EL AL ISRAEL AIRLINES LTD.

2016 ANNUAL REPORT

El Al Israel Airlines Ltd.

Periodic Report
For 2016

Chapter A
Description of the Corporation's Business

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Chapter 1: General

El Al Israel Airlines Ltd. is pleased to hereby submit the report of the description of the Corporation's business as of December 31, 2016, which reviews the description of the corporation and the development of its business, as occurred in 2016. The financial data contained within this Report are denominated in U.S. dollars unless otherwise stated.

Percentage holdings are presented in numbers rounded to the nearest whole percentage, unless otherwise stated.

Data appearing in this Report are true as of the date of the Report, unless otherwise stated. Data appearing in this Report as true as of the latest date prior to the approval of the Report, are updated as of March 14, 2017, unless otherwise stated.

The materiality of the information contained within this Report has been examined from the Company's point of view; however, in some of the cases, additional description is given to provide a comprehensive picture of the descried subject.

Definitions

For purposes of convenience, the following abbreviations used in this Periodic Report shall have the meaning ascribed next to them:

Board of Director's Report -	The Report of the Board of Directors of the Company on the state of the corporation's affairs for the year ended December 31, 2016.
Dollars -	United States Dollar.
The Stock Exchange -	The Tel Aviv Stock Exchange Ltd.
Financial Statements -	The consolidated financial statements of the Company for the year ended December 31, 2016, unless otherwise stated.
The State -	The State of Israel.
The Group -	The Company and its consolidated companies.
The Authority -	The Securities Authority.
The Corporation or the **Company** or **El Al -**	El Al Israel Airlines Ltd.
Fifth Freedom of the	Carrying passengers or cargo between two foreign countries by a third-country air carrier. For example, El Al carries cargo between Liege and

Air -	New York.
Sixth Freedom of the Air -	Carrying passengers or cargo between two foreign countries with a stopover in the air carrier's country of origin. For example, a flight operated by a European airline from Israel to the U.S. through an airport in the country of origin of the European airline.
Companies Law -	The Companies Law, 5759-1999.
Government Companies Law -	The Government Companies Law, 5735-1975.
The Securities Law -	The Securities Law, 5728-1968.
IATA -	International Air Transport Association.
Date of the Report -	December 31, 2016.
Knafaim -	Knafaim Holdings Ltd.
BGA -	Ben Gurion Airport.
Date Near Approval of the Report -	March 14, 2017, unless stated otherwise.
Sun d'Or -	Sun d'Or International Airlines Ltd.
NIS -	New Shekels.
Reporting Year -	Year 2016.
2003 Prospectus -	The prospectus published by the Company on May 30, 2003, as amended on June 2, 2003 and June 4, 2003.
ASK -	Available seat kilometer - the number of seats offered for sale multiplied by the airborne distance.
ATK -	Available Ton-KM: the capacity available to carry passengers (translated into tons) and cargo, multiplied by the distance flown.
RPK -	Revenue passenger kilometer - the number of paid passengers multiplied by the airborne distance.
RTK -	Revenue ton kilometer - which weights in tons the passengers and cargo

for payment multiplied by airborne distance.

FTK- Freight ton kilometer - weights in tons of the cargo (including mail) for payment multiplied by airborne distance.

FLF- Freight load factor - the occupancy rate on cargo flights calculated by RTK as a percentage of ATK.

PLF - Passenger load factor - the occupancy rate on passenger flights (percent of seats utilized) calculated by passenger - RPK as a percent of ASK.

Chapter 2: Description of the General Development of the Company's Business

1. Activities of the Company and description of the development of its business

1.1 General

The Company's main operations involve air transport of passengers and cargo (including luggage and mail) through passenger planes and a cargo plane. The Company's passenger planes mainly perform regular flights and charter flights.

The Company was appointed as Israel's designated air carrier in most of the international routes operating to and from Israel. For further information on the matter and on the meaning of the term "Designated Carrier" and the Government Resolution regarding the "Open Sky" policy, see Sections 7.1.1, 7.1.2, 7.1.10 and 9.11.7.2 below.

The Group is engaged in activities related to the air transport operations, such as the sale of duty-free products, food production and supply mainly to the Company's aircraft, providing security services, ongoing maintenance services and overall maintenance services to aircraft of other airlines at Ben Gurion Airport, managing travel agencies abroad, and the issuance of the Company's branded credit cards to members of the "Matmid" Frequent Flyer Club.

The business environment in which the Company operates is the international and civil aviation and tourism industry to and from Israel, which is characterized by seasonality and the high level of competition.

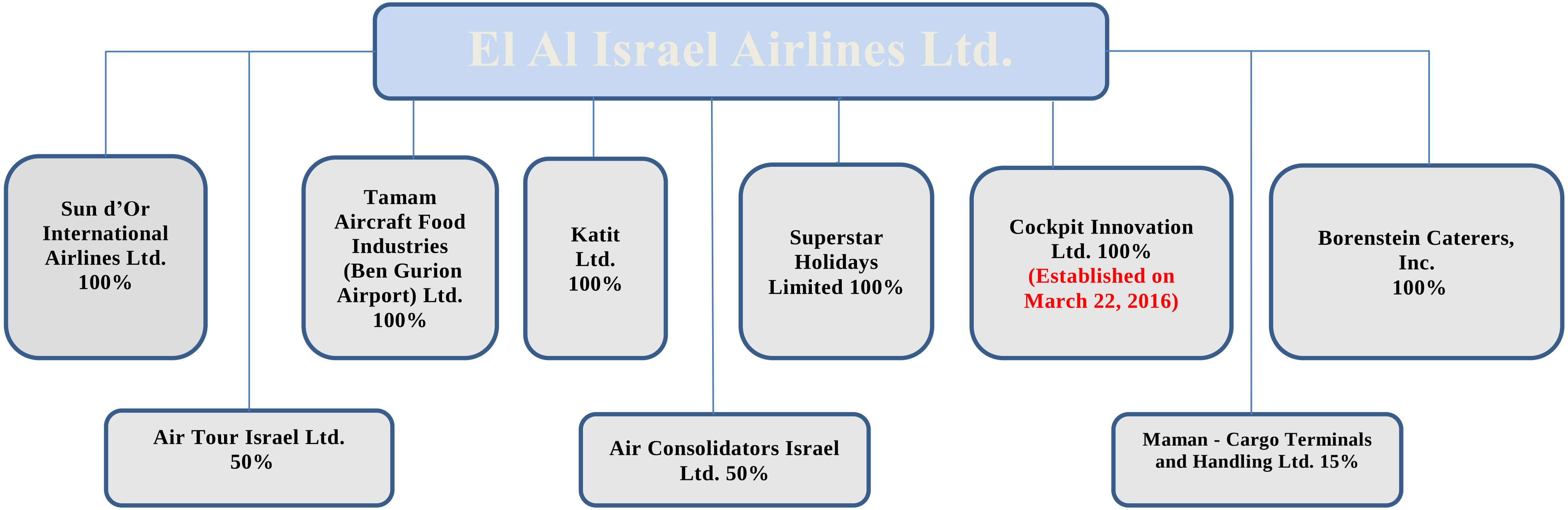
In the area of passenger transport, in 2016 the Company competed with approximately 60 foreign airlines that operated scheduled flights and about 50 foreign charter airlines, of which about 30 airlines operated flights on a regular basis, as well as two Israeli airlines (Arkia and Israir). Airline companies compete in different areas, mostly over prices, flight frequency and schedule, operational accuracy, type of equipment, aircraft configuration, passenger service and more. The competition is with airlines operating scheduled flights between different destinations, charter flights between the same destinations and/or Sixth Freedom flights.

In the area of cargo transport, eight airlines operating cargo aircraft on flights to and from Ben Gurion Airport competed in 2016 with the Company's operations, in addition to C.A.L. Cargo Airlines Ltd. Moreover, the Company competes with most scheduled airlines operating passenger aircraft and carrying cargo in their bodies.

For more information about the competition, see Sections 7.1.10, 7.8 and 8.7 below.

1.2 Chart of Holdings

Below is a chart of the Company's holdings in investee companies on the Date Near the Report's Approval (the percentages listed on the chart express the Company's holdings of the investee companies)[1]:



[1] In October 2016, the Company sold all of its holdings (20%) in shares of Holiday Lines Ltd. For additional details, see Note 8 of the financial statements.
Superstar Holdings Limited is registered in England and registered in Israel as a foreign company.
Borenstein Caterers Inc. is registered in Delaware, USA.
In March 2016, the Visitors and Legacy Center of EL AL Ltd.(CC) (the "**Visitors' Center**") was established, which is held by the Company, employees and retirees of the Company, and which was incorporated and registered as a public benefit company. As of the date of the Report, activity has not yet commenced within the Visitors' Center. In addition, the Company holds Seven Days International Club Ltd., as well as Morel Hotels Ltd., which are in the process of voluntary liquidation.

1.3 **Year of the Company's incorporation and incorporation type**

El Al Israel Airlines Ltd. was incorporated as a limited liability company on November 15, 1948.

1.4 **Changes in the Company's business**

Until June 6, 2004, the Company was working as a "government company" in "privatization" (as the terms are defined in the Government Companies Law). For additional details, see Section 9.11 below, "Restrictions and supervision of the Company's business."

To the best knowledge of the Company, the Government currently owns approximately 1.1% of the issued share capital of the Company, thus the Company still holds the status of a "Mixed Company." In addition, the Government owns the Special State Share (for details regarding the Special State Share and the rights attached thereto, see Section 9.11.9 below).

2. **Areas of activity**

The Group has two reported operating segments. For details, see Note 20 of the financial statements.

a. Air transport in passenger aircraft

In this segment, the Company carries passengers and cargo (including mail and baggage) in the body of the passenger aircraft and provides them with related services such as the sale of duty-free products. Revenues from the segment constitute approximately 90.6% of the total revenues of the Company in 2016.

b. Air transport in cargo plane

In this segment, the Company carries cargo in a dedicated 747-400 Boeing aircraft designed to carry cargo. Revenues from the segment reached approximately 3.1% of the total revenues of the Company in 2016.

Apart from the operating segments specified above, the Group has other activities that are not included in these segments and that are not material to the Company's operations as set forth in Section 1.1 above, the total revenues of which constitutes approximately 6.3% of the total revenues of the Group in 2016.

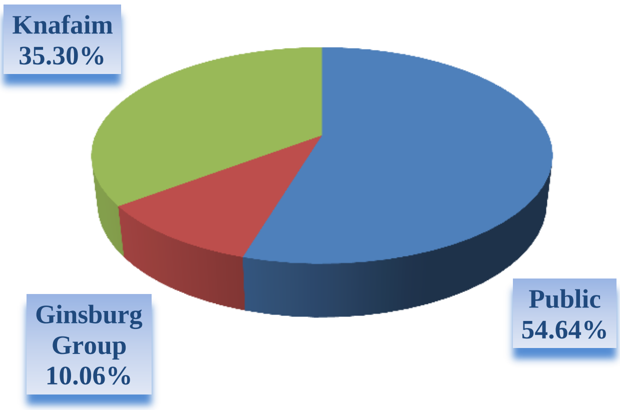
3. **Investments in the Company's capital**

3.1 **General**

In the Reporting Year, no investments were made in the Company's capital.

3.2 **Concentration of holdings of interested parties**

The following is the distribution of holdings in shares of the Company as of the Date Near Approval of the Report:



4. **Distribution of dividend**

On August 5, 2015, the Company declared a distribution of dividend in the amount of NIS 0.19 per share (USD 0.05) for each ordinary share par value NIS 1. The total dividend amount amounts to NIS 94.2 million (USD 24.7 million). The effective date for the dividend distribution was set for August 13, 2015, and was actually paid on August 25, 2015.

On March 23, 2016, the Company declared a distribution of dividend in the amount of NIS 0.117 per share (USD 0.03) for each ordinary share par value NIS 1. The total dividend amount amounts to NIS 57.8 million (USD 15 million). The effective date for the dividend distribution was set for March 31, 2016, and was actually paid on April 13, 2016.

On August 17, 2016, the Company declared a distribution of dividend in the amount of NIS 0.14 per share (USD 0.037 as of the approval of the interim financial statements) for each ordinary share par value NIS 1. The total dividend amount amounts to NIS 69.4 million (USD 18.3 million). The effective date for the dividend distribution was set for August 25, 2016, and was actually paid on September 7, 2016.

As of the date of the Report, the balance of the Company's distributable profits was NIS 129.2 million.

For details regarding the dividend policy, see Note 17 of the financial statements.

5. Financial information regarding the fields of activity of the Company

For details regarding new financial reporting standards published and their interpretations published by IFRS, see Note 2 of the financial statements. For details regarding the Company's operating segments, see Note 20 of the financial statements.

5.1 Nature of the adjustments

The adjustments between the total results of the reported segments and the overall result presented in the Financial Statements of the Company mainly include expenses that are not attributed to segments in accordance with the Results Report reviewed by the Chief Operating Decision Maker (CODM), as provided in Note 21B to the Financial Statements.

5.2 Explanation of developments in the areas of activity

For explanations of the developments that occurred in the Company's business results in the Report Year compared to the corresponding period last year, see Section 3a. of the Board of Director's Report.

6. General environment and the effect of external factors on the Company

6.1 International aviation traffic

The international aviation market is affected by the security and political situation, special events, such as the outbreak of epidemics and natural disasters around the world in general and in specific areas in particular, and the economic situation in Israel and the world.

According to the IATA's assessment, the year 2016 has been one of the most profitable years for the international aviation industry, while airlines are expected to show profits of USD 35.6 billion in respect of 2016. In 2016, more than 700 new routes were launched and the downward trend of ticket prices continued. As a result, passenger traffic increased to a peak of 3.7 billion passengers.

It is noted that according to IATA data, 2015-2017 are expected to be the three years in which the performance of airlines will be the best in aviation history, despite the security, political and economic threats faced by the airlines.

According to the IATA, the total passenger traffic (international and domestic flights together) increased by 6.3% in 2016 compared to 2015, the average capacity has increased by 6.2% compared to 2015, and the average occupancy rate reached a record of 80.5%. The growth rate of international traffic (alone) was higher than the growth rate of total passenger traffic (international and domestic) and reached the same rate of 6.7%. Traffic growth (international and domestic flights together) was led by the Middle East (11.2%) and in Asia (9.2%).

Overall cargo traffic (international and domestic flights together) recorded an increase of 3.8% in 2016 compared to 2015, following a growth of 2.3% in cargo traffic in 2015, compared to 2014.

The estimates and assessments of IATA regarding the global aviation industry and the profitability expected in the aviation industry are forward-looking information as defined in the Securities Law. This information is not based on the Company's estimates and relies on the assessments of the IATA alone, inter alia, in light of the existing trends of change in the aviation and tourism industry in recent years and the anticipated developments therein, and in light of the economic, security and geopolitical state in Israel and around the world. Therefore, this data may be materially different from the forecast as stated, if the IATA's assessments are not realized, as a result of a large number of factors, including a change in the economic, security and geopolitical situation in Israel and around the world.

6.2 **Movement in the aviation industry in Israel**

According to data provided by the Central Bureau of Statistics, a total of about 2.6 million tourist entries to Israel by air were recorded in 2016 (excluding day visits), thus reflecting a decrease of approximately 4.5% compared to 2015. An increase of approximately 15% was recorded in the traffic of Israelis departing by air, compared to 2015, and in total, about 6.3 million departures of Israelis abroad by air were reported.

According to data provided by the Israeli Airports Authority, international passenger traffic in Ben Gurion Airport increased in 2016 by approximately 17.3 million passengers, indicating a growth of approximately 11% compared to 2015.

6.3 **Fluctuations in the prices of jet fuel**

Aircraft jet fuel is a very substantial component of the Company's expenses. Jet fuel prices are characterized by high and sharp fluctuations. The following data refer to the weighted average of jet fuel market prices (before marketing margins and other fees) in the markets where the Company purchases fuel, as quoted by Platts[2]. During 2016, jet fuel prices dropped ("markets basket" - the weighted price in accordance with markets in which the Company purchases jet fuel) by approximately 19% on average, compared to 2015 prices. For further details, see Sections 9.5.1 and 9.18.6 below. For further details regarding the financial impact of jet fuel price, including as a result of hedging activities, see Sections A3 and B1 of the Board of Director's Report and Note 18 to the Financial Statements.

6.4 **Fluctuations in foreign exchange rates**

The Group's results are affected by fluctuations in several currencies in relation to the US dollar. Fluctuations in the dollar exchange rate in relation to other currencies may lead to an improvement or to the erosion of the Group's profitability. As of December 31, 2016, there was a 1.5% appreciation of the NIS/USD exchange rate, compared to December 31, 2015. As of December 31, 2016, there was an 3.2% appreciation of the USD/EUR exchange rate, compared to December 31, 2015. For details regarding the impact of the fluctuations on foreign exchange rates, including as a result of hedging activities, see Sections B1 of the Board of Director's Report and Note 18 to the Financial Statements.

6.5 **Fluctuations in interest rates**

For the purpose of financing aircraft acquisitions, the Company took a significant volume of loans bearing variable interest based on the Libor interest. A change in the Libor interest rates may affect the Company's financing expenses. An average Libor interest rate for three months was 0.74% in 2016, compared to an average rate of 0.32% in 2015. For details regarding the Company's loans, see Note 13 in the Financial Statements.

[2] To the best knowledge of the Company, Platts is a company of McGraw-Hill Group that has provided information on the energy sector for many years. Platts provides updated information and analysis, *inter alia*, with respect to prices and international events in the fuel, petrochemical, natural gas and electric and nuclear power markets.

Chapter 3: Description of the Company's Business by Area of Activity

The following is a description of the business of the Group with respect to each area of its operations separately, except in matters related to all areas of the Group's operations, described together in Section 9 below.

7. Field of activity of passenger planes

7.1 General information on the field of activity

The Company's main activity in this area is the transportation of passengers on regular flights. The Company also operates charter flights. In addition, the Company carries cargo in the passenger aircraft body, which accompanies passenger transport activities. The services in this segment include additional related services, such as sales of duty-free items to passengers on the aircraft. Therefore, in describing the segment, the Company focused on passenger transportation. Certain issues relating to cargo transport in the body of passenger aircraft are similar to the service of cargo transport on the Company's cargo aircraft, as described in Section 8 below.

Trends, events and developments in the macroeconomic environment of the Group, which have or are expected to have material impact on the business results or the development in the area of operations, are described below with respect to the following areas:

7.1.1 Structure of the field of activity and changes thereto

As stated above, the main area of operations of the Company is air transport on passenger aircraft on scheduled flights to and from Israel.

In the past, the aviation policy has been regulated by the decision of the Ministerial Committee for Social and Economic Affairs, shortly before the publication of the 2003 Prospectus (Decision SE/14 dated May 19, 2003), with regard to the appointment of the Company as "Designated Carrier." Thereafter, several government decisions were made, determining the aviation policy of the State of Israel with respect to the Company's operations and the State's participation in security expenses incurred by Israeli airlines. For details regarding regulatory arrangements applicable to the aviation operations, including traffic rights granted to the Company, see Section 9.11 below.

7.1.2 Restrictions, legislation, regulations and special circumstances applicable to the field of activity

The segment of passenger and cargo transport on passenger aircraft is characterized by international and local regulatory restrictions in various jurisdictions, provided for in international treaties and agreements and in local legislation. For details regarding international arrangements, see Section 9.11 below.

Additionally, these international and local arrangements provide for conditions and arrangements relating to air carrier's operation and liability for damages and for flight delays and cancellations.

The Company is obligated to act upon local legislation and relevant government decisions relating to the Company's areas of operations (including aviation security services), as set out in Section 9.11 below.

7.1.3 Changes in the volume of activity in the area and in its profitability

a. **International developments**

According to the IATA, in 2016, the total passenger traffic (international and domestic together) increased by about 6.3% compared to 2015.This rate was higher than the average growth rate in the last decade, which was about 5.5%. International traffic (excluding domestic traffic) increased in 2016 by approximately 6.7% and seat availability on international flights increased by approximately 6.9%, more than the growth rate of passenger traffic, therefore a slight decrease was recorded in occupancy on international passenger flights – 79.6% in 2016 compared to 79.7% in 2015.

In December 2016, IATA updated its profit forecast for 2016 upwards. According to the new estimate, airlines are expected to present in 2016 net profits of approximately USD 35.6 billion (compared to USD 39.4 billion, according to IATA forecast of June 2016). The update of the profit forecast was made based on the slow growth in GDP compared to the expectation and the increase in expenses of airlines in 2016. It is noted that despite the aforesaid profit forecast, 2016 is expected to be the year in which airlines record the absolute highest profit as well as the highest net profit margin, which is expected to be 5.1% of the total airline revenues in 2016. According to the IATA, airlines are expected to present net profits of USD 29.8 billion in 2017, representing 4.1% of their total revenues, which are expected to total USD 736 billion in 2017. IATA estimates that the trend of growth in passenger traffic is expected to continue in 2017 and to grow to 4 billion passengers and cargo transport by air is expected to reach 55.7 million tons in 2017.

Passenger traffic, international capacity* and profitability of the industry (including local activity), segmented by region:

Area	RPK Change in 2016 compared to 2015	ASK Change in 2016 compared to 2015	PLF	Estimated performance for 2017 (USD billion)	Estimated performance for 2016 (USD billion)	2015 (USD billions)
Africa	7.4%	7.4%	67.7%	-0.8	-0.8	-0.9
Asia	8.3%	7.7%	78.6%	6.3	7.3	7.8
Europe	4.8%	5.0%	82.8%	5.6	7.5	7.5
South America	7.4%	4.8%	81.3%	0.2	0.3	-1.7
Middle East	11.8%	13.7%	74.7%	0.3	0.9	1.1
North America	2.6%	3.3%	81.3%	18.1	20.3	21.5
Total	**6.7%**	**6.9%**	**79.6%**	**29.8**	**35.6**	**35.3**

*It is noted that RPK, ASK and PLF data refers only to international traffic.

As shown on the table above, passenger traffic increased in all of the regions, with the highest increase being the fifth consecutive year, marking an increase of 11.8% in international passenger traffic among Middle East airlines. These companies, some of which accounted for 9.3% of the international passenger traffic, constitute the third largest market in size of international passenger traffic after Europe (23.62%) and Asia (18.2%).

The data presented on the table above shows that the airlines of all of the regions other than Africa are expected to show profits in 2017. The expected profit, according to the IATA forecast, attributed to the North American airlines in 2015-2017 is more than 50% the total expected profit of all of the airlines in these years, *inter alia*, due to structural changes and mergers among the airlines in the region, which contributed to the efficiency of the companies.

The following are the highlights of the IATA forecast for 2017:

Oil Price - The price of oil is a key element in determining the IATA forecast for 2017. The average price (on an annual level) for a barrel is expected to increase from USD 44.6 in 2016 to USD 55 in 2017, and accordingly, the price of jet fuel is expected to increase from USD 52.1 per barrel on average in 2016 to USD 64.9 per barrel in 2017. The total fuel expenses in 2017 are expected to constitute 18.7% of the total expenses of the aviation industry, significantly lower than the rate of fuel expenses in 2012-2013, which peaked at 33.2%.

Demand - the accelerated demand that characterized 2016 due to the low oil prices is expected to gradually decrease in 2017.

Passenger traffic in 2017 is expected to increase by 5.1% compared to the increase of 6.3% in 2016. Seat capacity is expected to increase by 5.6% in 2017, compared to an increase of 6.2% in 2016. The expected increase in 2017 in capacity is higher than the expected increase in passenger traffic, and therefore, the occupancy rate in passenger aircraft is expected to decrease in 2017 to 79.8% compared to 80.5% in 2016.

The negative impact of the decrease in occupancy rates is expected to moderate to a certain degree as a result of the global strengthening of the economy of the various countries.

The expected growth in the global GDP from a rate of 2.2% in 2016 to 2.5% in 2017, and the anticipated structural changes in the aviation industry may help stabilize the return rates of the airlines in 2017, both in the passenger sector and the cargo sector, after 2012-2016 recorded a downward trend in returns (in dollar terms) of the airlines.

International activity in the aviation industry and profitability in the field of passenger aircraft and cargo of all of the airlines[3]

Year	Output[5]				Financial results [4](USD billions)	
	RPK (billions)	Annual change in RPK	RTK (billions)	Annual change in RTK	Operating income[6] (USD billions)	Net profit
2016[7]	7,075	6.3%				35.6
2015	6,679	7.4%	840	6%	718.3	35.3
2014	6,190	6.0%	786	5.9%	749.5	13.7

The assessments and estimates of IATA regarding the scope of international passenger traffic and the estimates for 2016 and 2017 in the various publications as stated above, including with respect to GDP, passengers, cargo, oil prices, income, returns and occupancy rates are forward-looking information as defined in the Securities Law. This information is not based on the Company's estimates and relies on the assessments of the IATA alone, inter alia, in light of the existing trends of change in the aviation and tourism industry in recent years and the anticipated developments therein, and in light of the economic, security and geopolitical state in Israel and around the world. Therefore, this data may be materially different from the forecast as stated, if the IATA's assessments are not realized, as a result of a large number of factors, including a change in the economic, security and geopolitical situation in Israel and around the world.

3 Including airlines that are not incorporated in IATA.
4 Financial results: in international and domestic flights, regular flights and charter flights, and non-passenger flights.
5 The output data on the table refers to regular international activity of all of the airlines of international and domestic flights together.
6 Including income from cargo aircraft.
7 Source of the data: RPK data and net profit - the annual report from the IATA dated December 2016 and IATA's notice of February 2017; RTK and operating income data - World Air Traffic Statistics. Data, assessments, estimates and forecasts of IATA relating to 2016 are preliminary. Final data for 2016 are expected to be published by IATA in June 2017 within the framework of the World Air Traffic Statistics.

b. **Developments in the Israeli market**

International passenger traffic to / from Ben-Gurion Airport in 2016, according to the Airports Authority, amounted to 17.3 million passengers, an increase of 10.6% compared to 2015.

Year	**Passenger traffic at Ben Gurion Airport**		**Visitors entering Israel (by air, without day visitors)**		**Residents departing Israel (by air, without day visitors)**	
	Millions of traveler segments	**Annual change**	**Thousands of passengers**	**Rate of change**	**Thousands of passengers**	**Rate of change**
2016	17.3	10.6%	2,623	4.5%	6,281	15.3%
2015	15.6	9.9%	2,509	0.7%-	5,449	15.2%
2014	14.2	6.1%	2,528	2.0%-	4,732	10.7%
2013	13.4	8.6%	2,580	4.0%	4,276	10.8%
2012	12.4	1.0%	2,482	1.8%	3,860	0.1%

7.1.4 <u>Developments in the markets of this area of activity or changes in the characteristics of its customers</u>

In recent years, a considerable deterioration has occurred in the competition existing in the area of Transportation by Passenger Aircraft between scheduled international airlines, including airlines operating low cost flights[8] and charter international airlines. The Company estimates that further competition is expected in 2017. For additional details, see Section 7.8.3 below. Airline companies compete in different areas, mostly over prices, flight frequency and schedule, operational accuracy, type of equipment, aircraft configuration, and passenger service. Price competition is particularly manifested by supply of discounted rates to passengers. Competition exists both with respect to scheduled direct flights between different destinations (including extensive activity of foreign airlines in Israel through their base airport to a third destinations – "Sixth Freedom" flights) and with respect to charter flights to the same destinations. For details, see Section 7.8.3 below.

The increase in the number of foreign airlines operating at Ben Gurion Airport, the number of regular flights and seat capacity of the foreign companies has led to additional competition in routes to Israel. For additional details, see Section 7.8 below.

