280
Wage of the Vice Chairman of the Board according to the new agreement	404	384	421
	(40)	(129)	(141)
The tax impact	10	34	38
Total pro forma impact	(30)	(95)	(103)
Pro forma net profit for the year attributed to the owners of the parent company	20,230	15,373	9,920

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 36 – INTERESTED PARTIES AND RELATED PARTIES** (continued)

G. (continued)

(2) Impact on the comprehensive income for the year

	For the year ended December 31		
	2 0 1 0	2 0 0 9	2 0 0 8
	USD	USD	USD
	thousands	thousands	thousands
Comprehensive income for the period attributed to the owners of the parent company	21,861	19,076	10,436
Pro forma impact	(30)	(95)	(103)
Pro forma comprehensive income for the year attributed to the owners of the parent company	21,831	18,981	10,333

(3) Impact on the research and development expenses

	For the year ended December 31		
	2 0 1 0	2 0 0 9	2 0 0 8
	USD	USD	USD
	thousands	thousands	thousands
Research and development expenses as reported	2,403	2,103	2,753
Pro forma impact	40	129	141
Research and development expenses	2,443	2,232	2,894

(4) Impact on the base and diluted earnings per share

	For the year ended December 31		
	2 0 1 0	2 0 0 9	2 0 0 8
	USD	USD	USD
	thousands	thousands	thousands
Base and diluted earnings per share as reported	0.068	0.052	0.034
Pro forma impact	0.000	0.000	0.000
Pro forma base and diluted earnings per share	0.068	0.052	0.034

The impact on the diluted earnings per share was not presented since the diluted earnings are identical to the base earnings per share.

AVGOL INDUSTRIES 1953 LTD.**NOTES TO THE FINANCIAL STATEMENTS****NOTE 36 – INTERESTED PARTIES AND RELATED PARTIES** (continued)

G. (continued)

(5) Impact on the balance of the surpluses

	For the year ended December 31	
	2 0 1 0	2 0 0 9
	USD thousands	USD thousands
Balance of surpluses as reported	46,169	33,685
Pro forma impact	(30)	(95)
Pro forma balance of surpluses	<u>46,139</u>	<u>33,590</u>

H. On March 23, 2011, the Company's Audit Committee and Board of Directors approved a bonus to the C.E.O. at the sum of approximately USD 120 thousand in respect of 2010.

NOTE 37 – ADDITIONAL DETAILS ABOUT INCOME AND EXPENSES**A. Expenses in respect of employee benefits:**

	For the year ended December 31		
	2 0 1 0	2 0 0 9	2 0 0 8
	USD thousands	USD thousands	USD thousands
Wages and benefits	17,854	15,570	16,092
Expenses in respect of a defined deposit plan	85	80	82
Benefits in respect of dismissal	750	791	497
Other benefits	2,745	2,691	2,379
	<u>21,434</u>	<u>19,132</u>	<u>19,050</u>

B. Depreciation and amortizations:

	For the year ended December 31		
	2 0 1 0	2 0 0 9	2 0 0 8
	USD thousands	USD thousands	USD thousands
Depreciation of fixed assets	15,518	12,974	11,291
Amortization of real-estate rights	63	38	11
Amortization of loan recruitment costs	158	136	174
	<u>15,739</u>	<u>13,148</u>	<u>11,476</u>

NOTE 38 – EVENTS SUBSEQUENT TO THE END OF THE REPORTING PERIOD

A. On January 18, 2011, the Company's Board of Directors resolved to distribute a dividend in cash at the sum of approximately USD 0.03357 per ordinary share, for the inclusive total of USD 10 million. The Company distributed the aforesaid dividend on February 16, 2011, the date set as the dividend distribution date.

AVGOL INDUSTRIES 1953 LTD.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 38 – EVENTS SUBSEQUENT TO THE END OF THE REPORTING PERIOD (continued)

- B.** On February 10, 2011, the Company's Audit Committee and Board of Directors approved a new master transaction for a period of five years, which regulates purchases of the raw material, polypropylene, by Avgol from Carmel Olefins Ltd. (hereinafter – "COL"). The master transaction defines that during each calendar year, Avgol shall purchase a quantity of polypropylene that shall not exceed 40,000 tons per annum. On the same date, the Company's Audit Committee and Board of Directors also approved an annual agreement for 2011 between Avgol and COL, which regulates purchases of polypropylene from Carmel Olefins Ltd. during 2011. Within the scope of the agreement for 2011, Avgol undertook to purchase a quantity of polypropylene from COL that shall not diminish from 22,500 tons (with a variance of +/- up to 10%). If Avgol shall purchase this quantity in its entirety, and subject to Avgol fulfilling the conditions of the annual agreement, COL shall credit Avgol with a 3% discount off the cost of the total purchases. In addition, Avgol shall be entitled to a volume discount according to the scale prescribed in the agreement. The Company's Audit Committee and Board of Directors also approved a framework for spot transactions for the purchase of up to 6,000 tons of the raw material, polypropylene, during 2011.

The transactions specified above are subject to the approval of the general meeting, which shall convene on March 30, 2011.

- C.** During January 2011, Avgol America signed a loan and refinancing agreement for an existing loan with Bank Leumi USA ("Bank Leumi USA") and Bank Hapoalim B.M. ("Bank Hapoalim USA") (hereinafter – "the Loan and Refinancing Agreement"). In the Loan and Refinancing Agreement, a loan at the sum of approximately USD 25 million that Avgol America had obtained from the said banks was rescheduled and the duration lengthened, so that this loan was rescheduled for a period of eight years ending in December 2018. Within the scope of this agreement, Avgol America also obtained an additional loan at the sum of USD 10 million (USD 5 million from Bank Leumi USA and USD 5 million from Bank Hapoalim USA) for a like period of eight years. Avgol guaranteed Avgol America's liabilities by virtue of the Loan and Refinancing Agreement.

NOTE 39 – APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved by the Board of Directors and were approved for publication on March 23, 2011.