[8] “Low cost” companies are airlines with a low expenses structure that arises mainly from direct marketing online and not through distribution systems and travel agents, use of secondary airports, a minimal service profile during the flight and activity with short range flights, without cooperation agreements with other companies and high aircraft utilization.

The Company's estimate regarding the increase in the number of foreign airlines operating at Ben Gurion Airport, the number of regular flights and seat capacity of the foreign companies, and their impact on competition in routes to Israel, is forward-looking information as defined in the Securities Law. This information is based, among other things, on the Company's assessments in view of the increase that has occurred in recent years as a result of the "open sky" policy. This increase may not materialize, in whole or in part, or may materialize in a materially different manner, inter alia, due to the extent of opening the market to additional competition, regulatory changes, the manner with which the Company deals with competition and the risk factors described in Section 9.18 below, as well as economic, security and geopolitical changes.

7.1.5 Technological changes that may have a material impact on the operating segment

- ✓ In January 2016, a project was completed to implement a new system for the distribution of a schedule from Lufthansa. The system is used by the Company to publish its seasonal schedule and changes to the schedule directly to the "Amadeus" distribution system and assists the Company in identifying gaps in the flight schedule operated by airlines with which the Company engages in code sharing agreements.
- ✓ In February 2016, the implementation project of the new pricing system by Cyber was completed. The system was intended to allow the Company to operate through various tools to maximize its income while adjusting and updating the prices of flights in accordance with the market demands and supply.
- ✓ In August 2016, the Company engaged in an agreement with Accelya for the implementation and application of a passenger income system, which will replace the "Barak" system. The new system will allow the Company to use advanced tools to manage all of the passenger revenue from flights and accompanying services. The project is expected to be completed during 2018.
- ✓ In September 2016, the Company engaged in an agreement to replace the online orders engine. The new system from INDRA will replace the online "Amadeus" online orders engine and allow the Company to use advanced tools to manage ticket bookings on its website. The project is expected to be completed in the first quarter of 2018.
- ✓ In November 2016, the Company launched a real time auction sales platform, in which the Company offers all of its customers the sale of available seats on the Company's flights to a variety of different destinations at attractive prices through

the online auction method. The system was developed by the start-up Bidflyer, a venture by Cockpit, a subsidiary of the Company.

- ✓ The Company continues to deal with information security on an ongoing basis, against cyber-attacks performed by hackers around the world. The Company has taken various steps over the year to prevent harm to its website and information systems, including toughening access filters to and from the Company and intensive monitoring of the network traffic. Preparations were also made for a fast response to unusual events, and the readiness of the external internet suppliers was also examined. It is further noted that the Company is taking ongoing actions to improve the ability to deal with and neutralize cyber-attacks in the future, if any. This contributes to identifying and preventing attacks of various kinds. For details regarding cyber-attacks as a risk factor, see Section 9.18 below.

7.1.6 Critical success factors in this area of activity and the applicable changes

For details of the positive factors that affect or may affect the Company's competitive position in this area of activity, see Section 7.8.4 below.

7.1.7 Changes in suppliers and raw materials to the operating segment

Fuel - The main raw material used by airlines is jet fuel, which is one of the main expenditure components of an airline. For details regarding fuel, see Section 9.5.1 below.

Aircraft - Since the Company's aircraft fleet is entirely manufactured by Boeing, the Company is dependent on this manufacturer for its ongoing maintenance of its aircraft, spare parts supply, repairs and engineering consultancy.

Engines - Since the 777 aircraft owned by the Company and the 787 aircraft, which are scheduled to be delivered to the Company during the years 2017-2020, are equipped with Rolls-Royce engines, the Company has a significant dependence on the engine manufacturer in terms of current maintenance and supply of spare parts for engines.

7.1.8 The main entry and exit barriers in this area of activity, and the applicable changes therein

In the past, one of the most significant entry barriers in the field of scheduled international flights was the need to obtain authorization to perform scheduled flights from one country to other countries and be appointed as "Designated Carrier" as well as to obtain approval for the number of flights and the capacity thereof. Due to the Open

Sky policy, this entry barrier is now quite insignificant with respect to destinations in Europe and the United States.

Moreover, each flight requires a window of time for takeoffs and landings (slot) at the airports to which and from which it operates.

Another significant entry barrier is the relatively large initial investment required to establish and operate an airline company, as well as to purchase or lease aircraft.

Furthermore, international aviation agreements and the regulation in various destinations may include requirements in relation to identity or nationality as a condition for actual ownership or control over an air carrier. Such requirements may constitute an entry barrier for the grant of authorization to operate flights. For additional details, see Section 9.11 below.

With regard to the operation of passenger aircraft in international charter flights, the Company estimates that there are no significant entry barriers in view of the liberal policy prevailing with respect to the grant of authorization in the charter flight segment, to both Israeli and foreign charter companies.

The restrictions applicable to the Company by the holder of the Special State Share with respect to reducing the Company's aircraft fleet constitute an exit barrier. For details, see Section 9.11.9 below.

7.1.9 Substitutes for services in the field of activity and changes thereto

The substitutes for transportation by passenger aircraft are transportation by other means (land and marine means as well as cargo aircraft regarding cargo carried in the belly of passenger aircraft). It shall be noted that there is no significant substitutes in Israel for passenger transportation by air. The Company estimates that the main considerations in choosing a flight over marine and/or land transportation are: the purpose of the trip, the passenger's schedule, as well as the distance and the nature of the route.

7.1.10 The structure of the competition in the field of activity and the changes therein; developments in markets of the field of activity

a. **General - Competition in the segment**

Strong competition exists in the segment of transport by passenger aircraft between dozens of scheduled international airlines (legacy), including low-cost airlines as well as charter airlines. Airline companies compete in various segments, the main of which are: prices, flight frequency and schedule, operational accuracy, type of equipment, aircraft configuration, passenger service, frequent flyer benefits, commissions and special incentives to travel agents, the structure of the ticket booking website, the supply of passenger services and more.

The competition is not only with the principal air carrier in the country located at the other end of the route and with charter airlines operating on the same route, but also with other airlines, including such that do not operate flights to Israel (offline airlines), due to the range of possibilities allowing the passenger to create his own flight schedule consisting of several airlines, and as a result of the strengthening of alliances between the airlines (Star, Sky Team, One World).

In addition, most of the scheduled airlines operating flights to and from Israel also carry passengers on Sixth Freedom flights, thus causing an increase in the operations of foreign airlines in Israel. Due to the fact that the flight from the base airport (Europe) to the final destination takes place regardless of the flight from Israel to Europe, thus allowing the foreign company to lower the overall price for a flight from Israel to the final destination (via Europe), without impairing the level of the price of a flight from Europe to the final destination. In fact, at times, foreign companies offer the flight ticket from Israel to the final destination (e.g. the U.S) at a lower price in relation to the price they offer for the flight from the interim destination (e.g. Europe) to the final destination. On the other hand, currently the Company does not benefit from a similar possibility to carry passengers between different countries via Israel, mainly due to the present geopolitical condition.

Apart from the foregoing, certain regulatory changes may affect the structure of competition in the segment. For details, see Section 9.11 below.

b. **Open Sky Policy**

The liberalization policy of aviation agreements, which has been implemented in the State of Israel in recent years, allows a substantial share of the increase in flight availability and seat capacity offered. This policy, as expressed in an ongoing process of updating aviation agreements by means of increasing the frequencies cap and the number of airlines allowed to operate scheduled flights, causes an increase in the number of flights and as a result, a decrease in ticket prices and growth in passenger traffic to and from Israel.

In addition to the execution of the Open Sky Agreement with the European Union on June 2013, whereby most of the restrictions on the number of each party's carriers entitled to operate scheduled flights between Israel and the European

Union (as derived from bilateral aviation agreements preceding it) have been removed, in the last few years aviation agreements between Israel and a number of countries with a significant volume of traffic between these counters and Israel, such as Russia, Ukraine, Canada and China.

For details regarding the Open Sky Agreement with the EU, see this Section in the Company's 2013 Periodic Report.

The following is a description of the main changes that occurred in 2016 until the Date Near the Approval of the Report:

Japan - In October 2016, Israel and Japan signed a new aviation agreement, which updated the aviation agreement signed between the countries in 2002. The new agreement allows each country to operate up to 14 regular weekly flights directly on this route, when the Israeli companies can travel to any destination in Japan, including the Narita Airport, the main international airport in Tokyo. The new agreement allows Israeli companies to carry cargo from Israel via Japan to a third country (“Fifth Freedom”). The agreement also allows for the signing of a code sharing agreement with airlines from a third country. It is noted that within the new agreement, the restriction set forth in the agreement that was in force until the signing of the new agreement was cancelled, regarding the type of aircraft of Israeli airlines that may land in Japan.

Thailand - in December 2016, Israel and Thailand signed a new aviation agreement that allowed airlines to substantially increase the frequency of the flights between the two countries and allows additional airlines to operate regular flights on the route. According to the new agreement, each country may operate up to 28 weekly regular passenger flights with no capacity limit, compared to eight weekly passenger flights currently operated by the Company alone. Additionally, the new agreement allows for commercial cooperation between airlines of the two countries, and signing a code sharing agreement between Israeli and third country carriers. It is noted that within the new agreement, the restriction set forth in the agreement that was in force until the signing of the new agreement was cancelled, regarding the type of aircraft of Israeli airlines that may land in Thailand.

India - In December 2016, Israel and India signed a new aviation agreement, which updated the aviation agreement signed between the countries in 1994. The new agreement allows multiple carriers, with each country being able to operate up to nine regular weekly passenger flights directly to Mumbai and Delhi and five weekly regular passenger flights directly to Goa and Cochin. The agreement also allows for the signing of a code sharing agreement with airlines from a third country.

Australia- In February 2017, Israel and Australia signed an aviation agreement that allows airlines of both countries to operate up to seven regular weekly passenger flights from Israel to each of the destinations Sydney, Melbourne, Brisbane and Perth. The agreement also allows for the signing of a code sharing agreement with airlines from a third country. It is noted that in February 2017, the Company and Qantas signed a memorandum of understanding in advance of signing a code sharing agreement. For additional details, see Section 9.13 below.

7.2 Services in the field of activity

a. General

The main services the Company provides in this segment are flying passengers and cargo to various destinations by means of passenger aircraft. As of the Latest Date Prior to the Approval of the Report, the Company operates flights on passenger aircraft to approximately 34 direct destinations in about 25 countries in Europe, North America, the Middle East, Central Asia and other destinations. In 2016 the Company operated an average of approximately 284 weekly flights to each destination. In addition to flights operated by the Company, the Company is engaged in marketing flights in the framework of agreements with other airline companies (Interline Agreements), allowing passengers of scheduled flights, subject to certain restrictions, to use flight tickets issued by one airline, for flights of another airline. The airline actually carrying the passenger submits an invoice for payment to the Company that issued the flight ticket. The parties settle between themselves on a monthly basis, usually through IATA Clearing House.

Furthermore, the Company operates Code-Share flights, thus allowing the air carrier to market flights of another air carrier as if they were its own, so that a passenger books a flight through one carrier notwithstanding the fact that he travels with another air carrier. Code sharing provides participating air carriers with an option to increase flight frequencies offered to their customers, access to other destinations and marketing advantages, such as enhancing the attractiveness of joining the Company's Matmid Frequent Flyer Club.

The Company operates, in some of its regular flights, up to four travel classes, distinguished from each other by the type of seat, the space between seats, food and beverage menu and manner of serving, supply of comfort and leisure products as well as number of flight attendants in proportion to the number of passengers. Said travel classes consist of: First Class, Business Class, Economy Class Plus and Economy Class. Scheduled flights offer a set of in-flight voice programs, movies, both broadcast and print magazines and a sales service of duty-free items.

Flights under the “UP” aviation brand are offer two travel classes: Economy Class and Economy Class Plus. For additional details, see Section 7.8.3(c) below.

In addition to scheduled flights, the Company is engaged, through Sun d'Or, in the marketing of charter flights by leasing aircraft capacity to charter flight organizers at pre-agreed prices, sale of seat packages to agents and sales to the public. Charter flights operate under a service profile adapted to charter flight operations. Most of the flights do not offer all of the classes.

The Company's flights are supported by ground services system, in charge of the process of boarding passengers and their luggage, embarking them at the destination airport and unloading the luggage as well as handling the cargo. Said ground services are available in Ben Gurion Airport and in each one of the destinations where the Company's aircraft land. Simultaneously, the Company operates, under the guidance of government security officials, ground security system in all overseas airports where aircraft of Israeli airlines land, and an aerial security system that operates during passenger flights operated by Israeli airlines (the Ben Gurion Airport Ground Security System is operated by the IAA).

b. **Data regarding the Company’s target groups**

The following are data on the Company's market share, in the Company’s estimate, segmented into groups of major destinations, out of all passenger traffic to or from Ben Gurion Airport to those destinations:

To/from Ben Gurion Airport	The Company's assessment regarding the total passenger traffic at Ben Gurion Airport segmented into destination groups by direct flights[10] (in thousands of passenger segments) based on data of the Airports Authority				The Company's assessment of the Company's market share (in percent)[9]		
	Change in % in 2016	2016	2015	2014	2016	2015	2014
North America	1%	1,671	1,655	1,599	37.7	35.6	36.5
Europe	12%	11,695	10,476	9,543	39.0	38.6	38.9
Far East and Central Asia[11]	6%	533	502	497	38.8	47.5	51.7
Other[12]	13%	3,412	3,012	2,594	12.4	11.3	9.9
Total	11%	17,312	15,645	14,234	32.6	32.5	33.3

c. **The routes to North America (to the United States and Canada)**

At the height of the 2016 summer season, the Company operated about 33 flights a week to North America, and about 26 flights a week in the winter season (mainly to New York).

On direct routes to North America, there is direct competition between the Company and United, Delta and Air Canada airlines.

9 This data are segmented by final destination of the passenger (including final destination on sixth freedom flights). The Company's assessment of the passenger's final destination is based on data from the global distribution systems. The Company cannot estimate the accuracy of the data received from the distribution system, which includes paying passengers only. It is noted that the Civil Aviation Authority publishes data that includes non-paying passengers, split based on the airline that carries out the flight (and not by destination). In cases of sixth freedom flights of a European company between Israel and the United States through an airport in Europe - the flight will be attributed to the parent country of the European airline. Based on the Company's analysis of the Civil Aviation Authority's data and the segmentation of the flights into the parent countries of the airlines, while disregarding sixth freedom flights, the Company's market shares were, in the North American route: 51.4% in 2016 compared to 48.6% in 2015; in the European route: 33.5% in 2016 compared to 33.2% in 2015; the Far East and Central Asia route: 80.6% in 2016 compared to 89.4% in 2015; other destinations: 12.8% in 2016 compared to 11.8% in 2015.

10 The data of the Civil Aviation Authority refers to airlines that carry out the flights and not the flight destinations. Therefore, this data constitutes the Company's assessment based on an analysis of data from the Airport Authority. This data is segmented by direct flight destination and does not distinguish the actual passenger destination with respect to "sixth freedom" flights of foreign companies.

11 The Company cannot estimate the accuracy of its assessment regarding the market share including "sixth freedom" in the Far East market and central Asia, Africa and regional destinations (such as Turkey, Greece and Cyprus), in light of the inaccuracy in information held by the Company regarding the passengers in other companies in these markets.

12 Others: traveling to regional destinations (Cyprus, Egypt, Greece, Jordan, Malta and Turkey) and to Africa.

Delta - 4 weekly flights were added on the Tel Aviv - New York route in the summer months (June - September) thus increasing the number of weekly flights operated by Delta during this period to 11. In total, Delta's passenger traffic increased by approximately 16%.

United Airlines - Expanded its operations to and from Israel, and began to operate, as of the end of March 2016, three weekly flights on the Tel Aviv - San Francisco route, and in October 2016, the frequencies with which it operates this route increased to 7 weekly flights, in addition to flights operated by United on the Tel Aviv - New York route. In total, United's passenger traffic increased by approximately 20%.

It is noted that US Airways, which merged with American Airlines and operated 7 weekly flights on the Tel Aviv - Philadelphia route discontinued its flights to Israel in January 2016.

For details regarding the code sharing agreement between the Company and American Airlines, see Section 9.13 below.

Additionally, the activity of European airlines that take traffic on routes to the United States and Canada through their home airports ("sixth freedom") continued. In total, in 2016, no material change was recorded (+1%) in the scope of passenger traffic on direct routes to North America compared to 2015.

The Company's passenger traffic on its direct flights to North America (USA and Canada) increased by 7% compared to 2015.

The Company has rights to transport passengers, cargo and mail to/from New York and other destinations in the United States, some within code sharing agreements. For details, see Section 9.13 below.

d. **Routes to Europe**

As of the Date of the Report, the Company operates scheduled flights to 23 destinations in Europe, mainly to London, Paris, Amsterdam, Moscow, Frankfurt, Rome, Milano, Madrid and Zurich. The Company generally competes, on routes between Israel and Europe, with airlines of the destination country as well as with other scheduled airlines carrying Sixth Freedom traffic via their base airport, to other countries, with foreign and Israeli charter airlines operating charter flights to various destinations in Europe, and with companies operating scheduled low-cost flights.

In 2016, there was an increase of about 12% in the total passenger traffic to Europe, with the foreign companies with scheduled flights, including the low cost companies, increased their passenger traffic by 10% and the charter flight companies on these routes recorded an increase of 3%. The Company increased its passenger traffic on these routes by 13%.

On routes to Western European countries, an increase was recorded in regular airline traffic compared to passenger traffic on charter flights on these routes, which experienced a decrease of 10%.

The most prominent increases were recorded in the following routes to: the Netherlands (31%), Spain (13%), Italy (9%), France (7%), England (6%) and Germany (5%). It is noted that there was a substantial increase in these countries both in activity of regular "traditional" airlines (legacy airlines) and activity of the low cost airlines, as described in Section 7.8.3 below.

On routes to Central and Eastern European countries, an increase was recorded of 19% in passenger traffic in the regular airlines and an increase of 15% in passenger traffic on charter flights. The most notable increases were recorded on routes to: The Ukraine (25%), Romania (20%), Poland (20%), Bulgaria (19%), Czech Republic (18%) and Russia (6%). Similar to the Western European countries, there was a substantial increase in the activity of the low cost airlines as well. In accordance with the aforesaid trend, the Company also increased its activity on these routes to the destinations of Prague, Berlin, Budapest, and Kiev, to which the Company operates low cost flights under the brand "UP."

For additional details regarding the increase in the activity of the foreign companies in Israel, see Section 7.8.3 below.

The aviation agreements signed in recent years and the continued application of the "open skies" agreement between Israel and the European Union countries signed in June 2013 are expected to lead to an additional exacerbation in the level of competition in these routes in 2017.For additional details regarding the expected increase in competition in these routes in 2017, see Section 7.8.3 below.

The Company's estimate regarding the increase in capacity and frequency in other airlines and the increase in competition is forward-looking information as defined in the Securities Law. The information is based, inter alia, on the Company's estimates in light of the current volume of activity of the Company and the competition in the markets which may not materialize, in whole or in

part, or that may materialize in substantially different manner. The actual reality may be different than predicted as stated, inter alia, due to the extent of opening the market to additional competition, regulatory changes, the manner with which the Company deals with competition and the risk factors described in Section 9.18 below, as well as economic, security and geopolitical changes.

e. **Routes to the Far East and Central Asia**

Other than the Company, which operates on routes to India (Mumbai), Thailand (Bangkok), China (Beijing), and Hong Kong, and Korean Air Airlines, which operates on the route to South Korea (Seoul) and Hainan, which operates on the route to China (Beijing), as of April 2016, regular companies operating in Israel run flights to these designations within the "sixth freedom" movement.
In total, in 2016, the number of passengers on direct flights to these destinations increased by approximately 6%, as a result of a sharp increase (95%) in the passenger traffic on the Tel Aviv - Beijing route as of the commencement of Hainan's activity in this route. It is noted that a decrease was recorded at a rate of approximately 4% in the Company's passenger traffic to these destinations.

Cathay Pacific has announced its intent to operate, as of March 2017, 4 weekly flights on the Tel Aviv - Hong Kong route. The Company estimates that the beginning of the operations of Cathay Pacific as stated is expected to cause an increase in competition in 2017, an increase in passenger traffic and a decrease in the Company's market share in routes to the Far East and Central Asia. Additionally, **Air India** has applied for the operation of direct flights on the Tel Aviv - Delhi route. According to Air India's announcement, opening the route is contingent on receipt of the approvals required from the authorities, which it estimates it will receive by May 2017.

The Company's estimate regarding the impact of the commencement of Cathay Pacific's operation to the Company's activity and the increase in competition is forward-looking information as defined in the Securities Law. The information is based, inter alia, on the Company's estimates in light of the current volume of activity of the Company and the competition in the markets which may not materialize, in whole or in part, or that may materialize in substantially different manner. The actual reality may be different than predicted as stated, inter alia, due to the extent of opening the market to additional competition, regulatory changes, the manner with which the Company deals with competition and the

risk factors described in Section 9.18 below, as well as economic, security and geopolitical changes.

f. **Other routes**

The other routes that were operated by the Company in 2016 included Greece, South Africa and Cyprus (Larnaca). In addition, the Company operates one-time charter flights from time to time or short series of charter flights to various destinations.

In the regional routes, an increase occurred of 9% in the total traffic to Turkey, mainly due to the increase in activity of Turkish Airlines, which increased its passenger traffic by 13%, as set forth in Section 7.8.3 below. The increase in traffic to Turkey arises mainly from an increase in the “sixth freedom” movement. The traffic to destinations in Turkey (Antalya, Dalman and Bodrum) increased at a rate of 16% compared to the previous year, and in total, the traffic to the destinations constituted about one quarter of all of the traffic to Turkey. It is clarified that in light of the security restrictions imposed on the Israeli airlines, no flights were operated in recent years by Israeli airlines on routes to Turkey. In this context, it is noted that in December 2013, the Israeli and Turkish aviation authorities signed an agreement that was supposed to enable the renewal of the flights of the Israeli airlines to Turkey. Following the restrictions determined by the Turks in the agreement, the security state in Israel which became more severe following Operation Protective Edge, and the travel warning issued by the Counter Terrorism Bureau on this destination, the preparations required for the operation of the flights to Turkey were frozen, such that at this stage, flights of Israeli airlines to Turkey cannot be renewed, and the inequality between the parties continued due to the increased activity of the Turkish airlines, as set forth below.

An increase in a rate of about 10% was recorded on routes to Greece or the Greek Islands, which serve as an alternative to the destinations in Turkey, due to an increase in the activity of the Company and the activity of Aegean Airlines, which replaced Cyprus Airlines, as well as a substantial increase in the activity of charter companies to these destinations.

A substantial increase (43%) was also recorded in traffic to Cyprus, mainly due to an increase in the Company’s activity on the Larnaca route under the “UP” brand and the activity of Aegean Airlines, as well as the commencement of activity of **Tus Airways** on this route, as set forth in Section 7.8.3 below.

In 2016, the total passenger traffic on the regional routes and routes to Africa increased by 13% and the number of the Company's passengers on these routes increased by 23% compared to 2015.

7.3 **Segmentation of income and profitability of services**

In 2016, there was a decline of about 1.4% in the Company's revenue in the field of activity compared to the revenue in 2015, with the passenger traffic at Ben Gurion Airport during 2016 increasing at a rate of 10.6% compared to 2015.

For details regarding data about distribution of the Company's revenue and profitability (consolidated) based on the Company's reported operating segments in the field of passenger aircraft, see Note 20 of the Financial Statements.

7.4 **New services**

- ✓ **737-900 Aircraft -** During the first quarter of 2016, the Company received three 737-900ER Boeing aircraft. Upon receipt of the same aircraft, the Company completed the purchase and absorption of eight aircraft of this model. In the advanced aircraft, the business class has 16 seats and the economy class has narrow seats manufactured with state-of-the-art technology. The airplanes include electrical outlets for laptops as well as USB connections.

- ✓ **Internal communications system (streaming) -** During 2016, the Company continued the process of installing a flight entertainment system that includes an internal aircraft system on some of the routes in Israel to Europe and South Africa, in order to improve the in-flight entertainment experience. The system broadcasts the AVOD content (audio & video on demand) to the passenger's personal device through the Dream Stream by El Al application. The service is provided to customers at no charge and allows the passenger to enjoy a variety of movies, television shows, songs, games, content for children, passenger information and more. As of the date of the Report, the system is installed on all of the Company's aircraft that are Boeing 767 and 737-900 models and some of the Company's Boeing 737-800 models.

- ✓ **Upgrade of the 767 aircraft -** In June 2016, the Company completed the upgrade process of the business class seats and their extension to bedsteads on all 767 aircraft.

- ✓ **Preseating flight service -** As of November 1, 2016, the Company charges a fee for seating in advance in some of the economy class seats for flights operated by the Company on the Tel Aviv - Europe routes.

- ✓ **Products in the insurance sector -** In December 2016, the Company engaged with Phoenix Insurance Agency 1989 Ltd. ("**Phoenix**"), a company that is fully held by Phoenix Insurance Company Ltd., in an agreement for the establishment of an insurance agency that is jointly held by the Company and Phoenix (the "**Insurance Agency**"), which will be held by the Company (50.1%) and Phoenix (49.9%). The Insurance Agency will be engaged in marketing and sale of insurance products both in the field of travel and in other areas, *inter alia*, to customers of the Company's Matmid frequent flyer club. The members of the club will also be given a unique option in the field of insurance to accumulate and exercise club points for the purchase of an insurance product. The Insurance Agency is expected to begin to operate during 2017.

For details regarding new areas of activity, see Section 9.15 below (business targets and strategy).

7.5 Customers

The Company provides its services to passengers who are both individuals and to the business sector. The Company's plane tickets are mostly sold through travel agents and marketers of travel packages, and directly by the Company to companies and individuals. For additional details, see Section 7.6 below. For details about the Company's "Matmid" frequent flyer club, see section 7.6.4 below.

In the area of transport by passenger aircraft, the Company does not have any customer, including agent, whose revenue or sales turnover amounts to 10% or more of the Group's total revenue. The Company estimates that it does not have dependence on any single customer or agent in the field of transport by passenger aircraft.

7.6 Marketing and distribution

7.6.1 Travel agents and marketers of travel packages

Most travel agents are IATA members, thus they sell flight tickets of the various airlines. Upon the sale, the agent is entitled to receive a commission from the airline company at a rate set by it and in accordance with IATA guidelines. At times, the agent is entitled to further commissions, including for the purpose of sales incentive, notwithstanding the discretion of the airline companies.

The majority of air fare marketing to passengers is carried out through travel agents and vacation package dealers. In addition, flight tickets are sold through the Company's sales offices and through phone and direct sales. As of the Date Near the Date of the Report, the Company has three sales offices in Israel (Tel Aviv, Jerusalem and Beer-Sheba) and about 29 sales offices in 21 representations abroad.

The Company also sells plane tickets through 58 general sales agents (GSA) to destinations to which the Company flies and other destinations (including beyond destinations).

Tour Air (Israel) Ltd. (hereinafter: "Airtour"), a company jointly owned by the Company and the travel agents, is another marketing channel of the Group in the Israeli market, acting as the distribution arm with respect to special offers and packages to all agents in Israel. The Company has agreements with Airtour for the distribution of the Company's flight tickets and the provision of various services by Airtour to the Company, including vacation package distribution, ticketing, payment transactions, etc.

Sun d'Or, the Company's subsidiary, also acts as a marketing arm of the Company's products mainly to charter flights and flights to various destinations.

The Company pays travel agents a commission (base component) as well as special incentives (variable component), particularly according to the volume of airline ticket sales.

The base rate for agents in Israel is a rate of 5%. The base rate to agents abroad varies by country based on market conditions.The additional incentive mechanism - the amount and duration of the commission - is determined with each of the agents in Israel and abroad.

Different methods are used in this regard around the world, which are adapted to market needs. In recent years, the aviation world has developed a trend of reducing commissions to the point of eliminating the agents' base commission and the addition of handling fees by the agent.

7.6.2 <u>Computerized system for booking, flight management and inspection</u>

The Company's computerized system for booking, flight management and inspection is the Amadeus system. This system presents the Company's updated flight schedule and allows the Company's service and sales centers to place orders and ticket the Company's flights. The system allows supervision of managing customer handling and use of the loading capabilities of the Company's aircraft by calculating weight and balance by concentrating the data calculation. It is noted that the Company has material dependence on Amadeus. For details, see Section 9.18 below.

The Company also has agreements with certain international distribution systems that interface with the Company's booking system and allow the users of the same systems (sales agents in Israel and abroad) to sell and have direct access to reservations and ticketing of the Company's flights.

7.6.3 Sales and marketing to passengers

The Company works to publicize its services to passengers in the Israeli market and other large markets. The Company also initiates marketing events, sponsorships and collaborations.

In 2016, the trend of increase in direct marketing of plane tickets through the internet in the aviation industry continued. This trend is aimed at reducing marketing and distribution costs for airlines. The Company continues to adapt its activities to this trend, and during 2016, sales increased through the website by about 15% (sales of packages, sales of accompanying services and upgrades) compared to the corresponding period the previous year, and they amounted in 2016 to a total of USD 310 million. The number of tickets sold through the internet during 2016 increased by 14% compared to 2015. Significant growth was also recorded in 2016, at a rate of 107% in the total sales of the Company through mobile. According to the Company's estimate, a continuing increase is expected in the upcoming years in revenue from the sale of plane tickets on the internet, which may reach, in the Company's estimate, USD 400 million per year in the coming years. This increase arises, *inter alia*, from continued improvement to the Company's website.

The information regarding the Company's estimate for revenue increase resulting from online direct marketing of airline tickets is forward-looking information, as defined in the Securities Law, which is based on the Company's estimates in consideration of global trends and developments in the consumption and aviation world. The materialization of the said information, in whole or in part, is uncertain and might be affected by external factors having effect on the competitive environment of the Company and/or by factors that cannot be assessed and are beyond the Company's control, including marketing and sales factors.

The Company makes direct sales to passengers through its Reservation Department and website. In addition, the Company operates a business desk to promote sales to business entities, mainly in Israel.

Sun d'Or, the Company's subsidiary, serves as the marketing arm of the Company's products, mostly with respect to the marketing of charter flights and flights to various destinations, with flights being operated by the Company or by other Israeli airlines (mainly in weekends and holidays).

In order to increase the attractiveness for the Company's passenger flights to passengers interested not only in transportation services to and from Israel, but also in tourism services, the Company markets, directly and through travel agents, diversified ground tourism services (hotels, tours, car rentals) to individual tourists. For this purpose, the Company markets package deals through Airtour. This activity is marketed at the Company's representative offices abroad through Superstar Holidays Ltd., by means of independent direct marketing or through travel agents.

In April and October 2016, agreements were executed with Taglit Birthright Israel Organization ("Taglit") to transport the participants of the 2016 summer program and the 2016-2017 winter program at an expected volume of about 19,500 passengers. Taglit brings teenagers between 18 and 26 to visit Israel and is considered a leading unique project in the Jewish world that brings young people from about 54 countries to Israel.

7.6.4 Matmid Frequent Flyer Club

As part of the marketing efforts and the efforts to increase passengers' loyalty to the Company, the Company offers special benefits to passengers who belong to the Frequent Flyer Club. Passengers accrue frequent flyer points for their flights on all flights operated by the Company.

These points provide various benefits to passengers, including discounted or free flight tickets (except for additional cash payment for airport taxes and other surcharges), upgrades to a higher-level of classes and entrance to lounges used by the Company worldwide.

The Company has agreements allowing the accumulation and realization of frequent flyer club point of other airlines (as set forth in Section 9.13 below) and/or the conversion of points/stars from credit cards and other businesses into Frequent Flyer Club points, and it further entered into cooperation agreements allowing the accumulation of club points and/or receipt of other benefits following an acquisition in a variety of businesses (in general, the Company is paid a consideration by the business), as well as into agreements for the use of frequent flyer points in different businesses. Payment for purchase of products on the Fly&Buy website as well as in the duty-free and on the Company's airplanes, can be made using the Club points.

Membership in the Frequent Flyer Club is determined by a number of parameters based on the volume of activity of the members: Regular Matmid, Silver, Gold, Platinum and "Top Platinum.

As of April 2016, travel agents can purchase plane tickets on the agents' website and pay for the plane ticket using the club points. For such transactions, the travel agents will be given Sell&Fly points, which are points intended for travel agents that allow for the purchase of plane tickets for personal use alone, as well as an agent fee.

During 2016, the Company engaged with Phoenix in an agreement for the establishment of an insurance agency. For additional details, see Section 7.4 above.

In 2016, the Company continued to implement a plan to cultivate, maintain and increase the number of luxury customers, *inter alia*, by issuing a branded "Fly Card" credit card, as set forth below.

Branded credit cards

Within the framework of cooperation agreements executed by the Company with financial institutions, the Company allows for the issue of branded credit cards to the members of the Company's Frequent Flyer Club - Fly Card and Fly Card Premium ("**Branded Credit Cards**"). The Branded Credit Cards were issued to Israeli account holders through the financial institutions listed below: (a) Diners Club Israel Ltd. and Cal - Israel Credit Cards Ltd. ("Diners and Cal"); (b) Poalim Express Ltd.; and (c) Leumi Card Ltd. and Bank Leumi Ltd. (hereinafter: the "**Agreements**" and the "**Financial Institutions,**" respectively).

The branded credit cards grant their holders unique benefits according to the type of card and the volume of activity therein, all in accordance with the commercial terms established between the parties. These benefits include, *inter alia,* the accumulation of perpetual passenger points in respect of transactions in branded credit cards.

According to the agreements described above, the Company is entitled to consideration from the financial institutions, which is also based on the scope of use of the Branded Credit Cards. The agreements also set forth participation in advertising, marketing and sales promotion expenses, as well as customer service to the holders of the Branded Credit Cards. The agreements are for an initial engagement term of five years, ending September 2019, and include the ability to extend for additional various periods subject to the cancellation rights available to the parties, under certain circumstances.

In addition, the Company has a cooperation agreement with the registered partnership Blue Square-Dor Alon Customer Club ("YOU Club"), whereby holders of Branded

Credit Cards issued by Diners and Cal may enjoy additional benefits, including accumulation of frequent flyer points in YOU Club chains. Some of these credit cards even allow the exercise of frequent flyer points in those chains, in pursuance of the terms and conditions agreed between the parties.

It is clarified in this context that the aforesaid cooperation agreement with the YOU club is an agreement with a registered partnership, whose partners are Alon Energy Israel (1988) Ltd. and Mega Retail Ltd. It is noted that the Company estimates that the acquisition of Mega Retail Ltd. by the Yeinot Bitan Group will not have a material impact on the Company’s operations.

In July 2016, the Company engaged in a cooperation agreement with the retail Group - Electra Consumer Products Ltd. (the “**Electra Group**”), which operates in various consumer fields, in which the parties act to recruit customers for the club through the Electra Group’s marketing and sales centers. Within the cooperation, the members of the Matmid frequent flyer club and holders of the Branded Credit Cards benefit from unique offers, including the ability for accelerated accumulation of Matmid frequent flyer points at chains owned by the Electra Group.

The Company expects that the implementation of the Branded Credit Card program will lead to a gradual increase in its revenues and an improvement in its cash flows together with a potential increase in liabilities for the accrual of points, depending on the development of the pace of accrual and exercise.

The number of members of the club as of the Date Near the Approval of the Report amounts to 1.76 million members.

As of the Date Near the Approval of the Report, the balance of Branded Credit Cards amounts to 210,000 cards.

In total, the rate of passengers that are members of the Matmid frequent flyer club from the total passengers was 28% in 2016 compared to 29% in 2015.

The Company expects a gradual increase in the number of club members to 2.1 million members and the balance of Brander Credit Card holders will amount to 300,000 cards.

The information regarding the Company's estimate as to the expected growth in revenue and the number of credit cards to be issued and the growth in the number of club members is forward-looking information, as defined in the Securities Law, based on the Company's assumptions in consideration of global trends and developments in the consumption and aviation world. The materialization of the said information, in whole or in part, is uncertain and might be affected by external factors having effect on the competitive environment of the Company and/or by factors that cannot be assessed

and are beyond the Company's control, including factors in the world of credit card retail and consumption.

The Company intends to separate the activity of the Matmid frequent flyer club and maintain it within the framework of a separate legal entity. For details regarding the accounting treatment of the club liabilities, see Note 12 of the Financial Statements.

7.7 Order backlog

The Company has “prepaid revenues” arising from the receipt of payments in advance for flights that have not yet been carried out, as well as for points accrued by the members of the Matmid frequent flyer club as stated in Section 7.6.4 above. It is noted that some of the plane tickets sold by the Company may be exercised by the customer for an ongoing period not exceeding two years. For additional details, see Note 12 of the Financial Statements.

7.8 Competition

7.8.1 General

a. The field of transportation by passenger aircraft is characterized by fierce competition between airlines providing transportation services to and from the same or alternative destinations.

b. The Company serves as the designated air carrier of the State of Israel to most destinations from where scheduled flights are operated to and from Ben Gurion Airport.

For additional details about the structure of competition in the area of activity, see Sections 7.1.10 above and 7.8.3 below.

7.8.2 The Company’s market share in the groups of services

Passenger traffic at Ben Gurion Airport in 2016[13] compared to 2015 was divided as follows:

[13] The information regarding the activity of foreign airlines is based on data from the Israel Airports Authority.

	Market share at Ben Gurion Airport[14]	
Company type	**2015**	**2016**
El Al[15]	32.5%	32.6%
Legacy companies	43.8%	44%
Low cost companies[16]	13.3%	14%
Charter companies[17]	10.4%	9.5%

7.8.3 Significant competitors in the field of transport by passenger aircraft

The Company estimates that during 2016, the competition on flights to and from Israel was with 110 airline companies, including the Israeli airlines Arkia and Israir (which operate charter and scheduled flights to specific destinations), of which about 60 foreign airlines operated scheduled flights to nearly 70 destinations in approximately 40 countries, and about 50 airlines operated charter flights (of which about 30 have been operating throughout the year whereas the other airlines have been operating individual flights). In addition, competition in the field of cargo transport in the belly of passenger aircraft, which is included in this segment, takes place with airlines engaged in cargo transportation on cargo aircraft and in the belly of passenger aircraft. For additional details, see Section 8.7.1 below.

To the best of the Company's knowledge, its significant competitors with respect to the Company's destinations in 2016, in terms of market share, in the field of transportation by passenger aircraft were: United Airlines (U.S.), Delta (U.S.), Air Canada (Canada), Lufthansa (Germany), British Airways (Britain), Alitalia (Italy), Air France – KLM (France and the Netherlands), Swiss (Switzerland), Ukraine Air International (Ukraine), Aeroflot (Russia), Turkish Airlines (Turkey), Pegasus (Turkey), Aegean Airlines (Greece), EasyJet (England), WizzAir (Hungary), Transavaia (Netherlands) and Hainan (China).

14 The airlines are classified at the discretion of the Company.
15 Including flights marketed by Sun d'Or.
16 Excluding UP flights.
17 Excluding flights marketed by Sun d'Or.

In 2016, many airlines expanded their operations on routes to Israel by adding destinations and/or increasing frequencies and/or capacity. Airlines that expanded their operations during 2016 substantially are:

a. **Legacy companies**

Legacy companies are regular airlines. Usually, these companies are part of alliances that allow them to offer flights to customers to a wide range of destinations and to benefit from the accumulation of miles/points for flights of other airlines in the alliance as well.

These companies offer “full service” to the passenger and provide the passenger with a variety of services before and during the flight, such as: various service classes (first/business/economy), transfer flights, airport lounges, frequent flier programs, food and drink services during the flight at no additional cost, etc.

United Airlines began to operate, in April 2016, three weekly flights on the Tel Aviv - San Francisco route. As of October 2016, it operates 7 weekly flights on this route, in addition to 14 weekly flights that it operates on the Tel Aviv - New York route. In total, United recorded a 20% increase in its passenger traffic.

Turkish Airlines added a daily flight on the Tel Aviv - Istanbul route, and therefore the number of weekly flights that Turkish Airlines operates on this route was an average in 2016 of 61. In addition, Turkish Airlines operated charter flights during the third quarter of 2016 to Antalya, and its passenger traffic increased by a total of 13%. It is noted that Turkish Airlines became the largest foreign airline in Israel, such that most of the Israeli passengers traveling with this Company are passengers that travel with the “sixth freedom” movement.

Lufthansa added a weekly flight on the Tel Aviv - Frankfurt route and two weekly flights on the Tel Aviv - Munich route, and the number of weekly flights operated by Lufthansa to and from Israel in 2016 amounted to 31 (21 Frankfurt, 10 Munich). In total, Lufthansa recorded a 12% increase in its passenger traffic.

Alitalia increased, in March 2016, its number of weekly flights on the Tel Aviv - Rome route from 29 to 33. In total, Alitalia recorded a 15% increase in its passenger traffic.

Aeroflot increased, in March 2016, the daily frequency in the Tel Aviv - Moscow route from 4 to 5, and the number of flights that Aeroflot operates to and from Israel in 2016 is therefore 33 weekly flights. In total, Aeroflot recorded a 47% increase in its passenger traffic.

Ukraine Air International operated, on average in 2016, 34 weekly flights from Tel Aviv to various destinations in the Ukraine, compared to 27 weekly flights on average in 2015. In total, Ukraine Air recorded a 25% increase in its passenger traffic.

Hainan began, in April 2016, to operate three weekly flights on the Tel Aviv - Beijing route, and as of November 2016, Hainan operates 4 weekly flights on this route. Regarding the impact of the commencement of Hainan's operations on the Company's activity in the routes to the East, see Section 7.2(e) above.

The increase in capacity allows for the same companies operating an international hub at their home airport to increase their number of passengers on flights between Israel and a large number of destinations on non-direct flights, while using their network of routes ("sixth freedom" movement) and of their partners to the global aviation alliances and code share agreements.

Passenger traffic at Ben Gurion Airport in 2016[18] was divided as follows: the Company (including flights marketed by Sun d'Or) -32.6% compared to 32.5% in 2015, other regular companies (including low cost companies) - 57.9% compared to 57.1% in 2015, charter companies (excluding Sun d'Or) - 9.5% compared to 10.4% in 2015.

In 2017, there is expected to continue to be an increase in the activity of the foreign airlines in routes to and from Israel. For details regarding the expected growth in 2017 in the activity of foreign airlines on routes to and from Israel, and the expected impact on the level of competition, see Section (d) below.

b. **Charter companies**

In total in 2016, there was an increase of 4% in charter traffic from and to Israel compared to 2015. For details, see Section 7.8.2 above.

c. **Low cost companies**

"Low cost" companies are airlines with a low expenses structure that arises mainly from direct marketing online and not through distribution systems and travel agents, use of secondary airports, a minimal service profile during the flight and activity with short range flights, without cooperation agreements with other

[18] The information regarding the activity of foreign airlines is based on data from the Israel Airports Authority.

companies and high aircraft utilization. Accordingly, they are able to generally offer very competitive prices. These companies have been able to grow significantly in the US, Canada, Europe and, more recently, Asia.

During 2016, the low cost companies continued to expand their operations on routes to Israel, both by opening new routes and by increasing frequency and/or capacity. The following are prominent examples:

EasyJet continued to expand its operations in routes to Israel and increased the number of flights that it operates on the Tel Aviv - Paris route from 2 to 5. In total, EasyJet operates 42 weekly flights from nine different destinations to Israel: Luton (11 flights), London Gatwick (3), Manchester (2), Basel (4), Geneva (5), Milan (4), Berlin (4), Paris (5), and Amsterdam (4). In total, EasyJet's passenger traffic increased by approximately 13%. It is noted that in February 2016, EasyJet cancelled its flights on the Tel Aviv - Rome route, due to the closing of EasyJet's home airport in Rome. It is noted that EasyJet announced its decision to temporarily discontinue flights as of May 2017 and for the duration of the summer season on the Tel Aviv - Gatwick route (London).

Transavia, which is owned by the Air France - KLM Group, expanded its operations during 2016 on the routes to Israel when increasing the number of weekly flights on the Tel Aviv - Paris route from 5 to 7 and increasing the number of weekly flights on the Tel Aviv - Amsterdam route from 3 to 5. Transavia began to operate three regular weekly flights on the Tel Aviv - Munich route. In total, Transavia recorded a 78% increase in its passenger traffic.

It is noted that due to the expected closure of the Transavia airport in Munich during October 2017, Transavia will cancel its flight on the Tel Aviv - Munich route as of the same date.

Wizzair expanded its operations on the routes to Israel and began to operate, as of summer 2016, 2 weekly flights in each of the Tel Aviv - Riga and Tel Aviv - Iasi (Romania) routes, and added a weekly flight on the Tel Aviv - Budapest route, in addition to flights that it operates on routes from Tel Aviv to Eastern Europe (Budapest, Bucharest, Cluj Napoca, Prague, Sofia, Warsaw, Katowice and Vilna). In total, Wizzair operated during 2016, 26 weekly flights from Tel Aviv to ten different destinations in 7 countries in Eastern Europe, compared to 21 weekly flights in 2015, and recorded an increase of 23% in its passenger traffic.

Smart Wings increased its activity on the Tel Aviv - Prague route due to the cessation of activity of Czech Airlines on this route. In total, Smart Wings operated during 2016 an average of ten weekly flights compared to six weekly flights on average in 2015, and its passenger traffic increased by 67%.

Norwegian Air Shuttle began to operate flights on the Tel Aviv - Barcelona route in October 2016, in addition to the flights that it operates on the Tel Aviv - Copenhagen and Tel Aviv - Stockholm routes.

Monarch, which has operated as of December 2015 three weekly flights on the Tel Aviv - London route (Luton) began to operate three weekly flights on the Tel Aviv - Manchester route as of March 2016.

Veuling began to operate flights on the Tel Aviv - Barcelona route in October 2016, in addition to the flights that it operates on the Tel Aviv - Rome and Tel Aviv - Barcelona routes.

It is noted that the Belgian low cost airline, **Jetair Fly** discontinued its activity on the Tel Aviv - Brussels route at the end of February 2017.

During 2016, two new low cost companies began to operate routes to Israel, as follows:

Tus Airways has operated, as of April 2016, flights on the Tel Aviv - Larnaca and Haifa - Cyprus routes (Larnaca and Paphos).

Tuifly operated 2 weekly flights on the Tel Aviv - Munich route in April-October 2016.

In total, the foreign low cost airlines increased their passenger traffic on routes to and from Israel in 2016 by 16% and accounted for 14% of passenger traffic at Ben Gurion airport.

In 2017, another increase in expected in the activity of the foreign low cost airlines on routes to and from Israel both by increasing capacity and/or frequency and by adding destinations, as well as the entry of new low cost companies. For details regarding the expected growth in 2017 in the activity of low cost airlines on routes to and from Israel, and the expected impact on the level of competition, see Section (d) below.

<u>The “UP” airline brand</u>

In response to the increasing competition from the low cost airlines, the Company has operated, as of the 2014 spring/summer schedule, the “UP” airline brand, in which it operates low cost flights to five destinations in Europe - Berlin, Budapest, Kiev, Prague, and Larnaca. The “UP” brand offers passengers three types of tickets: the UP Basic ticket - a basic ticket on which an additional fee can be paid for services such as baggage, seating and refreshments, as selected by the customer, while changes to the ticket would be subject to fees and no refund would be provided for cancellations; the UP Flexi ticket - a ticket that includes a number of additional service such as sending a first bag, seating in economy class and the ability to make a first change in the plane ticket without change fees; and the Up Smart ticket, which includes a variety of services, such as luggage, seating in the economy plus class, preferred seating, meals at the King David lounge at Ben Gurion airport, airport check-in and flexibility in the ticket terms. It is noted that members of the "Matmid club" can accumulate points on UP flights at reduced quantities compared to ordinary flights.

It is noted that some of the low cost airlines, including "UP" flights, from the total traffic at Ben Gurion, reached 18.5% in 2016 compared to 17.8% in 2015.

d. **<u>Expected competition in 2017</u>**

The trend of growth in competition that characterized 2016 is expected to continue in 2017 as well, as a result of the continued increase in expected in the activity of the foreign low cost airlines on routes to and from Israel both by increasing capacity and/or frequency and by adding destinations, as well as the entry of new airlines and as a result of the operation of regular flights to new destinations by the other Israeli airlines. The following are prominent examples:

Far East and Central Asia routes:

Cathay Pacific, the national airline of Hong Kong, has announced that as of the end of March 2017, it will operate 4 weekly flights on the Tel Aviv - Hong Kong route. For details regarding the Company's opinion on the effect of the commencement of activity of Cathay Pacific as stated, see Section 7.2(e) above.

Hainan announced the expansion of its activity on routes to Israel and will operate, as of the end of 2017, flights on the Tel Aviv - Shanghai route, and will add frequency to the Tel Aviv - Beijing route in May-June 2017, such that the number of weekly flights during those months will be five. As to the impact of the commencement of activity of Hainan on the Tel Aviv - Beijing route on the Company's activity, see Section 7.2(e) above.

Air India has applied for the operation of direct flights on the Tel Aviv - Delhi route. According to Air India's announcement, it intends to operate three weekly flights on their route, and opening the route is contingent on receipt of the approvals required from the authorities, which it estimates it will receive by May 2017.

In addition, following the signing of new aviation agreements with Japan, Thailand and India, as set forth in Section 7.1.10(b) above, additional airlines may operate flights on these routes.

Routes to Europe:

Alitalia is expected to operate, as of May 2017, daily flights on the Tel Aviv - Athens route.

Air Berlin is expected to double the frequencies of the Tel Aviv - Berlin route and operate, as of the end of March 2017, 2 daily flights on the route (14 weekly flights) instead of 7 weekly flights.

LOT has announced plans to expand its operations on routes to Israel and will operate, as of June 2017, 4 new flight routes from Israel to Poland (Gdansk, Wroclaw, Poznan and Lublin) and will also double the frequencies on the Tel Aviv - Warsaw route. In total, LOT will operate 14 weekly flights on this route.

In addition, during 2017, there is an expected continued growth in activity of the low cost airlines on routes to Europe both by existing airlines and by the entry of new airlines. The following are prominent examples:

Ryanair is expected to operate 15 new flights to and from Israel, as follows:

Flights from Tel Aviv to the following destinations: Baden-Baden (2 weekly flights), Gdansk (two weekly flights), Krakow (2 weekly flights), Milan-Bergamo (4 weekly flights), Poznan (2 weekly flights), Wroclaw (2 weekly flights) and Paphos (a daily flight).

2 weekly flights will be operated from the airport in Ovda to each of the following destinations: Baden-Baden, Berlin, Frankfurt-Han, Brussels, Milan-Bergamo, Gdansk, Poznan and Warsaw, in addition to flights operated by Ryanair today from Ovda to Budapest, Krakow, Bratislava and Kovno.

Wizzair is expected to operate, during 2017, flights on the Tel Aviv - Debrecen (Hungary) route and Tel Aviv - Varna (Bulgaria) route, and as of June 2017, 7 weekly flights are expected to operate on the Tel Aviv - London route (Luton).

Blue Air began in January 2017 to operate three weekly flights on the Tel Aviv - Bucharest route.

Tus Airways is expected to operate, as of March 2017, direct flights on the Haifa - Athens route, as well as to operate direct flights during June-October 2017 on the Haifa-Rhodes and Haifa-Kos routes, in addition to the routes that Tus Airlines operates on the Haifa-Larnaca, Haifa-Paphos and Tel Aviv-Larnaca routes.

Routes to North America:

Air Canada has announced its intend to expand its operations on routes to Israel and operate, during June-October 2017, 2 direct weekly flights on the Tel Aviv - Montreal route, as well as to add a weekly flight on the Tel Aviv - Toronto route, thus increasing the frequencies of Air Canada on this route during the year to seven weekly flights.

The Canadian charter airline, **Air Transat**, is also expected to operate, during June-October 2017, 2 weekly flights on the Tel Aviv - Montreal route.

The Company's estimate regarding the increase in capacity and frequency in other airlines, the impact of the commencement of activity of the other airlines on the Company's activity, the impact of signing new aviation agreements and the increase in competition in 2017 is forward-looking information as defined in the Securities Law. The information is based, inter alia, on the Company's estimates in light of the current volume of activity of the Company and the competition in the markets which may not materialize, in whole or in part, or that may materialize in substantially different manner. The actual reality may be different than predicted as stated, inter alia, due to the extent of opening the market to additional competition, regulatory changes, the manner with which the Company deals with competition and the risk factors described in Section 9.18 below, as well as economic, security and geopolitical changes.

The Company takes many actions when facing competition, including examining, from time to time, the option of increasing the frequency of flights and/or capacity to existing destinations and the option of holding flights to new destinations in accordance with the market needs, including through "code share" agreements and other agreements with other airlines. For details regarding the code share agreements signed by the Company, see Section 9.13 below.

7.8.4 Main methods for dealing with competition

The Company operates in several channels in order to increase its profitability, while preserving and increasing its market share and increasing its seat capacity, *inter alia*:

a. Procurement of new and advanced 787 Boeing aircraft.

b. Adjusting the schedule, to the extent possible, to traffic seasonality and international events.

c. Increasing the frequency of flights to popular destinations as well as the number of flight destinations.

d. Collaboration with other companies through code share agreements and interline agreements.

e. Striving to continuously improve the service to passenger, including the improvement of seat comfort, quality and diversity of inflight food and entertainment, etc., while focusing on Business Class.

f. Granting benefits to passengers who belong to the Frequent Flyer Club and to business corporations that are members of the Company's Business Desk.

g. Activity through all relevant marketing channels.

h. Addressing the passengers by means of advertising campaigns in Israel and worldwide.

i. Operating the “UP” brand (for details, see Section 7.8.3(c) above).

j. Issuing "Fly Cards" – the Branded Credit Cards (for details, see Section 7.6.4 above).

Among the positive factors affecting or liable to affect the competitive position of the Company, the following factors can be listed: large and diversified flight network; use of new aircraft; wide deployment of distribution network in Israel and worldwide; existence of an attractive customer club; strong brand in the local market; high level of safety and security; flight schedule stability and operational accuracy; adjustment of services to market needs and a set of cooperation agreements with other airlines.

Among the negative factors affecting or liable to affect the Company's competitive position, the following factors can be listed: geopolitical condition significantly reducing the Company's chances of operating Sixth Freedom flights (indirect flights via Ben Gurion Airport) vis-à-vis the increase of Sixth Freedom flights operated by other airlines; reducing regulatory barriers to operate in the Company's destinations, in particular in light of a liberal aviation policy; the entry of low-cost airlines; instability in work relations; collaborations between the foreign airlines in the framework of global aviation alliances (SKY, One World, STAR), regulatory changes and legislation restrictions and constraints applicable to the area of operations; excessive production capacity of competitors; the Company's reliance on distribution through agents vis-à-vis the increased trend of direct online marketing; the fact that the Company does not operate passenger flights on Sabbaths and holidays; possible deterioration of the economic, security and political situation in Israel.

7.9 **Seasonality**

The Company's activity is seasonal and focuses on peak periods. High traffic of Israeli passengers abroad is mainly in summer and during the Jewish Holidays, and there is high traffic of tourists to Israel in particular in the summer and towards Jewish or Christian holidays, or during vacations in the countries of origin. The Company's peak activity is in the third quarter of the year. In the third quarter of 2016, the volume of passenger traffic was approximately 33%, compared to 32% in the third quarter of 2015, of the total annual passenger traffic.

The following table presents data on the breakdown of the Company's revenues from passenger aircraft by quarter:[19]

Year 2016:

	Quarter (USD millions)				Annual (USD millions)
Year	**January-March**	**April-June**	**July-September**	**October-December**	**January-December**
2016	358.1	495	578.4	415.6	**1,847.1**
% of the operating segment	19.4%	26.8%	31.3%	22.5%	**100%**

Year 2015:

	Quarter (USD millions)				Annual (USD millions)
Year	**January-March**	**April-June**	**July-September**	**October-December**	**January-December**
2015	381.2	465.4	592.1	435.5	1,874.2
% of the operating segment	20.3%	24.8%	31.6%	23.3%	**100%**

7.10 **Production capacity**

Output indices accepted in the aviation world with respect to passenger aircraft are PLF and ASK. At the peak of demand (August), the Company's production capacity is close to the full output potential. In August 2016, the Company's ASK was 2,571 and the Company's PLF was 87.8% (excluding flights marketed by Sun d'Or).

Below is a table describing the monthly average of the ASK and PLF of the Company (excluding flights that have been marketed by Sun d'Or) over the last five years:

[19] The dates of Jewish holidays according to the Gregorian calendar changes from year to year, which may have a comparative effect on the corresponding quarterly activity from year to year.

Year	Monthly average (million)	L.F
2016	2,086	84.2%
2015	1,987	83.4%
2014	1,916	82.5%
2013	1,811	82.9%
2012	1,735	82.5%

The Company does not operate regular passenger flights on Saturdays and Israeli holidays, and therefore does not fully utilize its production capacity. According to an agreement reached in January 2007 between representatives of the Rabbinical Committee for the Sabbath and representatives of the Company, it was agreed that the Company would continue to maintain the status quo, according to which the Company does not carry out passenger flights on Saturdays and Jewish holidays. In light of the need for occasional flights on the Sabbath, it was agreed that prior to such flights, the Company would contact the Chief Rabbi or the Company's President and Chief Executive Officer to hear the position of Jewish law.

7.11 Aircraft Fleet

As of the date near approval of the report, the Company makes use of 42 passenger aircraft, of which the Company owns 28 and 14 are leased by the Company, as follows:

Model[20]	Average seats	Average age	Ownership	Lease	Total existing fleet	Aircraft ordering
747-400	408	21.3	6	-	6	-
777-200ER	279	13.6	6	-	6	-
767-300ER	215	21.2	2	5	7	-
737-900ER	172	2.0	8	-	8	-
737-800	165	13	6	9	15	-
787-9	-	-	-	-	-	9
787-8	-	-	-	-	-	7
Total	**226**	**13.5**	**28**	**14**	**42**	**16**

[20] Some of the 737-800, the ER 777-200 and the 737-900 were purchased through EXIM / EXIM guarantee, and therefore the legal format is that the planes were initially leased by the Company, with the Company having an option to purchase the aircraft at the end of the period for one dollar.

7.11.1 The Company's aircraft fleet is entirely manufactured by Boeing. Therefore, the Company is dependent on Boeing for its ongoing maintenance of its aircraft, spare parts supply, repairs and engineering consultancy.

For details regarding the Company's plan to equip it with large-bodied aircraft, see Section 9.12 below and Note 9 to the Financial Statements.

<u>Owned aircraft</u>

- ✓ During the first quarter of 2016, the Company received three 737-900ER Boeing aircraft. Upon receipt of the same aircraft, the Company completed the purchase and absorption of eight aircraft of this model. For additional details, see Note 9 of the Financial Statements.

- ✓ The Company has engaged with a foreign company in agreements for the sale of 2 of the Company’s Boeing 737-700 (EKD and EKE) aircraft in consideration for a total of USD 16 million for the two aircraft. The aircraft will be delivered to the foreign company in January 2016 (EKD) and in June 2016 (EKE). As of the date of the Report, the Company does not hold other aircraft of this model. For additional details, see Note 9 of the Financial Statements.

<u>Dry leases</u>

During 2016, and until the Date Near Approval of the Report, the Company has engaged in lease agreements as set forth below:

- ✓ During 2016, the Company signed extensions to the lease agreements of four 737-800 model passenger planes with a foreign company. The agreement with respect to the EKS aircraft was extended for an additional period of about 80 months, as of August 2016. The agreement with respect to the EKP aircraft was extended for an additional period of about 60 months as of October 2016. The agreement with respect to the EKT aircraft was extended for an additional period of about 72 months as of November 2016. The agreement with respect to the EKF aircraft was extended for an additional period of about 86 months as of December 2016.

- ✓ In January 2017, the Company signed with a foreign company to extend a lease agreement with a Boeing 767-300 passenger aircraft marked EAL for an additional period of 36 months as of December 2017.

For details regarding the dry lease agreements signed by the Company within the Company's plan to equip it with large-bodied aircraft, see Section 9.12 below and Note 9 to the Financial Statements.

The leasing fees for the Company's aircraft in this area of activity amounted to USD 116.4 million in 2016, USD 64.2 million in 2015 and USD 64.6 million in 2014. The above lease expenses also include payments made by the Company in respect of "wet leases" as detailed below.

Wet leases

During 2016, and until the Date Near Approval of the Report, the Company has engaged, from time to time, with foreign companies in "wet lease" agreements (the lease of aircraft with its crew) of passenger aircraft, including due to issues in manning flights, as set forth below:

- ✓ In January-March 2016 and in June-November 2016, the Company leased a Boeing 777-200 aircraft from a foreign company.
- ✓ In March-November 2016, the Company leased a Boeing 757-200 aircraft from a foreign company.
- ✓ In January-March 2016 and in September and October 2016, the Company leased a Boeing 767-300 aircraft from a foreign company.
- ✓ In March and in May-November 2016, the Company leased between one and three Boeing 737-800 aircraft from a foreign company.
- ✓ In July 2016, the Company leased a Boeing 747-400 aircraft from a foreign company.
- ✓ In August-November 2016, the Company leased one to two wide body Airbus aircraft from a foreign company.

The Company also leased aircraft with "wet lease" (the lease of an aircraft with its crew) in order to carry out flights ad hoc from the Israeli airlines Israir and Arkia.

The lease fees paid by the Company in 2016 for "wet leases" of aircraft amounted to USD 62.1 million.

For details regarding the increase in the Company's operating expenses, see Note 19 of the Financial Statements and Section a.3 of the Board of Director's Report. For details regarding work relations in the Company, see Section 9.4.6 below.

Maintenance and renovation agreements

During 2016, the Company entered into agreements for the maintenance and renovation of engines as follows:

- ✓ In February 2016, the Company signed an agreement with the Rolls-Royce engine manufacturer for the maintenance of engines for 787 aircraft, which are expected to be received by the Company in the years 2017-2020. For additional details, see Section 9.12 below.
- ✓ In December 2016, the Company entered into an amendment to the PW4000 engine maintenance agreement with Pratt & Whitney for the 747-400 and 767-300ER aircraft, which adjusts the agreement signed between the parties in 2014 for the plan for the expense of servicing these aircraft and the planned acquisition of 787 aircraft. For details regarding the Company's plan to equip it with large-bodied aircraft and the engine maintenance agreement, see Section 9.12 below and Note 9 to the Financial Statements.

8. Cargo plane segment

8.1 General information on the field of activity

Trends, events and developments in the macroeconomic environment of the Company, which have or are expected to have material impact on the business results or the development in the Company at large or the field of cargo aircraft, are described below with respect to the following areas:

8.1.1 Structure of the field of activity and changes thereto

Four types of competitors operate in the market of cargo aviation transportation: companies carrying cargo on cargo aircraft only; companies carrying cargo in the belly of passenger aircraft only; companies, like El Al, that carry cargo both by cargo aircraft and in the belly of passenger aircraft, as well as courier companies which, in addition to their courier services, carry other cargo on their aircraft.

In the last few years, a steady increase is seen in the volume of passenger aircraft on international routes worldwide, which increases competition.

In addition, the growing trend of shifting cargo transport to marine traffic has continues over the last year.

The Company estimates that its share of cargo transport in the years 2016, 2015, and 2014 is estimated at approximately 32.1%, 33.6%, and 34.3%, respectively, out of all cargo transported by air to and from Israel (including cargo carried in passenger aircraft belly; excluding Sixth Freedom and including mail operations).[21]

8.1.2 Restrictions, legislation, regulations and special circumstances applying to the field of activity

Regulatory restrictions applicable to cargo transport by cargo aircraft are similar to those applicable to passenger transport by passenger aircraft.

Regulatory arrangements have also been made in the cargo segment, with respect to many operational aspects, such as: permitted flight capacity, air carrier liability for damages, standards of flight safety, security and noise. For details, see Section 9.11 below. However, the policy of aviation authorities around the world regarding the provision of permits in connection with cargo aircraft tends to be more lenient than in the segment of passenger aircraft. This particularly impacts the ability to carry out flights on cargo aircraft in "fifth freedom" as well.

8.1.3 Changes in the volume of activity in the area and in its profitability

a. **Volume of international cargo transport**

According to IATA estimates, a growth of approximately 3.8% was recorded in 20156 in the volume of global cargo transportation (international only) by aircraft (including in passenger aircraft belly). In 2015, an increase of 2.3% was recorded (international and domestic).

The following table describes the development in the volume of air transport operations (international only) of cargo and mail for 2014-2016, based on data provided by IATA:

Year	**Output**	
	RTK (in millions)	**Annual change in RTK (%)**
2016	No data have yet been published	No data have yet been published
2015	184,927	3.2
2014	179,176	6.4

[21] It is noted that the periodic report published by the Company for 2015 including data regarding the Company's share does not include cargo transportation activity of the Company on "sixth freedom." The data presented above includes this activity, and accordingly, the data for 2014-2015 has been updated.

b. **The volume of cargo transportation in and out of Israel**

The following are data on cargo traffic entering and exiting Ben Gurion Airport in the last five years (data include cargo carried by cargo aircraft and in passenger aircraft belly)[22]:

Cargo traffic at Ben-Gurion Airport (thousands of tons) for the year ended December 31[23]									
	2016	**Change from 2015**	**2015**	**Change from 2014**	**2014**	**Change from 2013**	**2013**	**Change from 2012**	**2012**
Export	143	6%	135	(6%)	144	3%	140	(5%)	148
Import	173	12%	155	9%	142	4%	137	1%	136
Total	316	9%	290	1%	286	3%	277	(2%)	284

The cargo traffic at Ben Gurion Airport during the course of 2016 saw an increase of 8.8%[24] compared to 2015.

In addition to CAL Cargo Airlines Ltd. ("**CAL**"), the Israeli cargo company, cargo capacity of foreign airlines included cargo capacity of passenger flights and cargo flights operated by eight airlines: FedEx (USA), NMG and Turkish Airlines (Turkey), EAT and TNT (Belgium), Korean Air (Korea), Lufthansa (Germany) and Silk Way (Azerbaijan). Additionally, non-scheduled cargo flights were operated through foreign airlines, on an ad hoc basis.

About 55.8% of the total cargo traffic at Ben Gurion Airport was carried on cargo aircraft whereas the remaining traffic (44.2%) was carried in passenger aircraft belly (mainly wide-body aircraft). These data include cargo carried by the Company via Ben Gurion Airport under Sixth Freedom, in a scope of [25]2.5 thousand tons in 2016, in 2015 totaled 0.5 thousand tons, and an insignificant volume in 2014.

8.1.4 Developments in the markets of this area of activity or changes in the characteristics of its customers

The Israeli market in the segment of cargo transportation on cargo aircraft is characterized by high seasonal fluctuation, due to the relatively high weight of agricultural export (substantially carried out in wintertime) out of total export. For

[22] Source: the Civil Aviation Authority and the addition of the Company's postal activity.
[23] See footnote 21 above.
[24] Less "sixth freedom" activity of the Company through Ben Gurion Airport, the increase in traffic in 2016 is about 7.7%.
[25] The data includes cargo transported on cargo planes as well as cargo transported on passenger planes.

details about the Company's customers in the segment of transportation by cargo aircraft, see Section 8.5 below.

8.1.5 Technological changes that may have a material impact on the operating segment

In 2016, no technological changes were made that have a material impact on the operating segment.

8.1.6 Critical success factors in this area of activity and the applicable changes

In the segment of cargo transportation by cargo aircraft, several factors having impact on the competitive status in the segment can be counted: the ability to offer cargo transport to popular destinations at competitive prices; independent development of route network, including the option to operate Fifth Freedom and Sixth Freedom flights as activity supporting cargo transportation to and from Israel; cooperation with other airlines; cargo transportation at the required frequency and quality, while meeting schedules; risk management and hedging.

8.1.7 Changes in suppliers and raw materials to the operating segment

The main raw material used by airlines is jet fuel, which is one of the main expenditure components of an airline. For additional details regarding fuel, see Section 9.5.1 below. In addition, the Company is dependent on Boeing, as detailed in Section 7.1.7 above.

8.1.8 The main entry and exit barriers in this area of activity, and the applicable changes therein

Regulatory entry barriers (the need for a designated air carrier and permissions for flight frequency, capacity, etc.) with respect to scheduled cargo aircraft flights are essentially similar to the regulatory entry barriers with respect to scheduled passenger aircraft flights, as set forth in Section 7.1.8 above.

The Company estimates that in the segment of cargo flights, some of the countries have a more liberal policy on giving permissions. Therefore, the Company estimates that in the segment of cargo flights, this entry barrier may be less significant in some countries.

Another entry barrier in this segment is the relatively large initial investment required for establishing and operating an airline company, including aircraft acquisition and leasing.

The restrictions applicable to the Company by the holder of the Special State Share with respect to reducing the Company’s cargo aircraft fleet constitute an exit barrier. For details, see Section 9.11.9 below.

8.1.9 Substitutes for services in the field of activity and changes thereto

The main substitute for air transport by cargo aircraft is cargo transport in the belly of passenger aircraft, marine transport, or a combination of marine transport to a nearby destination port, from where the cargo is conveyed by means of land transport. In 2016, no material changes have occurred with respect to the substitutes for transportation by cargo aircraft. It shall be noted that marine transportation constitutes a significant substitutes for air cargo transportation.

8.1.10 **The structure of the competition in the field of activity and the changes therein**

In the last few years, a change has occurred in the structure of the segment in the Israeli market due to increase in supply to customers following the entry of other airlines operating designated cargo aircraft. Furthermore, the expansion of scheduled flights to and from Israel on passenger aircraft capable of carrying cargo in their bellies, is liable to increase competition in the field of cargo operations. Nevertheless, part of the growth in passenger aircraft arises from the operations of low-cost airlines operating flights from destinations in Europe to Israel on narrow-body aircraft which in most cases do not carry cargo. For further details, see Section 8.7 below.

8.2 **Services in the field of activity**

In this segment, the Company offers cargo transport services by a cargo aircraft from Israel to overseas destinations and from overseas destinations to Israel; cargo transport within “fifth freedom” from one foreign country to another foreign company, for example – from Liege to New York; and cargo transport under Sixth Freedom (indirect flights via interim destinations in the airline's parent country), for example – from Asia to Europe or the U.S. with a stopover in Israel. The Company distinguishes between three major destination groups: (1) North America; (2) Europe; (3) the Far East and Central Asia.

During the Reporting Year, the Company offered, in this segment, cargo transport services to one destination in Europe on scheduled flights, five destinations in Europe on charter flights, one destination in North America on charter flights and one destination in North American on regular flights. On top of that, the Company offers cargo transport services to many other destinations on the Company's passenger aircraft or through cooperation with other airlines as well as by means of marine transportation from the airport.

Cargo traffic on the Company's cargo airplane by region (tons) for the year ended December 31:

	2016	2015	2014	2013
To and from Israel to Europe	**36,728**	33,389	32,071	32,749
To and from Israel to the USA	**5,435**	7,126	6,305	5,120
To and from Israel to the Far East and Central Asia	**0**	71	79	32
Total	**43,163**	**40,586**	**38,455**	**37,901**

These data do not include air cargo carried by the Company other than via Ben Gurion Airport under Fifth Freedom and air cargo carried by the Company via Ben Gurion Airport under Sixth Freedom. In the years 2016, 2015, 2014, and 2013, the Company carried Fifth Freedom cargo by the cargo plane in a volume of 4 thousands of tons, 5 thousands of tons, 5 thousands of tons and 2 thousands of tons, respectively. The Company carried Sixth Freedom cargo by the cargo plane at negligible volume in 2013-2016. The major target markets for cargo transport services are importers, industrial factories and the agricultural sector.

For the purpose of cargo distribution from the Company's cargo hubs, the Company operates a truck transportation system in Europe, through subcontractors.

In May 2016, the audit and remuneration committee and board of directors of the Company approved the exercise of the Company's option for the extension of the engagement with Maman - Cargo Handling and Terminals Ltd. ("**Maman**") in a framework agreement (the "Framework Agreement") signed on February 3, 2010 for an additional period that began retroactively as of April 1, 2015 and until December 31, 2019, under improved commercial terms (the "**Extension Period**"). The Framework Agreement set forth the engagement terms regarding the terminal services provided to the Company by Maman that include, inter alia, cargo handling, transport of cargo and storage. In accordance with the letter of extension to the Framework Agreement and approval of the general meeting of shareholders of Maman in August 2016, the exercise period of the options allocated by Maman to the Company, that are exercisable to ordinary shares of Maman at a rate of 10% of the issued share capital of Maman on a fully diluted basis, was extended until December 31, 2018.

In May 2016, the Company engaged with a foreign company in an agreement for the supply of terminal and freight forwarding services at Liege Belgium (LGG) for a period of three years beginning January 2016.

In January 2017, the Company engaged with a foreign company in an agreement for the supply of terminal and freight forwarding services at Heathrow England (LHR) for a period of five years beginning January 2017.

8.3 **Segmentation of income and profitability of services**

In 2016, there was a decline of about 10.1% in the Company’s revenue in the field of activity compared to the revenue in 2015, with the cargo traffic at Ben Gurion Airport during 2016 increasing at a rate of 7.7% compared to 2015 .For details regarding data about distribution of the Company’s revenue and profitability (consolidated) based on the Company’s reported operating segments in the field of transport of aircraft cargo, see Note 20 of the Financial Statements.

8.4 **New services**

In February 2016, the Company launched the Cargo Plus service, which allows customers to reserve space for the transport of large cargo on requested flights up to 48 hours before the flight time.

The Company periodically examines the possibility of carrying out flights to new destinations and increasing the frequency of existing destinations, based on the market’s needs.

8.5 **Customers, marketing and distribution**

Most of the Company's sales in the cargo transportation sector are carried out to cargo agents (in 2016, about 92%). The remaining sales are made directly to the end customers which are not cargo agents.

In the segment of cargo transport by aircraft carrying cargo, the Company does not have customers the revenue from which is 10% or more of the Company's total revenues.

In addition, the Israeli cargo consolidation company ("ACI"), some of the shares of which are held by the Company, is engaged in consolidation of air cargo at Ben Gurion Airport and transfer thereof abroad, mainly through the Company. ACI, like other companies operating in this segment, consolidates cargo of individual dispatchers into one shipment, and in its capacity of dispatcher, it sends it for delivery to the Company.

8.6 **Order backlog**

As a rule, carrying cargo by cargo aircraft is done shortly after processing a service order. Therefore, in 2016, the Company did not have any significant backlog.

8.7 **Competition**

8.7.1 Competition in the segment

a. The segment of transportation by cargo aircraft is characterized by fierce competition between airlines providing transportation services between the sale destinations or alternative ones. Airline companies compete in various segments, the main of which are: transportation price, level of service, schedule and frequency of flights.

b. In the operating segment in Israel, the Company competes with CAL and foreign airlines operating cargo aircraft. As of the Date of the Report, CAL operates flights to various destinations in the U.S. and Europe.

c. In 2016, the Company competed with eight foreign airlines (in addition to CAL) operating cargo aircraft on flights to and from Israel, in carrying cargo on cargo aircraft to and from Israel.

d. The Company competes with most scheduled airlines operating passenger aircraft and carrying cargo in their bodies. In 2016, the Company's share of cargo carried in passenger aircraft belly was 40.5% compared to 25.5% of cargo carried by cargo aircraft.

As stated in Section 7.2(e) above, Cathay Pacific is expected to operate, as of March 2017, 4 weekly flights on the Tel Aviv - Hong Kong route. In the Company's estimation, this traffic may constitute competition for the Company in cargo operations to and from the Far East.

The Company's estimate regarding the impact of the commencement of Cathay Pacific's operation to the Company's activity in the field of cargo transport is forward-looking information as defined in the Securities Law. The information is based, inter alia, on the Company's estimates in light of the current volume of activity of the Company and the competition in the markets which may not materialize, in whole or in part, or that may materialize in substantially different manner. The actual reality may be different than predicted as stated, inter alia, due to the extent of opening the market to additional competition, regulatory changes, the manner with which the Company

deals with competition and the risk factors described in Section 9.18 below, as well as economic, security and geopolitical changes.

e. In recent years, the Civil Aviation Authority has tended to approve applications by foreign regular airlines to increase their flight frequencies to Israel. As a result, there has been an increase in the capacity of flying cargo in the airfield of passenger aircraft of foreign airlines as aforesaid. This increase is exacerbating competition in the transportation of cargo.

8.7.2 Significant competitors in the field of transport by passenger aircraft

To the best knowledge of the Company, its significant competitor in terms of market share in the segment of transportation by cargo aircraft is CAL.

8.7.3 Main methods for dealing with competition

The Company operates in several channels in order to increase its profitability, while preserving and increasing the volume that it transports, including:

a. Adjusting the schedule, to the extent possible, to traffic seasonality and maintaining stability of the schedule.

b. Increasing the frequency of flights to popular destinations as well as the number of flight destinations through collaborations with other companies.

c. Competitive bidding.

d. Increasing the frequency of the Company’s cargo flights between two foreign countries.

e. Launch of new services.

Among the positive factors affecting or liable to affect the competitive position of the Company, the following factors can be listed: the operation of a dedicated 747-400 Boeing cargo aircraft; a strong brand in the local market; high level of service; technological innovation; high level of security and safety; a wide range of direct flight destinations; schedule stability and operational accuracy.

Among the negative factors affecting or liable to affect the competitive position of the Company, the following factors can be listed: Israeli authorization for additional competitors or destinations. Regulatory changes limiting the possibility for entering into cooperation agreements with other airlines or preventing the exercise of traffic rights; the entry of new foreign competitors; instability in work relations; increasing flight capacity of foreign airlines (including under Sixth and Fifth Freedom); security restrictions and requirements; deterioration of the economic, security and political situation in Israel.

8.8 **Seasonality**

This segment is characterized by a seasonal fluctuation due to the relatively high weight of agricultural export out of total export using cargo aircraft. The following are data on the segmentation of the Company's revenues from the cargo aircraft, by quarters:

Year 2016:

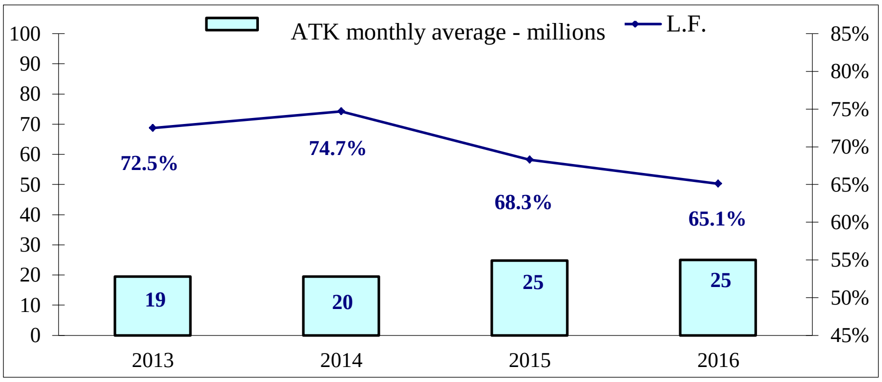
	Quarter (USD millions)				Annual (USD millions)
Year	**January-March**	**April-June**	**July-September**	**October-December**	**January-December**
2016	19.8	15.1	14.3	15	**64.2**
% of the operating segment	30.8%	23.5%	22.3%	23.4%	**100%**

Year 2015:

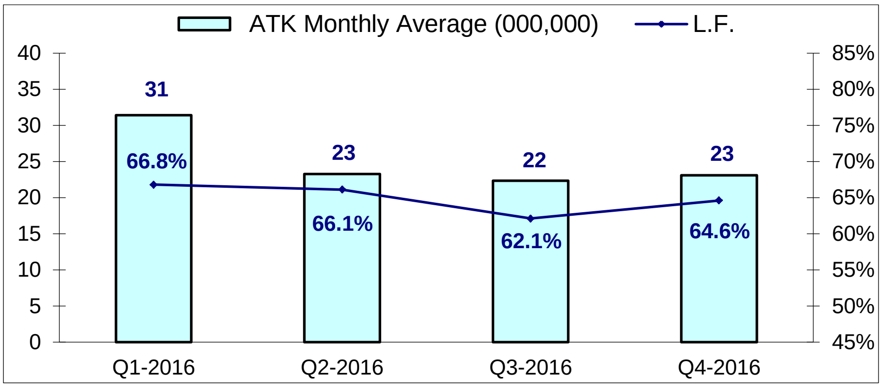
	Quarter (USD millions)				Annual (USD millions)
Year	**January-March**	**April-June**	**July-September**	**October-December**	**January-December**
2015	19.5	19.7	15	17.2	**71.4**
% of the operating segment	27.3%	27.6%	21%	24.1%	**100%**

8.9 **Production capacity**

Output indices accepted in air cargo transportation by cargo aircraft are capacity rate (FLF) and Available Ton Kilometer (“ATK"). It shall be noted that the capacity rate indicator is calculated only according to cargo weight, regardless of cargo volume.



Below is a graph showing the Company's FLF and ATK on average per quarter in 2016:



8.10 **Aircraft Fleet**

The Company leases a 747-400F (ELF) cargo aircraft (hereinafter: the "**Cargo Aircraft**") from a foreign company for the period ending July 2019.

During 2016 and the months of January-February 2017, the Company leased a Cargo Aircraft with a "wet lease" (the lease of an aircraft with its crew) from foreign companies, including due to delays in manning flights.

It is noted that the lease fees paid by the Company in 2016 for the "wet leases" of the Cargo Aircraft amounted to USD 22.7 million.

For details regarding the increase in the Company's operating expenses in 2016, see Note 19 of the Financial Statements and Section 3a. of the Board of Director's Report. For details regarding work relations in the Company, see Section 9.4.6 below.

The total leasing fees for the Company's aircraft in this area of activity amounted to USD 28.8 million in 2016, USD 18.4 million in 2015 and USD 8.7 million in 2014. The lease expenses also include payments made by the Company in respect of "wet leases" as detailed above.

8.11 **Raw materials and suppliers**

The Company's main raw material is jet fuel. For additional details, see Section 9.5.1 below. In the segment of cargo aircraft, the Company uses, in its various stations around the world, suppliers engaged in unloading and loading aircraft, storing cargo in warehouses, supplying airborne equipment and consumables for current use as well as in cargo land transport from the customer to the airport and vice versa. The rate of expenditure for entering into agreements with such suppliers in 2016 was approximately 15% of the segment's expenses. In 2016, the Company had no dependence on a single supplier.

9. Details regarding the two areas of activity

9.1 Fixed assets and facilities

a. **Real estate owned by the Company**

The Company owns office and commercial spaces with an area of 1,560 sq.m in the El AL building located at 32 Ben Yehuda Street, Tel Aviv (the "**El Al Building**"), which was used until May 2013 as the offices of the Company's Israel branch and was leased to others as of February 2013 for a period of five years, plus two option periods.

The Company also owns offices in Spain (Madrid) and Argentina (Buenos Aires) with a total area of 269 sq.m.

b. **Land use rights and buildings at Ben-Gurion Airport**

Main office

Ben Gurion Airport (BGN Airport) serves as the Company's base airport and its principal operations base. The Company's head office is located at BGN Airport and so are its aircraft hangers, aircraft parking spaces, workshops, warehouses and the other offices of the Company and its facilities. Most offices, aircraft hangers and the rest of the buildings used at BGN Airport were built by the Company on a land regarding which the Company is a long-term Authorisee.

By virtue of the agreement with the Airport Authority ("**IAA**") of June 1992, as amended in February 1995, the Company has a right of use (authorization) constructed area of approximately 80,000 sq.m on land with an area of 290 dunam at Ben Gurion Airport, until December 31, 2010. The aforesaid period can be extended for another period of up to a total of 25 years, in accordance with the terms of the contract or under different terms as agreed with the IAA. This Company has announced its intent to exercise the aforesaid extension in accordance with the agreement, and is negotiating with the IAA regarding the extension of the agreement for an additional term. Exercise of the option will seemingly require payment of purchase tax. The parties are acting in accordance with the agreement that has ended.

According to the aforesaid agreement, the IAA allows the Company to use the asset and access routes thereto, and allows the Company to operate airline services on and/or through the property. According to the Agreement, the IAA has the right to demand that the Company vacates an area and/or building required to it for the airport's operation, safety, development or security.

In 2005, the Company paid authorization fees for the above right of use in the amount of USD 960 thousand and from 2006 and thereafter, said authorization fees increased by 7.4% per year until the end of the contract term, provided the maximum annual payment does not exceed USD 4 million per year. Pursuant to the amendment of the agreement dated October 19, 2004, in addition to the payment for the land, the Company pays to the IAA yearly usage fees for certain buildings and facilities, for which the depreciation period has ended. The payment rate increases gradually (in accordance with and subject to the quantity and type of buildings terminating the depreciation period each year, according to a depreciation period of 40 years after the building's construction). The authorization fees for the land and structures in 2016 amounted to USD 5.1 million.

<u>Passenger service warehouse</u>

Under the agreement with the IAA, the Company has the right to use (authorization) constructed area of about 2,600 sq.m in addition to about 1,750 sq.m of operational space. The Company pays the IAA annual authorization fees in the amount of NIS 3.1 million. The term of the agreement was extended until December 31, 2019, while the Company has the right to terminate the Agreement with 180 prior notice.

<u>Terminal 1</u>

Under the Agreement with the IAA, the Company has the right to use (authorization) offices in a total scope of 140 sq.m in Terminal 1. The Company pays the IAA annual authorization fees of USD 20,000. The agreements are for various periods.

Terminal 3

The Company has entered into authorization agreements with the IAA, which provide authorization to operate the King David Lounge as well as operational areas in Terminal 3. The Company pays the IAA annual usage fees in the amount of NIS 18 million for the King David Lounge and annual usage fees of NIS 7.8 million for the operational areas in Terminal 3. The agreements were valid until November 1, 2014, and negotiations are being held for their extension. It is noted that as of the date of the Report, the parties are operating in accordance with the aforesaid agreements.

Within the operation of Terminal 3, the establishment of an aircraft maintenance center near Terminal 3 is being considered. For this purpose and as part of the preparations for the transfer to Terminal 3, in April 2000 a Principles Agreement was signed between the Company and the IAA for the construction of a maintenance center, hanger and auxiliary buildings in proximity to Terminal 3. The IAA Board of Directors approved the agreement, but it was conditioned on the execution of a detailed agreement between the parties and approval thereof by the Company's Board of Directors. The Company received a letter from the IAA, whereby the IAA would not be able to meet the Agreement and allow the Company to build a hanger for large aircraft in the location agreed upon. In light of this letter, the parties are in negotiations for finding an acceptable solution.

Officers for the Company’s cargo operations in the cargo transportation area

Under the framework agreement signed between the Company and Maman - Cargo Terminals and Handling Ltd. (“**Maman**”), whereby Maman provides the Company with terminal and loading and unloading services (for details regarding the framework agreement with Maman, see Section 8.2 below), the Company has a usage right (authorization) to offices in the Maman building with a total area of 445 sq.m. The annual authorization fees are estimated at a total of NIS 0.3 million per year. The agreement is in force until December 31, 2019.

c. **Lease of land in Israel**

The Company has transferred the “Israel Branch” offices from the El Al Building to the Part Terminal compound in Or Yehuda and the sales shop was transferred to 27 Rothschild Blvd., Tel Aviv.

The Company leases offices from various lessors for the El Al branches around Israel. The offices have a total area of about 1,500 sq.m (excluding parking spaces). The total annual cost of these leases is NIS 2.1 million. The agreements are for various terms.

The annual cost for the lease of areas in Israel is USD 8,200,000 for constructed area of 88,000 sq.m (of which 80,000 sq.m is for the main office).

d. **Lease of land abroad**

The following are details of real estate properties that the Group leases worldwide (excluding security areas) as of December 31, 2016:

Category	Area in square meters	Cost in thousands of dollars
Far East	930	460
Europe	4,940	2,990
North America and South Africa	3,390	2,300
Total lease fees abroad	9,260	5,750

9.1.2 Accessories, spare parts and replaceable motors

The Company keeps accessories, spare parts and engines for replacement in its warehouses, at a reduced cost of approximately USD 94.7 million as of December 31, 2016. For further details on fixed assets, see Note 9 to the Financial Statements.

During March 2017, the Company completed the implementation of the central information system for the maintenance of Company aircraft, which compiles the information, planning, control, operation and monitoring of the aircraft maintenance activity in Israel and some of the Company's stations overseas. The system's use is expected to improve, *inter alia*, the following: improved reliability monitoring of systems and accessories, improved planning of works and maintenance, improved logistical management, and improved quality and availability of the operational and managerial data.

9.2 Insurance

The insurance coverage of the Company substantially refers to two aspects: insurance of the Company's property of all types and legal liability insurance for bodily injury and property damage.

The Company's airline liability insurance, including insurance coverage for third party damages caused by acts of terror and wars, is limited to a cap of USD 1,500 million per occurrence. The Company estimates that the coverages specified above are sufficient for providing appropriate insurance coverage for its operations.

Both hull insurance for aircraft owned by or serving the Company against all risks (Hull All Risk Insurance) and insurance against loss or damage of aircraft which the Company agreed to be responsible for insurance thereof, are based on an "agreed value" of each aircraft and includes self-coverage levels acceptable in the aviation industry.

Aircraft hull insurance against war and similar risks covers, inter alia, acts of war, hostilities, civil war, strikes, riots, malicious damage, abduction and boycott.

In addition, the Company is covered with various insurances, which, as estimated by the Company, are sufficient for providing appropriate insurance coverage for the principal risks to which the Company and its employees are exposed. Such insurances include insurance policies covering employers' liability, buildings insurance against fire, earthquakes and so forth, health and personal accident insurance and more. The insurance policies are renewed annually.

For details of joint insurance agreements entered into with the Controlling Shareholders – Knafaim, see Note 23 to the Financial Statements.

The Company's overall cost in 2016 in respect of the insurance premiums set out above was approximately USD 6.7 million.

9.3 Intangible assets

The Company holds the title to the "El Al" trademark in Israel. This trademark is the anchor brand of the Company, both in its name and designed logo as well as in the trademarks “Flycard,” "El Al Economy Plus" and "Economy Class Plus” and “UP.” Trademark registration in Israel is valid for limited periods prescribed by law, and is renewable at the end of each period. Additionally, the Company is the holder of the title to the "El Al" trademark (name and designed logo) in the United States and in other countries around the globe. The Company estimates that the "El Al" trademark has an economic life span of many years, in view of its being part of the Company's name, the many years of using this trademark and its dominant market status.

Various domains are registered with the Company’s trademarks online, in Israel and abroad, with varying terms based on the registration rules in the various countries, with options to extend.

9.4 Human capital

9.4.1 Organizational structure

The ongoing management of the Company is in the hands of the President and Chief Executive Officer, who, for the purpose of fulfilling his role, is assisted by the management team at the Company's headquarters, and it consists of the Chief Finance Officer, Chief Maintenance and Engineering Officer, Chief Trade and Aviation Relations Officer, Chief Human Resources and Administration Officer, Chief Customers and Service Officer, Chief Operations Officers, Chief Computing Officer, Legal Counsel and the Company's Auditor.

Below is a chart of the organizational structure of the Company’s senior executives including the President and Chief Executive Officer, VPs and division heads, as of the Date Near the Approval of the Report:

9.4.2 Hired employees

On December 31, 2016, 6,002 workers were employed by the Company, of whom 3,640 are permanent employees (of whom 303 work at the Company's representations abroad (including 23 Israeli stations) and 2,362 temporary employees (of whom 99 are abroad)[26]. The following table sets out the numbers of permanent and temporary employees as of December 31, 2016, and December 31, 2015:

26 The distribution of temporary workers by occupation was: stewards (871), land and service operations (690), maintenance and engineering (427), marketing, sales and cargo (50), overseas (99), other (225) in various roles.

Position	December 31, 2016	December 31, 2015[27]
Permanent employees[28]	3,640	3,669
Temporary employees	2,362	2,276
Total employees	**6,002**	**5,945**

The sharp seasonality of the industry requires allocation of manpower according to demand, by means of a variable number of temporary employees. The Company's security apparatus includes, among others, state employees whose salary is partially paid by the Company (based on allocation of security expenses between the Company and the State – for details, see Section 9.11.12 below).

The following table shows the distribution of permanent and temporary employees of the Company in Israel and abroad according to areas of activity as of December 31, 2016 and December 31, 2015:

Position	December 31, 2016	December 31, 2015
Senior employees	44	45
Cargo	104	95
Sales and marketing	374	378
Pilots	545	525
Stewards	1,235	1,311
Land operations, security, control, operations and service	1,443	1,424
Maintenance, renovation, engineering and inspection	1,447	1,362
Auxiliary services	810	805
Total employees	**6,002**	**5,945**

9.4.3 Substantial dependence on a particular employee

The Company is not materially dependent on any particular employee or officer.

9.4.4 Training

The Company's Training Center is authorized as a "Training Establishment" pursuant to the Aviation Regulations (Training Establishments), 5739-1979. The Training Center

27 With respect to the comparative numbers, it is noted that they were updated mainly due to a change in the method of classification and counting of employees.

28 Including permanent employees in first and second generation (continuing generation).

qualifies workers and conducts trainings for most professions required by the Company: pilots, aircraft technicians, flight attendants, traffic officers, ground attendants, booking and ticketing staff, marketing and sales managers, medium-level management, etc. In addition, the Company conducts courses and trainings for travel agents and cargo agents in Israel and abroad.

The Company purchased a flight simulator to train Boeing 737 pilots (the "**Simulator**"), which as of December 2016 has replaced part of the training performed with simulators abroad. The Simulator is expected to improve the flight training system for the 737 fleet. The Simulator is located near the offices of the Israel branch in the Part Terminal compound in Or Yehuda.

In 2016, the Company invested about USD 15 million in qualification and employee training.[29]

9.4.5 <u>Exemption from application of the Budget Foundations Law</u>

The Company has an exemption from the application of the Budget Foundations Law, since 2005.

9.4.6 <u>Special collective bargaining agreements</u>

In addition to labor legislation and extension orders, the terms of employment of the Company's employees working in Israel, except for senior employees and other workers employed under personal agreements, are regulated in special collective agreements executed from time to time between the Company and the New Histadrut Labor Federation (above and below: the "**Histadrut**") and in procedures published from time to time by the management.

9.4.6.1 The following is a concise description of the main collective agreements applicable to the Company and its employees:

a. Special collective agreement for the Company's permanent employees (the "Generation A Agreement" or the "Collective Agreement"):

All permanent employees of the Company in Israel, including aircrews, are subject to a special collective agreements. The agreement does not apply to senior employees (senior officers and others) who have personal employment agreements,

[29] This cost includes the direct training budget, simulator training fees, including related expenses, as well as the employee salaries during their training days.

nor does it apply to temporary employees who have their own special collective agreement.

The agreement governs all the terms of employment of the permanent employees and determines, inter alia, work procedures, basic rights and obligations, productivity incentives, appointments and placement of workers abroad, internal tenders, insurance, pension arrangements, dismissal procedures, handling of disciplinary violations, rights to free or discounted airline tickets and a dispute resolution mechanism.

The agreement forbids strikes and job actions, unless the strikes are announced by the Histadrut subject to the Settlement of Labor Disputes Law, 5717-1957 and the Histadrut's Constitution, including a secret vote of all the workers.

Pursuant to the agreement, all the permanent employees of the Company are rated by a factory workers' salary rating which have no connection to the national ratings. There are several ratings: a rating for ground workers, a rating for "senior" aircrew personnel and a separate rating for "new" aircrew personnel with lower salaries, a rating for "senior" flight attendant personnel and a separate rating for "new" flight attendant personnel with lower salaries.

On June 22, 2015, the Company and the New Histadrut Labor Federation, the Professional Union Division - Transport Workers Union, and the Employee Representation of all El Al employees, entered into a special collective agreement which constitutes an interim agreement (hereinafter: the "Interim Agreement"), under which the parties established understandings related to the labor relations within the Company. The Interim Agreement was approved by the Board of Directors of the Company on June 24, 2015.

From the date of execution of the Interim Agreement until October 31, 2015, negotiations were conducted between the parties with respect to the professional sectors of the Company, with the aim to execute a new special collective agreement for the years 2015-2018 (the "**2015 Agreement**"); however, due to the fact that no further agreements were reached, on November 1, 2015 the Interim Agreement became, and was defined as, the 2015 Agreement. It should be noted that with respect to the Pilot Sector, by August 31, 2015 the parties have not reached any agreement, thus arbitration proceedings were conducted, chaired by Judge (Retired) Steve Adler, who delivered his decision as regards a number of issues raised before him, which concern the Pilot Sector.

The Interim Agreement contains, *inter alia*, the following issues:

a. Salary increase of 3%, starting from September 2015, to all employees governed by the said agreement, of which a salary increase of 2% applies retroactively for a period commencing January 1, 2015 and ending on the aforesaid date.

b. Right to contingent salary increases of 0.5% to 1%, subject to the Company's profits and to terms provided for in the Interim Agreement. It is noted that the salary increase for 2015 was paid during 2016, and the salary increase for 2016 will be paid in April 2017.

c. Payment of a one-time signing grant in the amount of USD 3 million gross, which is distributed among all the employees of the Company to whom the said agreement applies.

d. Termination of employment of 50 permanent employees – 36 employees terminated their employment by December 31, 2016 and 14 other employees will terminate their employment during the period of the 2015 Agreement.

e. Obligations of the Employee Representation and the Histadrut to maintain complete industrial peace regarding the issues regulated in the Interim Agreement.

b. Special collective agreement regarding temporary employees' employment ("Temporaries Agreement")

The terms of employment of the temporary employees are regulated in a special collective agreement, which was extended on May 20, 2004 until December 31, 2008. The agreement provides for the maximum employment duration of temporary employees, depending on the type of work and the department in which the worker is employed. The agreement provides for all the terms of employment of temporary employees, including wages, pension contributions, contributions to a comprehensive pension scheme, sick pay insurance, entitlement to airline tickets, etc. The validity of the agreement was extended in the special collective agreement from November 2, 2008 to December 31, 2012. In December 31, 2013 the agreement was extended for another year and from this date on, the agreement is for an unlimited period, and each party may notify the cancellation thereof by 60 days' notice.

In February 2011, a special collective agreement was executed with respect to temporary flight attendants and temporary workers in the administrative sector. Pursuant to the agreement, an employee pool was created, containing up to 150 workers of each sector, who will continue to be employed as temporary employees for a total period of up to ten years. The term of employment of these workers are the same as those of permanent Next Generation employees, except with respect to training fund. These workers are subject to disciplinary proceeding applicable to Next Generation employees. Incompatibility dismissal of such employees will be carried out by a parity committee, by agreement or arbitration award. On December 31, 2015, the Company and the Histadrut signed a Letter of Extension to this collective agreement, whereby the term of employment of the temporary employees to whom said Letter of Extension applies will be extended for another period until June 30, 2016. The parties conduct negotiations to extend the term of employment of these temporary employees for an additional period of three years. The term of employment of the Temporary Employees to whom the Letter of Extension applies will be extended for another period until August 31, 2016, and as of the same date, the employment of these Temporary Employees at the Company is terminated.

c. Special collective agreement (land employees - “Permanent Interim Generation")

The agreement was executed on May 20, 2004 and applies to employees who began their employment prior to January 1, 1999 and was intended to apply to them various conditions from those set forth in the Generation A Employee Agreement, and from those set forth for the Continuing Generation Employees. The agreement was extended under the 2015 Agreement and is valid until August 31, 2018.

d. Special collective agreement (flight attendants- “Permanent Interim Generation")

The agreement was executed on May 20, 2004 and applies to flight attendants who began their employment prior to September 1, 1996 and flight attendants who began their employment between January 1, 1996 and December 31, 1997, and was intended to apply to them various conditions from those set forth in the Generation A Employee Agreement, and from those set forth for the Continuing Generation Employees. The agreement was extended under the 2015 Agreement and is valid until August 31, 2018.

In July 2016, an agreement was signed with the employee union regarding flight attendants, which included various provisions regarding the terms of employment of the flight attendants, including provisions regarding shortening the time of stay of flight attendants overseas during certain periods and various provisions regarding the flight service managers. The agreement has not set a date for its termination and the parties have the right to terminate the agreement in accordance with the provisions of the law.

e. Special collective agreement (collaterals)

The agreement was executed on May 20, 2004 and obligates the Company to maintain a balance between all employees whose employment is governed under special collective agreements (First Generation, Middle Generation, Next Generation), to avoid preferring one sector over the other, and addresses the issue of future salary increases to different sectors. The agreement determines, inter alia, that on certain dates, the number of permanent employees working in certain sectors will not be less than the number prescribed in the agreement. The agreement was extended under the 2015 Agreement and is valid until August 31, 2018.

f. Special collective agreement for Generation A Employees for the deposit of severance pay money in the fund in the employee’s name.

The agreement was signed on December 22, 2011, in light of a legislative arrangement that came into effect on January 1, 2011, and that no longer allows the deposit of severance pay in the main compensation fund. In accordance with the agreement, employees with a Generation A Agreement that by December 31, 2010 had money deposited in the central fund for them, shall have money deposited for them as of January 1, 2011 to the severance component in the provident fund in the employee’s name.

g. Special collective agreement for engineers and architects

The agreement was signed in July 2016. The terms of employment of the engineers and architects employed by the Company are regulated in the agreement, including special provisions regarding salaries and dismissal procedures of the employees to whom the agreement applies. The agreement further provides that provisions of the collective agreements of the Company will continue to apply to the engineers (existing and new) in accordance with the application provisions therein and subject to the provisions of the agreement. The agreement has not set a date for its termination and the parties have the right to terminate the agreement in accordance with the provisions of the law.

9.4.6.2 Disruptions in the Company's operations and legal proceedings in the field of labor relations:

During the Reporting Year, the Company’s pilots, led by the representatives of pilots in the workers’ union, took actions that the Company claims constituted illegal sanctions, which were expressed, inter alia, in the unwillingness to man flights, conditioning consent to man flights on a demand to split the flight (one-way flight), excess sick notes and more. Consequently, the Company was required to delay takeoff times of flights, cancel flights or transfer to leased aircraft of other airlines. It is noted that the Company made sure to employ pilots in accordance with the collective agreement and refused to comply with the demands of pilots that are not anchored in the agreement, therefore resulting in additional cancellations. The ramifications of the disruptions were generally expressed - beyond the damage to the Company's reputation - in an increase in operating expenses (mainly due to aircraft leasing, increased salary expenses and various costs for cancellation of flights), as described in Section A3. of the Board of Director's Report and a decrease in revenue from plane tickets. For additional details, see Section (b) below.

a. Legal proceedings relating to veteran pilots - Age 65:

In accordance with the decision of the International Civil Aviation Organization ("**ICAO**"), on November 13, 2014, a decision by the organization came into force regarding the amendment of the Chicago Convention, following which pilots who are older than 65 may no longer fly commercial flights. Following ICAO's decision, the Civil Aviation Authority decided on August 13, 2014 that Israel would be subject to the new international standard as of the date on which it comes into force, and that as of the date on which ICAO's decision comes into force, all of the personal exemptions provided thereby to the Company's pilots would be cancelled (which had allowed them to fly despite the provisions of the Pilot Regulations, over the age of 65 as secondary pilots), and that the Director of the Civil Aviation Authority would not provide an exemption from the provisions of the Pilot Regulations for pilots who are 65 years old. Following the same decision, the National Association of Airline Pilots in Israel (the "**Pilots Association**") filed a petition to the Administrative Court of the Central District. On November 13, 2014, the court dismissed the petition, insofar as it pertains to the decision of the Civil Aviation Authority, whereby the new international standard binds Israel as well, as of the date on which it enters into force; however, the court granted the petition regarding the decision of the Civil Aviation Authority to terminate the personal exemptions provided, and the declaration to refrain from granting exemptions. Appeals were filed on this decision to the Supreme Court. In the agreement between the Civil Aviation Authority and the Pilots Association, which was given the force of a judgment of the Supreme Court on April 1, 2015, the court effectively approved the position of the Civil Aviation Authority (based on the decision of ICAO) - whereby pilots should not be permitted to fly after the age of

65. However, the judgment provides a special arrangement that makes it easier for pilots who held an existing exemption as well as for pilots who turned 65 within three months after the decision was given by the District Court, while emphasizing that the aforesaid special arrangement would not "grant an exemption for the airlines regarding placing pilots on commercial flights." In addition, it was determined that any other request for an exemption would be decided based on the Aviation Law.

In this context, the Histadrut filed a motion of a party in a collective dispute to the Regional Labor Court in Tel Aviv to grant remedies whereby the Company would take steps to restore permits to pilots who are over 65 from the Civil Aviation Authority and refrain from changing their employment terms, and the Court was requested to determine that the grounding chapter in the collective agreement applies to pilots who are 65 years old and who can no longer serve as pilots due to the entry of the international standard into force.

In July 2015, a judgment was given by the Regional Labor Court of Tel Aviv in the aforesaid petition, in which the Court granted the position of the Company whereby the situation was not one of "grounding" or "temporary grounding" under the collective agreement, since the "grounding" is a specific situation in which a pilot loses his qualifications, his license, as opposed to a situation in which the Company is unable to employ a veteran pilot as a pilot since the countries from and to which the Company travels is unwilling to allow the pilot to fly to and from them. The Court held that the matter is not one related to "grounding" a pilot, but rather is a situation of a "market failure," faced by the Company for which it is not responsible. The Court further held, regarding salary, that the demand that the Company permit pilots who are over 65 to maintain the same salary as the salary that those pilots earned for air travel during employment in their "land" positions is not reasonable, since the same would constitute discrimination against other veteran employees in the same positions.

On July 27, 2015, an appeal was filed by the Histadrut, and in November 2016, a judgment was given by the National Labor Court on the appeal, which rejected the claims of the Histadrut whereby the Company's pilots who are over 65 should be subject to the grounding chapter in the collective agreement. In addition, the National Court held that there was no collective agreement between 2004-2008 with respect to the discrepancy between the legal retirement age and the maximum age in which a pilot is permitted to fly a commercial flight. In order to resolve the discrepancy that was created, the National Labor Court held that collective negotiations must be conducted with the Histadrut, substantively, expeditiously and in good faith. The National Labor Court also held that as long as no collective agreement is reached, the parties will act as follows: the Company will, in the first stage, make a reasonable effort to examine the placement of some of the veteran pilots in training/examining positions or supervisory roles, subject to professional considerations, the needs the Company and the provisions of the law. In this regard, the National Labor Court held that the same does not serve to express a position in the dispute between the parties, which the Court was not deciding, regarding the amount of salary that must be paid to veteran pilots carrying out supervisory work or training/examining work. In this regard, the parties will operate in accordance with the existing agreements. In the second stage, insofar as the aforesaid placement is not possible, the veteran pilot must be assigned a suitable and proper ground position. In such a case, he will be paid the wages for the same position in which he is placed. Alternatively, and in parallel, the option of early retirement under terms agreed upon by the parties will be considered.

The National Labor Court determined that the Regional Labor Court was correct in determining that any pilot may file a specific action, if the same pilot feels that the Company was in violation of its duties of good faith and fairness towards the pilot. It was clarified that the actions vis-a-vis each individual pilot as stated would only be implemented as long as the collective negotiations are not successfully completed.

It is noted that following the judgment of the National Labor Court, the parties conducted negotiations following which a veteran pilot agreement was signed in February 2017, the main terms of which are set forth in Section (b) below.

b. <u>Legal proceedings relating to disruptions in the Company's operations:</u>

In December 2015, the Company filed a motion of a party in a collective dispute to the Regional Labor Court in Tel Aviv against the representative of the Company’s pilots in the workers’ union, the Histadrut, claiming that the Company’s pilots were taking actions and unlawfully striking. In January 2016, a decision was given by the Court in the motion for temporary remedies, which held that the Company did not prove that these actions were being taken, and the Company’s motion for temporary remedies was therefore denied. In light of the agreements obtained by the Company and the pilots’ representation, the Company decided not to file a motion for leave to appeal on the decision of the Regional Court.

During January-March 2016, the Company's management and the pilots' representation conducted negotiations to update the provisions of the collective agreement related to the pilots sector. The negotiations did not result in a binding agreement, and during the same period, the actions and disruptions in the Company's flights continued. During the sanctions and in order to deal with the disruptions, the Company was forced to lease aircraft with "wet leases" as described in Sections 7.11 and 8.10 above.

On March 4, 2016, the parties reached an understanding whereby accelerated negotiations would be held in a short period of time, and representatives of the pilots' sector in the representation would call on the pilots to reduce, to the extent possible, splitting flights - the operative meaning of this understanding being the cessation of the disruptions to the Company's flights.

In light of the understandings reached as stated between the representatives of the pilots and the Company's management, the Company filed a motion to summary the legal proceeding described above on March 8, 2016, and the judgment was given on March 9, 2016, whereby the proceedings were dismissed.

After the aforesaid negotiations failed to result in an agreement, and due to the pilots' sanctions taken as of October 2015, both in the disruptions to flights and as of May 2016 in the disruption of training and qualification as well, on July 6, 2016, the Company filed a motion of a party in a collective dispute and a motion for a temporary remedy to the Regional Labor Court. According to the Company, these sanctions were expressed in the various actions taken in a coordinated and organized manner by the Company's pilots, including unwillingness to man flights contrary to the agreement and practice; conditioning consent to man a flight on a demand to split the flight and while conditioning manning the flight on the performance of only one flight segment and maintaining a spot for the pilot in business class on the flight in which the pilot is not part of the flight's active staff; refusal to enter unplanned flights, contrary to the agreement and practice; decline in preparedness for a "ready state"; reports of "sickness" in a high volume compared to corresponding periods in previous years and a serious disruption in the execution of training and qualification programs for pilots.

On July 19, 2016, a hearing was held in the motion for temporary remedies in which a decision was given with the consent of the parties, *inter alia*, whereby no sanctions or strikes could be taken in any manner in the absence of a declaration of a labor dispute in the Company. It was also agreed that the representation of the pilots would contact the pilots in order to encourage them to continue to execute the functions entrusted with them, with great vigor and specifically in the field of training, and to recruit the pilots to fulfill the tasks at hand. On November 10, 2016, an evidentiary hearing was held in the proceeding, and a schedule was set forth filing the parties' summations, following which the judgment would be given. It is noted that within the pilots' agreement, which is described below, the parties agreed to dismiss the aforesaid legal proceeding. On January 5, 2017, a judgment was given whereby the motion of the party was dismissed.

On November 10, 2016, the Company's offices received a letter from the chairman of the Union of Transport Workers at the Histadrut, whereby the Histadrut had announced the commencement of a labor dispute process in the Company. The main claims of the Histadrut in the letter were that during the last year, the Company had outsourced its activity through wet lease aircraft, while harming employees of the Company in the various sectors and harming the organized work on the Company. Based on the aforesaid, it was stated that the Histadrut was acting to declare a labor dispute in the Company and was calling the Company to hold negotiations with the Histadrut and the Workers' Union in connection with the above.

On November 14, 2016, an additional letter was received from the chairman of the Histadrut's Transport Workers Association, which expanded the list of matters that must be addressed according to the Histadrut, within the labor dispute in the Company, if declared, related to employees of the Company in the various sectors (the "**Histadrut Notice**").

At the end of the extended negotiations, the Company reached an understanding with the Workers' Union regarding the matters related to the pilots sector of the Company, and on December 4, 2016, an efficiency agreement was signed, which constitutes an addendum to the collective agreement between the Company and the Histadrut regarding understandings with the pilots sector (the "**2016 Pilots' Agreement**"), which was approved by the Company's board of directors. The 2016 Pilots' Agreement includes the following major agreements:

Commitments to maintain industrial quiet; a commitment by the Company's pilots to maintain and carry out the schedule planned and operate regularly and in good faith, the decision to appoint an inactive team (including a one-way flight or two) will be made by the Company alone; the pilot training program of the Company will be determined by the Company's management in a reasonable manner and in good faith, and the pilots will carry out the training program in an orderly manner; the Company will be entitled to shorten the stay times at North American destinations and flight times for salary payments were also agreed and set; the Company will discontinue the operation of the chartered passenger planes under a wet lease from other airlines operated at the time; the Company will pay all pilots a salary increase of 8.75%, subject to a partial reduction mechanism of 2.4% of this increment in the event of non-compliance with the undertakings under the agreement, in accordance with the decision of the Chairman of the Histadrut. It was further agreed that the parties will discontinue the legal proceedings held between them in the Regional Labor Court as described above.

It was also determined that the parties will establish a follow-up committee to monitor its execution, which will be comprised of the Chairman of the Histadrut and the President and Chief Executive Officer of the Company, and that will convene once a month or more (as necessary) in order to resolve issues arising from the implementation of the 2016 Pilots' Agreement. It was further agreed that the parties would conduct negotiations with the aviation sector in order to reach agreements regarding efficiency, the fruits of which would be divided between the Company and pilots regarding a number of additional matters.

It is noted that notwithstanding the undertakings of the pilots in the 2016 Pilots' Agreement to uphold the training plan and to execute the planned flight schedule operated by the Company in an orderly manner and in good faith as described above, the Company announced in an immediate report dated February 5, 2017 (reference no.: 2017-01-012621) that the pilots had again disrupted the training programs and the flights, which had forced the Company to cancel a number of flights. The Company reported that the cancellations arise from the unwillingness of the aircrew to man the flights, which, to the Company's understanding, arises from planned disruptions due to discussions that the Company held with the pilots, under the auspices of the Chairman of the Histadrut, regarding arranging the position of veteran pilots that were 65 years old and that cannot serve as active pilots based on the Aviation Regulations.

Following the disruptions that occurred in the flights and the training plans as stated, the Company filed a new party motion to the Labor Court in which injunctions were requested against the actions taken in the Company. On February 6, 2017, a temporary order was given by the Regional Labor Court that ordered the representative of the pilots' sector to exercise their authority and organizational supervision in order to cause absolute industrial quiet and proper work.

On February 14, 2017, the Company petitioned the Regional Labor Court in Tel Aviv with a motion of a party in a collective dispute for urgent temporary remedies. It is noted that the motion was filed prior to the entry into force of the resignation notices delivered to the Company, according to the Company in a collective manner, by a number of pilots who served in supervisory roles in the Air Operations Division, whereby they requested termination of their positions as supervisors (the "**Supervisors**"). The Company announced in an immediate report dated February 14, 2017 (reference no.: 2017-01-016032) that the entry to force of the Supervisors' notices may cause the Company's flights to cease to operate, which will cause the Company damages in an amount that the Company is unable to assess at the time. In light of the above, the Company petitioned the Court with a motion to declare that the resignation of the Supervisors constitutes an unlawful disruption and to prevent this action from being taken, which would disrupt the Company's activity.

On February 15, 2017, a hearing was held on the matter in the Court, following which the Court gave force to the decision to the parties' agreement to continue to conduct intensive negotiations in order to reach an agreement. It was agreed that the pilots who serve in supervisory roles in the Air Operations Division of the Company, who announced the resignation from their supervisory roles in the Company, according to the Company in a collective manner, would continue to work in an orderly manner in their operational roles, while their positions regarding the resignation letters would be delivered by February 18, 2017.

On February 16, 2017, the Company announced in an immediate report (reference no.: 2017-01-016671) that after the negotiations held by the Histadrut between the Company's management and representatives of the pilots, a letter of understandings was signed that addresses the principle matters in dispute.

Further to the signed letter of understandings, on February 17, 2017, an agreement was signed between the Company and the Histadrut and workers' union (the "**Veteran Pilots' Agreement**"), which was approved by the Company's board of directors on February 27, 2017, to address the position of senior pilots when reaching the age of 65, when they can no longer continue to serve as active pilots based on Aviation Regulations.

Under the Veteran Pilots' Agreement, some of the aforesaid pilots will serve as instructors and supervisors, while others will conclude their employment at the

Company and be entitled to retirement grants in accordance with the determined amounts in the Agreement.

The term of the Veteran Pilots' Agreement is for seven years, after which it will be automatically renewed each year unless either party wishes to terminate it. The Agreement includes a mechanism for completion within 45 days from the signing date of the agreements regarding a number of details at the basis of the principles set forth in the Agreement.

The Veteran Pilots' Agreement sets forth that the parties will maintain operational quiet on the matters regulated by the Agreement.

After the signing of the Veteran Pilots' Agreement, the pilots serving in supervisory positions in the Air Operations Division of the Company, who announced their resignation from the supervisory posts, withdrew the notices of resignation.

For details regarding the actuarial implications of the Veteran Pilots' Agreement, see Note 14 to the Financial Statements.

For details regarding the increase in the Company's operating expenses, and the impact on the Company's revenue in 2016, see Note 19 of the Financial Statements and Section 3a. of the Board of Director's Report.

It should be noted that the Company is working to formulate and sign an agreement with the representatives of the employees and the Histadrut regarding the understandings reached by the parties on issues relating to employees in the other segments of the Company.

9.4.7 Liabilities to employees

For further details regarding the pension agreement, directors' insurance agreement, severance pay deficit and deficit cover as well as details of the Company's obligation for employee benefits, see Note 14 to the Financial Statements.

9.4.8 Legislative amendments in labor relations

In February 2016, the Control of Financial Services (Provident Funds) (12th Amendment) Law, 5775-2015 (hereinafter: "**Amendment 12**") entered into force. Amendment 12 determines that it is impossible to correlate the deposit rate with a certain type of fund as used to be prior to the approval of Amendment 12. In view of Amendment 12, in February 2016 a general collective agreement was executed between the Coordinating Bureau of Economic Organizations and the New Histadrut Labor Federation with respect to increasing the pension insurance contributions in Israel (the "**Agreement**") for all employees in the market. In May 2016, an expansion order was signed for the general collective agreement to increase the provisions to pension in the amount of [*sic*] for all of the employees gradually in two stages - in July 2016 and in January 2017 (the "**Expansion Order**"). In accordance with the Expansion Order, the employee's payments to pension insurance were increased to 5.75% as of July 1, 2016, and amount to 6% as of January 1, 2017. The employer's payments for the benefits component in the pension insurance, regardless of whether the policy is a pension fund or managers insurance, were increased to 6.25% as of July 1, 2016, and amount to 6.5% as of January 1, 2017.

In February 2016 an amendment to the Annual Vacation Law, 5711-1951 was approved. According to said amendment, employees with a seniority of up to 4 years will be entitled to two additional vacation days to be granted in two increments – one vacation day commencing July 1, 2016 and the other vacation day commencing January 1, 2017.

In July 2016, an amendment to the Employment of Women Law, 5714-1954 came into force, whereby fathers are entitled to be absent from work for five days following the birth of their child (with the first three days being offset from the balance of vacation days of the employee and the remaining two days of absence being considered to be absence due to illness at payment of 50% of the salary). The fathers are also entitled to a sick day on the date of the birth itself.

9.4.9 Eligibility for airline tickets

In accordance with IATA Regulations, the Company's employees, including retired employees, are entitled to receive, for themselves and for their family members, air tickets service – vacation (free or at discount), mostly on an available seat basis. This right is anchored in the employment agreement (and with respect to senior executives (except for directors) – their personal employment agreements), personal retirement agreements, the Company's procedures and professional guidelines of Human Resources Division. The maximum amount of free or discount air tickets is limited by the provisions contained in the employment agreements, personal or retirement agreements and the Company's procedures, and regarding directors, based on the approval of a meeting of the Company's shareholders.

9.4.10 Local employees at the Company's overseas offices

Most of the Company's employees overseas, except for Israelis positioned overseas, are employed under collective labor agreements between the Company and the professional union in that country, or labor agreements with the employee representation, whereas a small number of these employees are employed under agreements between the employers' organization (the foreign airlines) and the umbrella union of airlines' employees, or under other agreements. The terms of employment of the Company's employees in certain countries are not regulated in a collective agreement, but rather determined by the Company on terms customary in the aviation industry or the national airlines of those countries. In some of El Al's overseas stations, employees are employed under personal agreements or through a contractor.

In some of the overseas stations, the law or the agreement imposes a severance pay obligation whereas other stations are subject to national or other pension insurance obligation. In these cases, the Company regularly transfers payments to pension insurance.

9.4.11 Israeli workers stationed abroad

The Company employs abroad, inter alia, Israeli resident permanent employees who are sent to fill managerial positions abroad ("**Posted Employees**"). As of December 31, 2016, 23 employees out of the overall number of the Company's overseas employees (303) were Posted Employees.

Similarly to State emissaries abroad, the salary of Posted Employees during their stay abroad ("**Overseas Salaries**") is different from their Israeli salary, taking into account the standard of living and taxation abroad, as well as the fact that their salary is subject to income tax and social tax, both abroad and in Israel. The Overseas Salaries, including participation in vehicle maintenance, is payable to the Posted Employee on a "net salary" basis (taxes, including social tax and the grossing-up abroad, are paid by the Company).

Should the Overseas Salary, or payments exceeding the tax-exempt ceiling, be subject to tax in Israel, then the Company shall bear the Israeli tax. In addition to the Overseas Salary, the Company pays the rent of Posted Employees as well as the tuition of their children. These payments (up to a certain limit) are exempt from tax in Israel, but are subject to tax under the laws of the various countries. The Israeli salary of a Posted Employee (a salary determined by rank and status as if he was employed in Israel) serves as the effective salary for the Company's provisions for compensation, benefits (or pension and managers' insurance) and training fund, as provided for in the Posting Letter.

9.4.12 Social services and welfare payments

In addition to wages and entitlement to plane tickets as set forth in Section 9.4.9 above, some of the Company's permanent employees receive welfare services and payments, which include, among other things: subsidized employee meals and related tax gross up, employee medical tests, contribution to employees' health and welfare insurance and dental insurance, and partial participation in high school education. Some of these benefits are provided to temporary workers as well.

Employees may, under certain terms, obtain all-purpose loan guarantees. These loans are provided for a period of up to 60 months under terms approved by the Ministry of Finance.

9.4.13 Limitations on chartering wet lease aircraft

Pursuant to a letter of December 1999 from the Company's President and Chief Executive Officer to the Chairman of the Professional Union Division of the Histadrut, the Company shall limit itself for a future lease of up to four airplanes from Israeli airline companies, so that flight hours performed by Israeli airlines for the Company do not exceed 10% of the Company's overall flight hours (including wet lease flight hours performed by the Israeli airlines and excluding aircraft leased from foreign airlines), provided they are performed on specific aircraft models on routes to and from Israel to destinations within a flight range of up to 2,400 nautical miles. It was further determined that the Company shall continue to plan the employment of its aircrews in a volume of 83 flight hours per month on an annual average, as it used to do until then (currently, the planning volume is 85 flight hours per month) and in the event of a significant change in external circumstances that would lead to changing this policy, the Company's President and Chief Executive Officer shall discuss the matter with the Chairman of the Professional Union Division of the Histadrut, before reaching a decision on the matter.

Additionally, in July 2001, a letter on the subject of cargo aircraft leasing policy was sent by the Company's President and Chief Executive Officer to the Chairman of the Professional Union Division of the Histadrut, stating that, in case of limited availability of aircrew or aircraft, the Company will be leasing cargo aircraft in accordance with the terms set out in the said letter.

It should be noted that the Labor Court has recognized the authority of the Company to make leases in order to provide response to its commercial needs, in consultation with the Employee Representation, and the Employee Representation's position whereby the Company should be obligated to negotiate the leases, in and of themselves.

On October 31, 2016, an amendment to the procedure for “Handling wet lease for the operation of international commercial flights to which an Israeli air carrier is party” came into force (the “**Procedure Amendment**”) by the Civil Aviation Authority, which relates to a distinction between a short-term wet least, up to 60 days per season and a long-term wet least between two specific operators, over 60 days per season. In accordance with the

Procedure Amendment, a long-term lease will only be permitted if it is published that the flights will be operated by a foreign operator before the beginning of the flight's marketing. The Amendment also limits the scope of the wet leases from a non-Israeli operator to 50% of the scope of the flights per season.

For details regarding "wet leases" executed by the Company during 2016, see Sections 7.11 and 8.10 above. For details regarding the increase in the Company's operating expenses in 2016, see Note 19 of the Financial Statements and Section 3a. of the Board of Director's Report.

9.4.14 Officers and senior management

The Company's Board of Directors:

Chairman of the Board of Directors

Mr. Amikam Cohen has served as the Chairman of the Board of Directors of the Company as of February 2009. For details regarding the employment agreement of the Chairman of the Company's Board of Directors, see Note 23 to the Financial Statements of the Company.

Directors

As of the date of publication of the Report, ten members serve on the Board of Directors of the Company (including the Chairman of the Board). The Company's Board members are not employees of the Company.

On December 1, 2016, an Annual Shareholders Meeting of the Company was held, at which the following resolutions, *inter alia*, were adopted: to approve the re-appointment of directors serving on the Company's Board (except for external directors): Messrs. Amikam Cohen, Tamar Mozes Borovitz, Yehuda (Yudi) Levy, Pinchas Ginsburg, Shlomo Hanael, Sofia Kimerling and Ruth Dahan (Portnoy), and Eli Defes, until the end of the next Annual Meeting.

Senior management

On March 20, 2014, Mr., David Maimon began his term of office as the Company's President and Chief Executive Officer. Mr. David Maimon served as vice president of the Company since 2005, as starting from 2011 he served as Vice President Commercial & Industry Affairs.

For details regarding the employment agreement of the Company's President and Chief Executive Officer, see Note 23 to the Financial Statements.

In December 2016, Captain Harel Chalamish began serving as VP Operations of the Company.

In January 2017, Mr. Gonen Usishkin began to serve as the Company's Vice President of Commercial and Industry Affairs.

For details regarding the Company's senior management, see Article 26A in Chapter D of the Periodic Report of the Company - "Additional Details on the Corporation."

In addition to the President and Chief Executive Officer, other senior employees are employed under personal employment agreements. The salary of senior employees under such agreements is updated in a manner that the overall salary is linked to the Consumer Price Index and is adjusted each year in January, less cost of living allowances that have already been paid.

The Company used to approve one month's salary for each year of employment in addition to severance pay for senior employees, and a provision was recorded in the Financial Statements in respect thereof. For details, see Note 14 of the financial statements.

Remuneration policy for senior officers

On December 1, 2016, a meeting of the Company's shareholders approved the remuneration policy for officers of the Company for the years 2017-2019. For details, see the invitation to a meeting of shareholders published by the Company on October 27, 2016 (reference no: 2016-01-068523).

For details regarding the remuneration of high-paid employees in the Company among the Company's senior officers, see Article 21 in Chapter D of the Company's Periodic Report "Further Details on the Corporation."

Internal enforcement programs

For details of the Internal Enforcement Program in the field of securities and corporate law and the Enforcement Program in the field of antitrust, see Section C.7 of the Board of Director’s Report.

9.5 **Raw materials and suppliers**

9.5.1 Fuel

a. The main raw material used by the Company consists of aircraft jet fuel. Jet fuel is one of the Company's major expenditure components, as with any airline. The Company purchases fuel in Israel and abroad. In 2016, the Company's jet fuel expenses amounted to approximately 23.4% of the operating expenses of the Company, compared to approximately 30.2% in 2015.

b. Jet fuel prices materially affect the Company's profitability. The Company estimates that, in terms of operations as of the date of the Report, each increase of 1 cent in the price of one gallon of jet fuel for a year increases the Company's expenses for jet fuel by approximately USD 2.5 million.

c. The Company takes action to hedge part of the estimated jet fuel consumption. The Board for Directors determines the Company's policy on jet fuel prices hedging, the term of the hedge and the hedge rate out of the total jet fuel consumption for the same period, and a special Market Risk Management Committee of the Company's Board examines, on a regular basis, the hedging transactions carried out by the Company's Management. The Company requests proposals from several financial institutions and fuel companies with which the Company enters into framework arrangements, conducts commercial negotiations and carries out hedging transactions. Account settlement between the parties is made at the end of the transaction, in such a manner that, if the average market price in that period is higher than the hedged price, the Company receives reimbursement of the price difference during that period, multiplied by the relevant quantity for that period, whereas if the monthly average market price is lower than the hedged price, the Company pays the difference multiplied by the relevant quantity for that period. In 2016, the Company paid (a cash flow amount of) approximately USD 32 million in respect of hedging jet fuel transactions.

d. In 2016, the average price of jet fuel was lower by about 19% before hedging activity, compared to its price in 2015. The impact of this price decrease on the financial results of the Company is material. For details, see Note 18 to the Financial Statements and Section 3A. in the Board of Director’s Report.

e. In 2016, the Company purchased fuel in Israel from three suppliers selected in an RFP published by the Company in October 2015 between companies for the supply of fuel and companies carrying out fueling services for the supply and fueling of jet fuel in Israel. Following negotiations held with the companies, in December 2015 the Company's Board of Directors approved the agreements with the fuel supply companies "Paz", "Sonol" and "Delek", for supply of 60%, 30% and 10% of the Company's annual fuel consumption for 2016-2017. In addition, the Company decided to enter into agreements with refueling companies (franchisers of the IAA) "Paz Aviation Services" and "Mercury", under which each of these companies shall supply 50% of the fueling services provided to the Company at Ben Gurion International Airport in 2016-2017. The aggregate annual amount of the agreements (for jet fuel supply and fueling services in Israel) is estimated at approximately USD 196 million (jet fuel prices as of September 2016).

f. Outside Israel, the Company purchases fuel from a number of suppliers, including fuel companies supplying jet fuel at a significant number of airports. The contracts are for periods of two years, except in cases where it is impossible to enter into one year contracts. Most contracts are executed with the suppliers after winning the RFP process and following commercial negotiations conducted by the Company with the suppliers, except for stations where there is only one supplier.

g. In 2016, the Company purchased from one supplier (the Paz Fuel Company) about 30% of its total fuel purchases that year (in Israel and abroad). The Company works with four other suppliers, from each of which it has purchased more than 5% of its total fuel purchases that year. The Company believes that the volume of purchases from the main supplier in Israel (Paz) may result in dependency on said supplier for as long as there are no appropriate and immediate alternatives for jet fuel supply at Ben Gurion Airport.

h. In February 2017, the Company published a request for proposals (“RFP”) for fuel supply companies abroad as of July 2017 and for a period of two years. As at the Date Near Approval of the Report, no such proposals have yet been received.

i. The Company holds a jet fuel inventory, which was purchased from suppliers in Israel and abroad. As of December 31, 2016, the Company held an inventory of jet fuel in the amount of about USD 7.2 million.

9.5.2 <u>Aircraft and engines</u>

a. All aircraft operated by the Company are manufactured by Boeing. The Company has a material dependence on Boeing, as specified in Section 7.1.7 above. However, the Company estimates that the probability of termination of engineering support and the supply of spare parts for its planes is low.

b. The 777 aircraft fleet owned by the Company and the 787 aircraft fleet, which are scheduled to be delivered to the Company during the years 2017-2020, are equipped with Rolls-Royce engines. The Company has a material dependence on Rolls Royce, as specified in Section 7.1.7 above. However, the Company estimates that the probability of termination of the ongoing maintenance and supply of replacement engines by Rolls Royce is low.

For additional details regarding the purchase and sale of aircraft and engines, see Note 9 of the Financial Statements.

9.6 Working capital

9.6.1 Inventory

The Company has a raw materials inventory, which includes an inventory of jet fuel for consumption, duty free products sold on its flights as well as consumable inventory products (chemicals, food and provisions). Average inventory days are as follows:

	Year 2016	**Year 2015**
Jet fuel inventory	5	4
Food inventory and passenger supplies	40	51

Duty-free product inventory policy

The Company purchases about 80% of the duty-free products from DFASS, and the remaining are Israeli products purchased directly from local suppliers (about 20%).

Alcoholic beverages and cigarettes are supplied directly to the duty-free warehouse, on a quarterly basis, whereas the remaining products are supplied to El Al stations abroad, and transported by the Company to Israel on availability basis.

The Company is entitled to return any product (other than food, tobacco or branded products), provided the products remain in their original packaging. The Company is responsible for delivering the products, delivery and insurance costs included, to the place of delivery thereof (cigarettes and alcoholic beverages from the duty-free warehouse, the other products to the Company's station overseas).

Storage of Goods in the Customer Service Warehouse

All purchased products are stored in the Duty-Free Warehouse (a separate unit in the Customer Service Warehouse, with a limited accessibility). Products requiring designated storage conditions (such as chocolate) are stored at refrigerated conditions. The value of the inventory in the warehouse, at any given moment, is about USD 1.5 million on average. For details regarding the volume of inventory, see Note 7 to the Financial Statements.

9.6.2 Reservation cancellation policy

Generally, the Company's policy maintains that a customer is entitled to cancel the reservation, without charge, until the airline ticket is issued ("**Ticketing**"). The customer may also cancel certain tickets even after "ticketing", at times without payment of cancellation fees and at other times with payment, depending on the terms of the ticket. There are also tickets that, based on their terms, cannot be cancelled at all after Ticketing. Generally, the higher the ticket price rate, the more flexible the terms of the ticket regarding cancelling the ticket at a fee or at no fee at all. The above is subject to the provisions of the law not providing otherwise. In this regard it shall be clarified that the Consumer Protection Law, 5741-1981 and the Consumer Protection Regulations (Cancellation of Transaction), 5770-2010, provide for special provisions relating to the option to cancel the transaction, which, on the date on which they apply, allow cancellation subject to cancellation fees at a rate of 5% of the value of the transaction, or NIS 100, whichever is lower (for details regarding a legal proceeding conducted in connection with cancellation fees, see Note 15 to the Financial Statements).

9.6.3 Warranty policy for services

The Company's liability for damages (bodily injury and property damage) incurred in the course of international air transportation was determined by international treaties adopted by the Air Transport Law, 5740-1980 and orders issued thereunder. Additionally, the Company operates in accordance with IATA Guidelines on various issues related to liability for passengers and baggage. The Aviation Services Law (Compensation and Assistance due to Flight Cancellation or change of Conditions), 5772-2012, and the regulations enacted thereunder provide that the Company is required to provide passengers whose flight has been delayed or canceled with a variety of remedies, depending on the duration of the delay or the circumstances of the cancellation, such as: assistance (food, beverages, lodging), reimbursement of proceeds or an alternative flight and even financial compensation, and set forth the liability of the Company for delaying passenger flights due to overbooking. In all matters pertaining to the rejection of passengers from flights and delays in flights from member states of the EU, Regulation 261/2004 of the European Parliament applies. In addition, and with respect to rejection of passengers from flights and delays in flights from the U.S., Enhancing Airline

Passenger Protections III 2016 applies. For details regarding legislative amendments in this field in Israel, see Section 9.11.2 below.

9.6.4 Credit policy

a. **Credit to customers**: travel agents or baggage authorized by IATA enjoy special payment arrangements in accordance with IATA Regulations (an agent not authorized by IATA is committed to provide a guarantee or cash payment). The Company provides agents in Israel with credit for periods ranging on average between 15 and 90 days. As a rule, direct sales of air transportation to customers are made in cash, except for credit sales to government offices and certain commercial customers.

b. **Credit from suppliers**: the Company receives credit form its suppliers in Israel and abroad, for periods ranging between 30 and 90 days, in accordance with the type of supplier and the agreement entered into therewith (except for fuel suppliers).

c. The following table presents average **volume of credit** and average **credit periods** with respect to the Company's customers and suppliers in each of the years 2016 and 2015:

	Year 2016		Year 2015	
	Average credit volume in USD millions	Average credit days	Average credit volume in USD millions	Average credit days
Customers	155	27	147	26
Suppliers	146	44	147	45

d. It shall be noted that the difference between customers' credit policy and suppliers' credit policy arises, inter alia, from the fact that suppliers' credit policy is determined by the Company, among other things, in consideration of market conditions, liquidity and the customary policy in the field. On the other hand, customers' credit policy is determined, in most cases, by the customary practice of the aviation industry and in accordance with guidelines and work procedures acceptable to IATA and to the travel and baggage agents.

9.6.5 Working capital deficiency

As of December 31, 2016, the Group has a working capital deficit of approximately USD 373 million compared to approximately USD 444 million at the end of the previous year.

As at the end of 2016, the current ratio of the Company was approximately 54%, compared to approximately 47% at the end of the previous year.

For details of the factors causing the decrease in working capital deficit, see Section A7 of the Board of Director's Report.

9.7 **Investments**

For details regarding all companies held by the Group, see Notes 8 and 21 to the Financial Statements.

9.7.1 Summary of the business of the principal subsidiaries:

a. **Sun d'Or International Airlines Ltd. ("Sun d'Or")**

The charter operations of the Group is carried out through Sun d'Or (a company fully owned by El Al). Sun d'Or operates as a tour operator for wholesalers and individuals and markets charter flights and regular flights, both by chartering an entire aircraft capacity to a third party or by capacity of parts of aircraft to a number of partners at pre-agreed prices, or direct sales. Sun d'Or has to serve as a tourism organizer, while preserving the "Sun d'Or" label for charter flights it markets and which are carried out by the Company (on weekdays) and by other airlines (on weekend and holiday flights).

During 2016, Sun d'Or marketed scheduled flights to new destinations (Valencia, Tbilisi, Grenoble and Stuttgart) and significantly expanded operations to existing destinations such as Lisbon and Venice. Additionally, Sun d'Or marketed flights to new charter destinations such as Batumi and marketed flights to exotic destinations in Africa – Seychelles, Kilimanjaro and Zanzibar. In total, in 2016, Sun d'Or marketed 1,510 flights to about 60 destinations in Europe and Africa, compared to 1,141 flights in 2015, indicating an increase of approximately 32%.

As of April 2016, some of the flights marketed by Sun d'Or from Terminal 1 have been shut down.

Sun d'Or's revenues in 2016 totaled nearly USD 77,467 thousands, compared to approximately USD 57,486 thousands in 2015 and USD 46,076 thousands in 2014. As of December 31, 2016, Sun d'Or employed 28 workers.

On February 16, 2016, investigators on behalf of the ISA arrived at Sun d'Or's offices, collected documents and asked a number of managers to accompany them for investigation. In addition, investigators on behalf of the Antitrust Authority arrived at the Company's offices to collect documents. At this stage, the Company has no information as to the circumstances under investigation. It is noted that some of the documents that were sent were returned to Sun d’Or.

On February 9, 2017, the Company published an immediate report (reference no.: 2017-01-014592), with respect to an immediate report published by IDB Development Corporation Ltd., in which it was stated that the negotiations between the parties for the examination of the transaction between Israir Aviation and Tourism Ltd. (“**Israir**”) and Sun d’Or had continued but not yet been completed. Assuming that the negotiations will be formulated and a binding agreement is signed by the parties, and subject to the receipt of all of the approvals required under law and the fulfillment of the other conditions precedent agreed upon in the agreement, the following are the agreements reached:

IDB Tourism will transfer to Sun d’Or all of its holdings (100%) in Israir in consideration for the allocation of shares of Sun d’Or, such that after the transaction Israir will become a fully held subsidiary of Sun d’Or and Sun d’Or will be jointly held by the Company (75%) and IDB Tourism (25%) (the “**Transaction**”).

The Company and IDB Tourism will engage in a shareholders agreement in which, *inter alia*, the Company will be given a call option (and IDB Tourism will be given a put option) for the purchase of shares of IDB Tourism in Sun d’Or (about 25%, as stated) by the Company, at a price and under the terms determined in the aforesaid shareholder agreement.

A services agreement will be signed by the Company and Sun d’or and Israir, which defines the services that the Company will provide to Sun d’Or and Israir and the consideration for them.

After the signing of the Transaction documents and before the completion and subject to receipt of the approvals required under law, including approval of the Antitrust Authority, Israir will sent the aircraft that it owns (the “**Aircraft**”) by way of a sale and lease back transaction. The consideration expected for the sale of the Aircraft is estimated at USD 70 million, and is expected to serve, in part, for payment of Israir’s liabilities, including to its shareholders.

As of the publication of the report, no memorandum of understandings and/or binding agreement has been signed by the parties and the negotiations have not yet concluded, and therefore the structure and/or terms of the Transaction, including the terms formulated above, may change. There is also no certainty that the

Transaction will be formed and that a binding agreement will be signed by the parties, and if a binding agreement is signed, there is no certainty that all of the approvals required will be received, including approval of the Antitrust Authority, for the completion of the transaction.

b. **Tamam Aircraft Food Industries (Ben Gurion Airport) Ltd. ("Tamam")**

Tamam (a fully owned El Al subsidiary) is primarily engaged in the production and supply of prepared kosher airline meals. The company has recently expanded its non-aviation activity and it supplies, *inter alia*, institutional catering services. Tamam is located in Israel and its offices are located in Ben Gurion Airport. The Company is Tamam's main customer, with approximately 77% of its sales in 2016 being to the Company, and the rest to other airlines and other customers. Tamam's revenues in 2016 totaled nearly USD 35 million, compared to approximately USD 31.2 million in 2015 and USD 32.3 million in 2014. As of December 31, 2016, Tamam employs 416 workers.

In December 2016, the Company signed an agreement with the Israel Airports Authority for authorization to manufacture, transfer, load, unload and supply food, drink and related products to aircraft at Ben Gurion Airport, further to the Company winning a tender in August 2016 published by the Israel Airport Authority for the receipt of up to three permits to manufacture, transfer, load, unload and supply food, drink and related products to aircraft. In accordance with the terms of the tender, Tamam will construct and operate a structure, in place of the existing structure, for the supply of food to aircraft for 25 years. The investment in the construction of the aforesaid building, its maintenance and the annual authorization fees that Tamam will be required to pay the IAA are immaterial to the Company.

It is noted that in accordance with the provisions of the tender, the execution of the engagement and its term are subject to receipt of government approval and budgetary approval as required.

The construction of a new and advanced building for Tamam will allow Tamam to expand its activities substantially in the field of airplane and off-airplane food, and the Company estimates that this will allow Tamam to be a leading company in Israel in the food industry.

It is noted that upon the completion of the building’s construction, the Company’s customer service warehouse will be transferred from its present location at Ben Gurion Airport to the aforesaid structure.

The Company's assessment regarding the substantial expansion of Tamam's activities in the field of airplane food and off-airplane food as a result of the transition to the new structure, and regarding the company becoming a leader in Israel in the field of food as a result of the aforesaid move is forward-looking information as defined in the Securities Law. The information is based, inter alia, on the Company's estimates in light of the current volume of activity of Tamam and the competition in the food industry which may not materialize, in whole or in part, or that may materialize in substantially different manner. The actual reality may be different than predicted as stated, inter alia, due to the change in the level of competition in the food industry, regulatory changes, the manner with which Tamam deals with competition and the risk factors described in Section 9.18 below, as well as economic, security and geopolitical changes.

c. **Katit Ltd. ("Katit")**

Katit (a company fully owned by El Al) is mainly engaged in the production and supply of meals to the Company's employees. Katit's place of business is in Israel and its offices are located at Ben Gurion Airport. Katit revenues in 2016 were approximately USD 5,067,000 compared to USD 4,179,000 in 2015 and USD 4,348,000 in 2014. As of December 31, 2016, Katit employed 114 workers.

d. **Borenstein Caterers, Inc. ("Borenstein")**

Borenstein (a fully-owned subsidiary of El Al), incorporated in the United States and operating out of New York's JFK airport, deals mostly in the production and delivery of prepared meals for airlines and other institutions. The Company is Borenstein's primary customer. Borenstein's revenues in 2016 totaled nearly USD 16,882 thousands, compared to approximately USD 15,324 thousands in 2015 and USD 14,006 thousands in 2014. As of December 31, 2016, Borenstein employed 108 workers.

e. **Superstar Holidays Limited ("Superstar")**

Superstar (a fully-owned subsidiary of El Al), is a tourism wholesaler marketing tour packages to travel agents and individual travelers, and selling airline tickets on Company routes at reduced prices. Superstar is registered in England and registered in Israel as a foreign company. Superstar has operations in several other countries besides England. Superstar's revenues in 2016 totaled nearly USD 9,556 thousands, compared to approximately USD 9,920 thousands in 2015 and USD

15,482 thousands in 2014. As of December 31, 2016, Superstar employed 10 workers.

f. **Cockpit Innovation Ltd. ("Cockpit")**

Cockpit (which is fully held by El Al) was established in March 2016 and operates in the field of development of ventures and concentrates the Company's "Cockpit" innovation plan to accelerate and support startups in Israel and abroad in aviation and tourism. The objective of the plan is exposure of the Company to innovative technologies in all of its fields of activity, the implementation of innovative solutions in the Company's systems and its position as an innovative company. The plan is designed for companies in various stages, as of the early prototype and to the growth stage. The startups selected for the program benefit from a comprehensive program that includes access to the Company's systems for integration and development (beta site), initial financing, professional consulting, exposure of the product and opening doors to local and global markets and the possibility that the Company will be the first substantial customer of the startup. The Company has engaged with a number of startups in cooperation agreements. It is noted that the Company is considering recruiting strategic partners for Cockpit.

In July 2016, Cockpit engaged with JetBlue Technology Ventures, the investment arm of the JetBlue airline, in a cooperation agreement in which the parties launched the Navigator program, an international program for startups in the fields of air travel, which will be awarded within the investment plan, for consulting and assistance in various business fields.

9.7.2 Below is a summary of the business of the principal investee companies:

a. **Cargo consolidation: Air Consolidators Israel Ltd. ("ACI")**

The main business of ACI (a company whose class B shares are fully held by the Company, thus granting it the right to appoint half of the directors as well as vote and participate at general meetings) is air cargo consolidation at Ben Gurion Airport to allow reduction in air cargo rates. Cargo transportation is carried out through the Company, at special rates, as well as through foreign airlines. The shares do not confer upon the Company rights to receive profits by way of dividend distribution or other benefit distributable by ACI, except for profits and dividends from capital gains.

In 2016, the Company paid ACI fees in the amount of USD 448 thousand. To the best of the Company's knowledge, ACI's revenues in 2016 totaled nearly USD 24,345 thousands, compared to approximately USD 27,328 thousands in 2015 and USD 30,734 thousands in 2014. As of December 31, 2016, ACI employed 20 workers.

b. **Flight marketing: Tour Air (Israel) Ltd. ("Airtour" or "Tour Air")**

Currently Airtour (a company under 50% ownership of El Al) is mainly engaged in marketing the Company's flights and special offers to all the destinations to which it operates. Airtour shares owned by the Company grant it the right to participate and vote at shareholders meetings and appoint half of the directors, but they do not confer upon the Company the right to receive dividends or profits.

The Company pays Airtour for various services that Airtour supplies to the Company such as ticketing services and also shares in part of its operating expenses. Airtour's revenues in 2016 totaled nearly USD 4,217 thousands, compared to approximately USD 4,478 thousands in 2015. As of December 31, 2016, Airtour employed 70 workers.

c. **Maman - Cargo Terminals and Handling Ltd. ("Maman")**

Maman is a public company whose shares are listed on the Tel Aviv Stock Exchange. The Company owns approximately 15% of Maman share capital as well as options at a rate of 10%, exercisable into Maman shares. The option exercise date was recently extended and is until December 31, 2018. The main activity of Maman is management and operation of cargo terminal authorized to handle all import and export cargo at Ben Gurion International Airport, pursuant to the authorization of granted by the IAA. Additionally, Maman operates in the field of logistics services and in real estate leasing, and provides aviation services. Maman operations is carried out in Israel, the Czech Republic and India.
For details regarding the framework agreement between the Company and Maman, see Section 8.2 above.

To the best of the Company's knowledge, Maman's revenues in 2016 totaled nearly USD 202,839 thousands, compared to approximately USD 181,851 thousands in 2015 and USD 189,225 thousands in 2014. As of December 31, 2016, Maman employed 2,551 workers.

9.8 Financing

9.8.1 Loans not for dedicated use

As of the Date of the Report, the Company has non-designated loans totaling about USD 5,407 thousands, of which short-term loans stood at approximately USD 270 thousands and long-term loans stood at approximately USD 5,137 thousands. Interest rates for these loan range between 3.15% and 4.35%.

9.8.2 Main restrictions and conditions in obtaining credit

a. **Ratio of balance of loans to collateral**

For details, see Note 13 of the financial statements.

b. **Limitations on transfer of control**

For details, see Note 13 of the financial statements.

c. **Calling for immediate repayment by the Bank**

For details, see Note 13 of the financial statements.

9.8.3 Credit facilities

As of the date of the Report, the Company has credit facilities of USD 29 million, with the balance of credit utilized as of this date being USD 19 million. As of the Date Near Approval of the Report, the Company has credit facilities of USD 33 million, with the balance of credit utilized as of this date being USD 23 million.

9.8.4 Guarantees against collateral

The total guarantees provided by the Company to secure its liabilities to third parties, as at the Reporting Date, are immaterial.

9.8.5 Loans for dedicated use

The Company has loans for the purchase of aircraft and engines. For details regarding these loans, see Note 13 to the Financial Statements. For details regarding liens and collateral, see Notes 9 and 13 to the Financial Statements.

9.8.6 Financing the Company's investment plan

The Company examines, from time to time, the possibility of raising additional external resources to finance other investment plans of the Company, if decided to implement them.

For details regarding the Company's plans to finance the wide-body aircraft acquisition program, see Section 9.12 below.

9.9 Taxation

9.9.1 Tax laws applicable to the Company

For details, see Note 16 of the financial statements.

9.9.2 Status of tax assessments of the Company

For details, see Note 16 of the Financial Statements. For details regarding tax assessments received at the Company's offices, see Section 9.14 below.

9.9.3 The tax laws applicable to material related companies incorporated abroad

The subsidiaries of the Company incorporated overseas are subject to the tax laws in the countries of incorporation.

9.9.4 Reasons for the material difference between the effective tax rate and the statutory tax rate

For details, see Note 16 of the financial statements.

9.9.5 Accumulated losses for tax purposes

For details, see Note 16 of the financial statements.

9.10 Environmental protection and corporate responsibility

9.10.1 Material implications deriving from environmental regulations

Many countries, including Israel, have adopted the accepted international standards on aircraft noise and determined additional rules for protecting the environment. Some airports around the world are subject to many restrictions on the times of aircraft takeoffs and landings. Airlines' schedules, similar to that of the Company, are set in accordance with these restrictions.

The Company attributes great importance to the environmental issue and contributes resources and time in taking care of this issue (inter alia, through the Company's Safety and Quality Division which is responsible for such activities).

The Company implements internal operations to raise awareness of the environment, such that each of the Company's regions was assigned a person responsible for environmental protection, preventing pollution and conserving resources.

With respect to reducing the amount of waste – paper, cardboard and other recyclable materials from the Company's flights and offices are taken for recycling.

In addition, ongoing activities are conducted on the issue of environmental protection, *inter alia*, visits to maintenance and operational areas and taking care of issues requiring modifications in coordination with the IAA; ongoing coordination with the IAA regarding oil removal at Terminal 3 and improving technological systems in order to control and monitor findings related to the field of environmental protection.

9.10.2 Limitations on the operation of aircraft at airports and Ben Gurion Airport

For details regarding restrictions on the operation of aircraft at the airports in which the Company operates and at Ben Gurion Airport, see this section in the Company's 2014 Periodic Report.

9.10.3 Sewage care

The Company's sewage is handled by a central facility in Ben Gurion Airport, approved by the Ministry of the Environment and operated by the Israel Airports Authority. For the use of the central facility, the Company pays the Airports Authority usage fees for a period of 22 years (from 2008). The usage fees are in the amount of USD 150,000 per year. The Company also operates, as of June 2009, a facility that was built in the Company’s area and is used as an emergency reservoir in the event of a malfunction in the quality of the Company’s sewage. At the same time, the toxic waste generated by the Company is sent to the Ramat Hovav Environmental Services Company.

9.10.4 Fuel tanks

Following soil pollution surveys conducted by the Company in 2010 and 2011, in which pollution points were identified in various areas in the Company's premises, the Company hired the services of an environmental consulting company, which examines the findings of the survey and offers the Company appropriate measures for land treatment. Accordingly, the Company decided to take efforts to restore the polluted soil, despite the fact that the Company did not cause the pollution. The Company reported the findings of the survey to the Ministry of Environment and held a tour with the representatives of the Environmental Protection Ministry. The Company submitted an application to the Ministry of Environmental Protection to perform an on-site treatment, but at this stage the Ministry of Environmental Protection decided that a historic comprehensive survey of the site should be conducted. Accordingly, at this date, the Company is performing a survey in accordance with the requests of the Ministry of Environmental Protection through an environmental consulting firm that is supposed to provide the Company with the findings of the survey towards the end of 2017.

9.10.5 Material environmental costs and investments for the Reporting Year and projections for subsequent years:

The Company performs many operations and invests in financial costs in improving environmental elements, including the performance of liquid separations at the Company's premises and the execution of local separations between the drainage systems and the sewage systems.

	2015	2016	2017 (forecast)
Costs	Approximately USD 150 thousand per year	Approximately USD 150 thousand per year	USD 150 thousand per year
Investments	Approximately USD 95 thousand per year	Approximately USD 120 thousand per year	USD 150 thousand per year
Total	Approximately USD 245 thousand per year	Approximately USD 270 thousand per year	USD 300 thousand per year

The information regarding anticipated environmental costs and investments is forward-looking information, as defined in the Securities Law. The information is based on current environmental law requirements and on the current market prices of the products and services that the Company must purchase as part of the environmental investments. Therefore, the actual costs and investments may differ materially from those predicted as a result of a large number of factors, including changes in legislation, requirements of authorities and changes in the cost of products and services that the Company will be required to purchase as part of environmental investments.

9.10.6 Limitations on the level of air pollution from engines (Emissions)

Following increased global awareness to the process of global warming up, governments are willing to monitor and limit the level of air pollution caused by engines. In the coming years, laws on the subject are expected to be enacted in various countries worldwide.

In January 1, 2012, the European Union (EU) Regulation on monitoring, reporting and verification of gas emissions (ETS - Emissions Trading Scheme) on incoming and outgoing flights from the EU countries (hereinafter: the "**ETS Plan**") has entered into force, as a result of the inclusion of the aviation industry under the emission policy applicable in other industries, as determined by the EU Decision dated June 26, 2008. According to said EU Decision, the Netherlands was appointed as the body supervising the Company's operations. The duty to report, the reporting procedures and the manner of reporting have been fully regulated binding instructions were even published in this regard. The supervising body audited the report and declared in writing that the Company has successfully passed the audit.

During 2012 the objection on the part of some countries outside the European Union to the implementation of the ETS Plan and future payments in respect of deviation from approved exempt allocations, has increased. The United States even based its objection on a law prohibiting American Airlines from participating in the ETS Plan. In order to prevent unilateral implementation of the ETS Plan with respect to air carriers landing at and taking off from European Union airports, the ICAO proposed a global outline that was due to be voted on by the ICAO management in September 2013. As a gesture of goodwill, the European Union countries agreed to "stop the clock" with respect to compliance with quotas set by the European Union, until receipt of information regarding the ICAO outline and then decide whether to continue with the first outline or join the ICAO outline.

The EU decision effectively froze the implementation of the ETS plan regarding flights entering and departing from the European Union, excluding regarding flights between EU member states (destinations within Europe) until the end of 2016. In accordance with the publications of the EU, the EU intends to increase the freeze of the ETS implementation regarding flights entering the EU and departing the EU for an additional term. It is noted that in the event that the EU retracts its intention to continue to freeze the implementation of the ETS plan as stated, or if it cancels the intended freeze after its implementation, the Company expects an annual expense of an immaterial amount.

On March 6, 2017, the ICAO organization announced that it had decided in the organization’s institutions to adopt a new standard regarding the reduction of greenhouse gas emissions by aircraft by gradually applying production restrictions on passenger aircraft as of 2020.

Some of the Company's airplanes are equipped with crankshafts, which improve the aerodynamics of the aircraft and thus save fuel consumption. The Company is also working to reduce unnecessary weight of the aircraft in order to reduce the amount of fuel consumed. As a result of the savings in fuel consumption, the amount of greenhouse gas emissions is reduced. In addition, the aircraft engines are rinsed in order to increase their efficiency, as well as external rinsing of the aircraft's body for the purpose of lowering the towing. These actions also help reduce greenhouse gas emissions.

The extent of the impact of the entry into force of instructions provided by the authorities (including the EU and ICAO), including the EU resolution on the cancellation of the freeze for the ETS Plan's implementation, legislation or results of legal proceedings in this regard and the scope of annual expenses expected, and the Company's expectation that it will not be material, may constitute forward-looking information, as defined in the Securities Law, based on the Company's assumptions and estimates. Therefore, the actual results of the entry into force of a legislative amendment, imposition of financial charges or legal proceedings as mentioned above, or the extent of the impact thereof on the Company's operations may be significantly different then the results estimated or implied by such information.

9.10.7 Corporate responsibility

9.10.7.1 General

The Company considers itself committed to the community and the environment within which it operates, and attributes great importance to participation in promoting and fostering them. As "National Carrier," the Company places the security and safety of its passengers at the head of its priorities and conducts extensive activities to ensure their security and safety. Similarly, the Company considers its employees as the source of its power and acts to provide an attentive, considerate, safe and fair working environment, as a result of understanding the linkage between a quality business-strategic management and the commitment to act and promote corporate responsibility.

In 2016, the Company continued its work within the various fields of corporate responsibility and continued to implement the subject of corporate responsibility among employees and managers by a variety of measures and activities. In 2016, the Company published the "Corporate Responsibility Report" for the years 2014-2015.

The Company is a member of Maale – an umbrella organization of businesses committed to manage corporate responsibility, acting to assimilate social, environmental and valued-ethical considerations in the ongoing conduct of corporations, and to promote development and implementation of corporate responsibility strategies as a business approach. The Company was rated by Maale in 2016 with a “Platinum” rating.

The Company also has agreements with associations and organizations that operate out of social, ethical, humanitarian and non-profit goals to contribute Matmid Club points to those organizations and associations by the club members.

In addition, volunteer activity in explaining Israel abroad is performed by air crews, pilots and flight attendants during their stay abroad as part of the "Ambassadors" project, which is successfully held in cooperation with the Ministry of Foreign Affairs, the Jewish Agency and Stand With Us.

9.10.7.2 Code of Ethics

In 2016, the Company continued to implement the Ethical Code, in conjunction with employees and officers of the Company and its subsidiaries, and with the assistance of an external consulting company specializing in the subject.

The Ethical Code contains values, norms of conduct, enforcement and implementation policy and communication channels for reporting violations of the Ethical Code and the ethical rules designed to guide the operations of the Company and all officers thereof throughout the course of their work and to dictate standards for their operations.

9.10.7.3 Community involvement and support

The Company attaches great importance to its responsibility to the community, due to a genuine and unique link to the State of Israel. The Company formed a Community Responsibility Policy, in the framework of which it conducts contribution activities for the community and volunteering activities of employees, while establishing a long-term cooperation with community partners. The target population supported by the Company in this framework includes: IDF soldiers, students in need who are active within the community, sick or disabled children or children with special needs as well as families in need.

Within the activity, the Company donated cash and cash equivalents in 2016. For details see section C.1. of the Board of Director's Report.

9.11 Restrictions and supervision of the Company's business

9.11.1 General

Most aspects pertaining to the Company's operations as an air carrier are subject to a set of regulatory arrangements, Israeli and International, relating, inter alia, to traffic rights, capacity and flight safety standards, security and noise, and are contingent upon obtaining Commercial Operator Certificate and Air Operator Certificate.

In addition to the operation certificates, the Company's operations are conditioned upon being an Israeli air carrier (substantial ownership and effective control in the hands of the State or its citizens), and upon foreign countries permits to use traffic rights granted to the Company as a Designated Air Carrier. For details regarding aviation agreements and the CAAI Policy, see Sections 9.11.6 – 9.11.8 below. Further, additional restrictions apply to the operation of the Company by virtue of the Special State Share. For details, see Section 9.11.9 below.

9.11.2 Regulatory arrangements

The main principles of regulatory arrangements, both Israeli and international, relating to the operation of the Company as an air carrier are set forth below:

(For security arrangements see Section 9.11.12 below; for operation in times of emergency see Section 9.11.13 below).

a. **The Aviation Law, 5771-2011 (the "Aviation Law") and the Aviation Regulations**

The law regulates the operations of all entities engaged in the civil aviation sector – personal licensing of flight employees (air crew, air traffic controllers, repair station employees trainers and instructors) as well as licensing of organizations (aircraft manufacturers, airline companies, repair stations, flight instruction schools, institutes for authorizations of repair station technician, etc.). The Aviation Law encompasses many aviation-related issues, including issues addressing aviation professions and the duties thereof, aircraft, air traffic control area, control authorities, investigation of a security incident, and in addition, said law provides for provisions concerning penal and financial sanctions due to a breach of the law.

On May 10, 2016, an amendment was published to the Aviation Regulations (Operation of Aircraft and Flight Rules), 5742-1981 (the "**Regulations**"), which adopted to Israeli law the existing arrangement in the American regulations regarding the management of fatigue of pilots and flight attendants, such as minimum rest periods between flights, limitation on the duration of time for the execution of a flying role, et. ("FTL"). In accordance with the Regulations, the adoption of the American regulations will be done regarding "Chapter 13 operators" (El Al, Israir, Arkia, and CAL). Together with the application of the American regulations in Israel, the Aviation Regulations (Limitations of Flight Time in Aviation Services), 5731-1971 will no longer apply to the Company, excluding the provision in the Regulations regarding the entitlement of pilots to 30 vacation days per year. The new regulations will come into force on May 1, 2018. The Company is preparing to implement the Regulations and is examining their implications for the Company.

b. **Aviation Services Licensing Law, 5723-1963 (hereinafter: the "Licensing Law") and the Licensing Regulations**

This law regulates licensing principles applicable to the various aviation fields and by virtue of which El Al received a commercial operation certificate. Regulations issued under the Licensing Law, regulate, inter alia, excessive registration, the operation of charter aircraft and limitations of flight time in aviation services.

c. **The Air Transport Law, 5740-1980**

This law and the orders and notices issued thereunder, adopt several international conventions setting different rules on international air transport, mainly regarding the liability of air carriers for damages (bodily injuries and property damages), caused during international air transportation, and the compensation imposed on air carriers due to such liability. The law applied the convention of unification of certain rules dealing with international air transportation (the "Warsaw Convention"), as well as the Montreal Convention, which updated the system of existing rules under the Warsaw Convention, including increasing the limitation of liability for damage caused to the person or property of the passenger, the addition of jurisdiction and the imposition of an insurance obligation on the airline carrier. The Montreal Convention entered into force on March 20, 2011.

d. **The Airport Authority Law, 5737-1977**

This law and the regulations and rules in effect thereunder, regulate, inter alia, the following issues: aviation fees, transport of import consignments, entry into restricted areas, authorization fees, and loading and unloading of aircraft.

e. **Civil Aviation Authority Law, 5765-2005**

This law provides for the functions of the Civil Aviation Authority which, among others, are: to determine and ensure compliance with domestic and international aviation arrangements pursuant to the aviation laws; to grant licenses, permits and approvals within the field of civil aviation, pursuant to the aviation laws; to supervise the civil aviation sector including, inter alia, maintaining proper safety level of flights on aircraft operated by Israeli airlines and aircraft within the airspace of the State of Israel.

f. **The Antitrust Law, 5748-1988**

In January 1, 2009, Amendment No. 10 to the Antitrust Law entered into force; the Amendment reduced the application of the statutory exemption contained in the Antitrust Law until the end of 2008, for arrangements between air carriers in connection with international transportation. As an accompanying step to reducing the scope of the statutory exemption, the Trade Practices Rules (Block Exemption for Arrangements between Air Carriers), 5769-2008 were enacted by the Antitrust General Director (hereinafter: the "**General Director**" and the "**Air Carrier Block Exemption,**" respectively), which exempt various types of arrangements between air carriers from the need for a prior individual authorization in order to prevent a comprehensive and undesirable application of the Restrictive Arrangements Chapter on thousands of arrangements that form the basis for aviation activity to and from Israel and do not jeopardize competition.

The Air Carrier Block Exemption addresses a wide range of arrangements, and exempts from the requirement of separate approval for various commercial and operational arrangements, such as Interline Passenger and cargo Agreements that do not ensure a minimum amount of seats or cargo capacity, and frequent flyer agreements.

On December 11, 2012, the Restrictive Arrangements Rules (Block Exemption for Arrangements Between Air Carriers Concerning Marketing Flight Capacity to Destinations Covered by Open Sky Arrangements), 5772-2012 were published, providing an exemption from obtaining a prior individual authorization for a flight capacity marketing arrangements (including Code Share agreements) upon compliance with the following rules: (a) the arrangement addresses airlines to which the Open Sky Agreement applies; (b) the arrangement does not limit competition in a substantial part of the market it affects, or may affect competition in a substantial part of such market, but it cannot cause significant damage to competition in such market; (c) the arrangement is not in reducing does not aim to reduce competition nor prevent it, and it does not contain restrictions that are not necessary for the implementation thereof; (d) the parties to the arrangement notified the General Director thereof.

On November 28, 2013, the Antitrust Authority published the Antitrust Rules (Block Exemption for Arrangements between Air Carriers) (No. 2), 5773-2013 (the "**New Block Exemption**"), which renews and amends the Air Carrier Block Exemption published in August 2008. The New Block Exemption, same as the former block exemption, deals with the exclusion of types of arrangements between air carriers from the application of the Restrictive Arrangements Chapter of the Antitrust Law, 5748-1988. The new Block Exemption upholds the legal arrangements provided for in the former block exemption, except for matters pertaining to lease arrangements between air carriers. As for these arrangements, the New Block Exemption sets out different requirements for the application thereof, while distinguishing between dry lease and wet lease, between aircraft lease for cargo transportation and other types of lease, and between leases among Israeli carriers on the one hand, and leases between an Israeli carrier and a foreign carrier on the other hand.

BSP exemption

In November 7, 2013 the Antitrust General Director published his decision on the grant of an exemption from court approval for a restrictive agreement the parties to which are the International Air Transportation Association (IATA) and airline companies, and the subject of which is the BSP Plan (Billing and Settlement Plan), pursuant to Section 14 of the Antitrust Law (the "**Exemption**"). The arrangement deals with the installation and use of a central computerized billing system that manages the billing and payment process between IATA certified travel agents and airline companies that joined the arrangement by means of the BSP Plan. The exemption shall be in effect until November 7, 2018 and is contingent upon various conditions. The conditions so determined address the following issues: IATA's obligation to connect all interested travel agents to the BSP system and act in a non-discriminatory manner, restrictions on the transfer of information, the ability to remove a travel agent from the Plan, and the ability of travel agents to refrain from paying amounts in dispute, etc. In addition, it was determined that, should an airline be suspended from the BSP arrangement due to financial difficulties, travel agents must not be allowed to offset any disputable amount attributed to such airline and at the same agents must not be obligated to pay amounts they owe that airline by means of the BSP Plan.

Decisions and procedures regarding the subject of a monopoly

On October 27, 2005, the Company received the notice of the Antitrust General Director regarding his declaration of the Company as a monopoly in the transportation of time sensitive and price sensitive passengers in civil aviation markets to the following destinations: Johannesburg, Hong Kong, Bangkok and Bombay.

On September 9, 2012, the Company received the notice of the Antitrust General Director, whereby it was declared a monopoly in the provision of services of aviation security services overseas according to professional guidelines provided to airline companies in accordance with the provisions of the Regulation of Security in Public Bodies Law 5758-1998 and the Flight Law (Security in Civil Aviation), 5737-1977, with respect to passengers and cargo on passenger flights.

g. **Legislative provisions that apply to the Company as a "mixed company"**

For details regarding Legislative Provisions applicable to the Company as a "Mixed Company," see this section in the Company's 2013 Periodic Report.

h. **Aviation Services Law (Compensation and Assistance for Cancellation of a Flight or a Change in its Conditions), 5772-2012**

The Aviation Services of (Compensations and Assistance due to Flight Cancellation or Change of Conditions), 5772-2012 adopts, while making certain adjustments and changes, the principles of EU Regulation 261/2004, which set out conditions for removing passengers from flights as well as for flights delays and cancellations. Said law applies to all outgoing flights from Israel (scheduled and charter flights) as well as incoming flights to Israel, in the event the passengers of such flights did not receive the remedies requested in accordance with the laws of the country of origin. Pursuant to the said law, in cases such as flight cancellation, delay, refusal to admit a passenger to a flight and downgrade of the seating class, subject to meeting the preliminary conditions and circumstances determined by the law, a passenger shall be entitled to benefits such as free assistance, reimbursement of expenses, alternative flight tickets and even a financial compensation.

As of the publication of the Report, the Knesset is considering the Bill for Aviation Services (Compensation and Assistance for Flight Cancellation or a Change in its Conditions) (Various Provisions), 5776-2016, which expands the existing law by a number of matters, including the issuance of a plane ticket within 24 hours from the payment for the same, the obligation to actively deliver information to the customer, providing the customer with the ability to choose receipt of compensation under Israeli law or the foreign law, imposition of authorities for the enforcement of the law to the Authority for Consumer Protection and Fair Trade. As of the Report Date, the Bill has not yet been passed and there is no certainty regarding its final formulation, if passed.

i. **Equal rights for people with disabilities**

The Third Chapter of the Equal Rights for People with Disabilities Regulations (Access to Public Transportation Services), 5763-2003, sets forth provisions in connection with the obligation to arrange equipment for the handicapped in air transportation, which impose various obligations on air carriers.

9.11.3 Business licenses and building permits

Some of the Company's activities are subject to obtaining licenses pursuant to the Business Licensing Law, 5728-1968, or permits from various regulatory agencies. Since the beginning of 2003, the Company has submitted business license applications for activities requiring license. In the process of obtaining such licenses, the Company acts to arrange permits for all the buildings within its premises, including old ones, for which the Company does not have building permits since the time it was a government company. The Company works in coordination with the representatives of the Ministry of Interior and employs expert consultants to assist in the process. In the framework of this activity, the Company acts according to a proper Master Plan for the purpose of completing the process of obtaining building permits and adjusting them to currently existing buildings as well as for obtaining business management licenses for the Company. During recent years (since 2008), five building permits have been obtained for various building complexes that include most of the buildings that do not have permits. In addition, in 2015 a request for a building permit was submitted for minor deviations that were found following cross-checking of situational measurements against building permits received prior to 1965 and an aerial photograph taken this year for a plot that includes most of the buildings constructed prior to 1965.The request was prepared and discussed by the Central District Planning and Building Committee, and was approved by the District Committee and is currently in the process of fulfilling conditions.

For its operations, the Company is required to have 33 business licenses. As of March 2017, the Company holds 18 permanent business licenses, 9 temporary licenses and 6 applications for renewal of licenses in approval stages

Regarding the subsidiary Katit – Katit has five business licenses and license for alcoholic beverages, which are renewed in accordance with the requirements of the Committee and the authorities.

Regarding the subsidiary Tamam - the Tamam factory submitted a request to renew a business license that expired in June 2016, and the Company is making efforts to renew it.

It should be noted that operations without a building permit and/or business license may force the Company to cease its operations in buildings or in businesses, as applicable, for which the required permits were not obtained, which may harm the Company's revenues. Furthermore, operations without a building permit and/or business license may result in criminal proceedings under the Building and Planning Law, 5725-1965 and the Business Licensing Law, 5728-1968, against the Company and its executives.

Failure to obtain licenses and permits or failure to comply with the terms set out therein and the consequences resulting therefrom, constitute forward-looking information as defined in the Securities Law, which contains estimates or forecasts of the Company as of the Report Date. Therefore, the actual results of a failure to obtain business licenses and building permits or failure to obtain appropriate permits for the Company's operations, may be materially different than the results estimated or implied by such information as a consequence of a large number of factors, inter alia, actions taken by competent authorities in connection with licenses, changes in legal or operational provisions and results of legal proceedings.

9.11.4 Commercial license

The Company was granted new Commercial Operation Certificate (No. 1/88) which was issued by the Minister of Transportation and Road Safety under the Licensing Law and includes contains general provisions concerning the operation of aircraft, including the obligation to operate flights under a license, the duty to comply with the provisions of the law and maintain the security of the State and the safety of fight. The Certificate is valid for as long as it is not cancelled or suspended by the Minister of Transportation or the CAAI.

The Certificate provides that the licensee shall be an "Israeli Operator" as defined in the Aviation Services Licensing Law, 5723-1963, and sets out obligations regarding the duty to submit reports and information to the CAAI.

The licensee is entitled to offer and perform the services specified in the annex to the Certificate, which mostly consists of passenger transportation and cargo transportation on scheduled flights between Israel and destinations in foreign countries and in-between such destinations. It shall be noted that some of these destinations are not offered by the Company due to lack of economic feasibility (and accordingly, the Minister of

Transportation is entitled to cancel such appointment); passenger transportation between Ben Gurion Airport and Eilat on feeder flights; passenger transportation on domestic flights on the route between Ben Gurion Airport and Eilat; cargo transportation by all-cargo flights on scheduled international flights and international charter flights; passenger transportation and cargo transportation on international charter flights.

9.11.5 Air operation license

The Company has an Air Operator License (No. 1/88) (the "**License**") issued from time to time by the CAAI.

The License provides that, inter alia, the operator (El Al) may execute operational commercial operation, as defined in the Operation Specifications that form part of the License, in accordance with the operator's Operation Manual and the Aviation Regulations as specified in the License. By virtue of the License, the Company may operate pursuant to Chapter 13 of the Air Navigation Regulations (Operation of Aircraft and Rules of Flight).

Aircraft listed in the Operation Specifications are either registered in Israel (under Israeli ownership or foreign ownership approved by the CAAI and the Minister of Transportation and Road Safety). The operator is subject to the obligation to report any change in the list of aircraft included in the Operation Specifications, such as sale, purchase, lease to another operator and /or lease from any Israeli or foreign operator. Said report will be submitted to the CAAI.

9.11.6 International regulatory arrangements

The universal rule governing civil aviation provides that every state is sovereign of its airspace and therefore every commercial flight to or from any state requires a permit from that state. The permit may be granted in the framework of a bilateral agreement (as customary for scheduled flights) or an "Open Sky" agreement or with respect to ad-hoc flight/s.

The International Civil Aviation industry operates under a set of regulatory arrangements relating to most operational aspects of an airline company, in particular the subject of traffic rights, permitted capacity, air carrier's liability for damages (bodily injury and property damage), standards of flight safety, security and noise. This set of arrangements consists of international conventions, laws, regulations and administrative guidelines, as well as bilateral and multilateral agreements.

The current basis of international regulatory arrangements relating to International Civil Aviation is the Chicago Convention of 1944.

Following the Chicago Convention, the international Civil Aviation Organization (ICAO), an agency of the United Nations, was established. In the framework of the ICAO and under its sponsorship, recommended standards and procedures in various areas of aviation operations were determined. Rights to transport passengers and cargo between countries in return for payment and related issues are regulated in air transport agreements or aviation (bilateral) agreements based on reciprocity and on giving fair and equal opportunity to airlines of both countries.

In October 2016, the approval of the Minister of Justice was received to proceed with the adoption of the Cape Town Convention in domestic legislation. The Cape Town Convention is an international treaty that guarantees the rights of creditors, such as financiers and lessors, to valuable equipment, such as aircraft and engines, which do not have a permanent seat. The Convention was signed in 2001 and entered into force in 2006. The purpose of the convention is to overcome the difficulty of securing protected and enforceable rights by creditors on the same equipment and the determination of special arrangements in cases where guaranteeing the rights of creditors and their incorporation into an international treaty is required. The adoption of the Convention will facilitate the development of the aviation industry in Israel and will place the State of Israel in line with the advanced standards of the international aviation industry.

9.11.7 Aviation agreements and the principles of civil aviation in Israel

9.11.7.1 ***Aviation Agreements - General***

Most air traffic rights under which the State of Israel allows the Company to carry passengers and cargo on international routes are regulated in aviation agreements between Israel and foreign countries, and the rest of such rights are regulated (in the absence of aviation agreements) in agreements between aviation authorities or commercial agreements between the Company and an air carrier of the other state, which require the approval of the authorities of both states. The main components of aviation agreements include, inter alia, the granted air traffic rights, the determination of a designated carrier and the permitted capacity.

Most aviation agreements to which Israel is a party may be terminated or cancelled by giving one-year prior notice. In general, following such a notice, negotiations take place between both states for the purpose of establishing an interim arrangement or new rules prior to the expiration of the agreement.

As stated above, in June 10, 2013 an Open Sky Agreement was executed in Luxemburg between Israel and the EU. Said agreement allows all airlines in the EU to operate direct flights to Israel from everywhere in the EU, and allows Israeli airlines to operate flights to all airports within the EU. Upon entry into force, the agreement replaced all bilateral agreements between Israel and the EU States and removed most restrictions on the number of carriers, frequencies, capacity and types of aircraft allowed to operate between Israel and the EU States.

Additionally, new aviation agreements were executed in 2016 between Israel and several other countries, allowing other designated carriers to enter existing and new destinations and allowing to increase the number of frequencies permitted for airlines from both parties. For additional details, see Section 7.1.10 above.

9.11.7.2 ***Designated carrier***

In the past, each government granted to another government, under an aviation agreement, the right to designate one or more air carriers on its behalf ("Designated Carrier"). In recent years, a change has occurred in the Company's status after the grant of a Designated Carrier license to other Israeli carriers, with respect to several flight destinations, some of which in lieu of the Company, as well as due to the execution of the Open Sky Agreement with the EU, which in practice, obviates the need to appoint a Designated Carrier to destinations included in this Agreement.

9.11.7.3 ***Ownership and control over air carrier***

There is no standard international arrangement as to the percentage of actual ownership and control over an air carrier, which should be held by the State or its citizens. Bilateral aviation agreements to which Israel is a party contain a provision whereby, each contracting state reserves itself the right to suspend or cancel the permit granted by it to an airline of the other state, if the "substantial ownership and effective control" are not held by the contracting state or its citizens. The agreements do not include definitions of this term.

In the past, the practice in the countries of the Western World has been to accept the appointment of an airline company as a designated air carrier as if such appointment contains a statement that the requirement of substantial ownership and effective control has actually been met, and if found that said requirement ceased to be met, the relevant state shall be required to remedy the situation.

The Open Sky Agreement with the EU updated the provisions addressing ownership and control in a manner allowing airlines owned and controlled by any of the EU States to operate flights from any destination in the EU to Israel.

Capacity

Most aviation agreements to which Israel is a party have included restrictions of maximum capacity or maximum frequency that any airline is allowed to offer on the agreed routes in order to ensure equal opportunities to all air carriers of the two states that have entered into an aviation agreement. As mentioned above, the Open Sky Agreement executed by Israel and the EU States gradually cancels previous restrictions that applied with respect to the number of air carriers, capacity and types of aircraft.

9.11.7.4 ***Flight rates***

IATA publishes airfare of flights on international routes are published by. These fares enable passengers to buy a flight ticket with one airline, and use it to fly with another, or use it for other flights with other airlines (in the framework of Interline Agreements). In addition to the fares published by IATA, which are supervised by the aviation authorities, the Company is entitled to set special fares unilaterally.

As a rule, the Israeli Ministry of Transportation does not interfere in setting the fares unilaterally published by the Company, provided the level of such fares is not higher than IATA fares. IATA examines the Company's fares and accordingly, publishes Flex Fares used as Interline Fares.

Notwithstanding the Flex Fares published by IATA, most airline tickets and cargo capacity are sold at special rates as published by the airlines under different terms in accordance with the various fares. The Company acts in accordance with practices customary in the industry, while adapting its policy to market conditions. A substantial portion of the Company's income is derived from sales under such conditions.

In recent years, a larger variety of prices have been published. All travel classes for flights has several types of booking classes (or fare types). Each travel class as stated has a different demand for each and different terms for different seasons of the year. Additionally, the price offered to the public includes supplements charged by air carriers, including a cash addition of the carrier.

Charter flights rates are set differently from regular airfares. Every Organizer is committed to pay the air carrier for the capacity (number of seats) leased by it, as the Organizer sets the price per seat with respect to the seats purchased by the Organizer -

generally, a price per package deal, which includes flight and ground arrangements. An organizer requesting authorization for a flight or a series of charter flights, must indicate the fare offered to the public and obtain authorization for such flights and fares from the aviation authorities of the relevant country.

9.11.8 Israel's international civil aviation policy

In the course of the last years, the "Open Sky" policy of increased liberalization in the aviation industry has been implemented in Israel, aiming to encourage and increase tourist traffic to Israel by intensifying the competition between the airlines.

For further details regarding open skies policy, see Section 7.1.10 above.

9.11.9 Special State Share

9.11.9.1 1.1.1.1. Shortly before the publication of the 2003 Prospectus, the Company allocated to the state a "Special State Share." The rights granted to the holder of the Special State Share are set forth in the Company's Articles of Association, which further detail the State's essential interests in the Company that must be protected by means of the Special State Share. Such essential matters are:

- ✓ Maintaining the existence of the Company as an Israeli company so that the Israeli law, including legislation that allows acquisition of equipment for security purposes, would continue to apply to the Company and the conditions required to retain its operator certificate and flying rights would be met by it.
- ✓ Maintaining the possibility to ensure that the Company's operational capacity and its ability to carry passenger and cargo do not fall below the capacity provided for in the Company's Articles of Association, in order to allow the State an effective use of essential assets, in emergency or for security purposes as determined from time to time by the authorized parties, all as specified in the Company's Articles of Association.
- ✓ Preventing parties hostile to the State of Israel or parties who might cause damage to the vital interests of the State or to the State's foreign or security affairs or Israel air relations with foreign countries, or parties who are and/or might be in a material conflict of interest that could damage any of the matters set out above – from becoming interested parties of the Company, or otherwise from having a certain impact on the management thereof.
- ✓ Fulfilling instructions and security arrangements that apply or will apply, by virtue of government resolutions or under any law, with respect to the security of flights, passengers, baggage, cargo and ,ail, in Israel and overseas, including with respect

to the Company's operations abroad and the cooperation required from local authorities abroad in the areas mentioned above; in the area of security clearances of employees and service providers of the Company; and in the area of classified information security and security knowledge protection.

9.11.9.2 The holder of the Special State Share is the State of Israel by a Minister or Ministers. In order to maintain these vital interests, certain provisions relating to the Special State Share were established in the following matters:

- ✓ Provisions for preserving the Company's nature as an Israeli company, including restrictions relating to citizenship, residency and security clearance of the Company's officers;
- ✓ Provisions for compliance with security provisions and arrangements;
- ✓ Provisions relating to rights in security information and classified information of the Company;
- ✓ Provisions relating to the Company's discussions on security matters;
- ✓ Provisions for reviewing the Company's documents and information;
- ✓ Provisions for maintaining minimum flight capacity – the Company is not allowed to enter into certain transactions related to the Company's aircraft without the consent of the holder of the Special State Share, if, as a result of such transactions, the Company's flight capacity falls below the threshold stipulated in the Special State Share;
- ✓ Acquiring influence or status in the Company requires the consent of the State – pursuant to the Company's Articles of Association, transactions in the Company's shares, at certain rates, shall not confer any rights arising from holding and/or acquisition of the Company's shares, against the Company, without the prior written consent of the holder of the State Special Share (the State by the Ministers designated for this purpose by the Government). The Articles of Association provides detailed procedures regarding the manner of submitting the application to approve the holding of the Company's shares, should such approval be required;
- ✓ Provisions for obtaining approval to vote at General Meetings – a voting right at the General Meeting requires the approval of the Company. The approval to vote at the General Meeting will not be granted in circumstances where the consent of the holder of the State Special Share is required but has not been provided. The Company's Articles further determine special provisions in cases where there is a reasonable concern that foreign entities' holdings of the Company's shares would violate the Company's traffic rights or its operator certificate.

9.11.9.3 Any change, including amendment or cancellation, in the provisions of the Memorandum and Articled of Association of the Company which relate to the rights granted and/or attached to the Special State Share and to the holder thereof shall be null and void towards the Company, its shareholders and a certain third party, without the prior written consent of the holder of the Special State Share.

9.11.9.4 Within the refinancing of the two loans with a local bank (as set forth in Note 13 of the Financial Statements), the Company is required to re-register liens on certain of the Company’s aircraft. In accordance with the provisions of the Special State Share with respect to maintaining a minimum flying capacity, in order to allow the State to effectively use essential assets, on February 8, 2017, the Company contacted a holder of the Special State Share with respect to the loan’s turnover. The notice stated that the financing documents would include the requirements set forth in the Company’s articles of association, and that according to the Company, the update to the holder of the Special State Share regarding the registration as stated is sufficient, and if approval of the Special State Share is required, the inquiry will be considered to be a request as stated. According to the Company’s articles of association, the holder of the Special State Share will be considered to have provided its consent to the Company’s request if no response is given to the request submitted by the Company within 30 days from the date on which it received all of the information required at its discretion in connection with the request. As of the publication of the Report, the Company has not received any response to the aforesaid request.

9.11.10 <u>Standardization</u>

The maintenance layout of the Company was certified by the Standard Institution of Israel for Quality Standard ISO 9001. In addition, the Company’s maintenance layout was certified as a Certified Repair Station by the CAAI, the U.S. Federal Aviation Authority (FAA). In addition, the Company’s line maintenance system was approved by the European Agency for Aviation Safety (EASA) of the EU.

<u>IOSA</u>

During 2016, the Company completed the implementation of the IATA safety standards audit, known as IOSA - IATA Operational Safety Audit. The audit integrates the requirements of the International Civil Aviation Organization (ICAO). The IOSA Standard is an international standard in the fields of operations, safety and quality of airlines, as receipt of said Standard Mark places the Company among the world's leading airline companies on the subject of aviation safety, and compliance with IOSA audits is a condition for membership in IATA.

Within the Company’s preparations and implementation of the IOSA audit, a comprehensive survey was conducted in the various operational divisions of the Company.

IOSA audits are regularly conducted by qualified safety assessors within the Company on a continuous basis and periodically over a period of 24 months, and are assessed at the end of the process by IATA. During 2016, the Company successfully completed the IOSA audit and fulfilled the requirements and, accordingly, the safety standard registration of the Company was renewed for two additional years (until October 2018).

It is noted that failure to comply with the IOSA audit may result in loss of the Company’s status as a member of IATA and consequently the imposition of operational restrictions on the Company. For details regarding the risks in the field of aviation safety or flight safety, see Section 9.18 below.

In addition, the Company has a "crisis event" system, which is prepared and practiced according to the directives of IATA. The Company conducts "crisis events" at a social scale once per period (the last social exercise was carried out in 2016) and updates its procedures in accordance with the global development in this area on the matter (newsletters, conferences and professional media).

9.11.11 <u>Quality control</u>

The Company's maintenance operations are reviewed by an Internal Audit and Quality Control Division at the Company's Repair Station. The Repair Station is supervised by the Continued Airworthiness Officer on behalf of the Company, who is responsible for the continued airworthiness of the Company's aircraft and for ensuring that the Repair Station's aircraft checks performed by the Repair Station comply with the maintenance program authorized by the CAAI.

9.11.12 <u>Security arrangements</u>

The civil aviation industry, particularly on routes to and from Israel, is a target for attacks by various parties, mainly terrorist organizations all over the world. The Company takes special security measures directed by the government body in charge of this issue.

State Participation in Aviation Security Costs

For details regarding Government Resolutions concerning the percentage of State participation in aviation security costs, see the corresponding section in the Company's Periodic Report for 2013.

On December 18, 2013, the Company received the approval of Government bodies to increase the percentage of State participation in security costs of Israeli airlines, such that the percentage of State participation will be 97.5%. According to the Government bodies' notice, said approval applies retroactively as of July 16, 2013, the date the State confirmed that the conditions provided in Government Resolution No. 4026 for the implementation of the Open Sky Agreement have been met in a manner that entitles Israeli airlines to increased percentage of participation.

In this regard, it shall be noted that, as of the Date of the Report, the Ministry of Finance has not yet approved the request of El-Al Security Division to increase the 2017 security budget due to the expected expansion in the operations of Israeli airlines, as a result of the Open Sky Agreement with the European Union. So long as the said budget is not fully approved by the relevant regulatory bodies, difficulties may arise in connection with the operations of Israeli airlines, including the Company.

The implementation of the Government Resolution with respect to participation at a rate of 97.5% of the aviation security expenses of Israeli airlines and its possible impact on the Company's operations and financial results, is forward-looking information, as defined in the Securities Law. The manner and extent of the actual implementation of the Government Resolution, receipt of the funding for the security costs at the updated rate and in line with the growth in the operations of Israeli airlines, may actually be carried differently than estimated, inter alia, due to regulatory restrictions, economic limitations, inter alia due to the need to purchase equipment for the launch of additional flight routes, contractual restrictions requiring amendments to bilateral or other aviation agreements, changes in the security, financial and geopolitical situation and its effect on competition, as well as any change in Government Resolutions.

The following table details direct security costs related to the security of the Company's passengers, aircraft and employees, while distinguishing between the share of costs financed by the Company and the share financed by the State:

	State financing (USD thousands)	Company's share (in USD thousands)	Total (USD thousands)
2016	141,772	3,465	145,237
2015	129,216	3,208	132,424
2014	127,470	3,486	130,956

Aircraft protection systems

In 2016, the Company installed, as subcontractor of Elbit Systems Electro-Optics Elop Ltd. (hereinafter: "Elop"), a protection system in some of its aircraft, pursuant to an agreement executed on September 30, 2014 between the Company and Elop, whereby the Company will act as subcontractor for the installation of the protection systems in the Company's aircraft and in the aircraft of the other Israeli airlines.
The Company is expected to continue the installation process of the protection systems in other aircraft during 2017.

For further details regarding the agreement executed by the Company and Elop as well as the Agreement executed by the Company and the State of Israel with respect to the State's participation in the expenses for the installation of protection systems in the aircraft, see the same section in the Company's 2014 Periodic Report.

Security services for Israeli airlines

In addition, the Company provides security services to Israeli airlines in return for reimbursement of the Company's related expenses. Payment in respect of these services was settled by means of a "price list" which was updated in 2015 and applies retroactively from 2013, as well as according to the understanding reached with Ministry of Finance on the issue of security and the Government Resolution No. 4026 regarding the provision of aviation security services by the Company.

9.11.13 Emergency operation and essential purposes

The Work Service in Emergencies Law, 5727-1967, grants the Minister of Labor, in consultation with the Minister of Defense, and in times of combat the Minister of Defense in consultation with the Minister of Labor - the authority to authorize an operator as an “essential operator,” meaning to operate the Israeli airlines, including the Company, for the State’s defense or public security, or to uphold the essential services or supply.

The Company was approved as an “essential operator.” The approval is renewed from time to time at the Company’s request. The existing approval is valid until December 31, 2017.

The Work Service in Emergencies Law, 5727-1967 grants the Minister of Labor the authority, after the Company is approved as an “essential operator,” to call upon all of the workers for essential work.

The Registration of Equipment and its Enlistment to the IDF Law, 5747-1987, confers upon the Minister of Defense, if convinced that the security of the State so requires, the power to announce, by order, the need to recruit equipment (including aircraft). The Law refers to equipment that the company will have during an emergency. The law requires the State to pay usage fees for recruited equipment and if, during the period of recruitment, the equipment has been damaged – said law requires the State to also pay compensation for the damage.

The Government Companies Order (Declaration of a Vital Interest to the State in El Al Israel Airlines Ltd.), 5765-2004, provides that the State has an essential interest in connection with the Company to allow effective use of essential assets, as defined in the Company’s articles of association, in emergency times or for safety purposes to secure the continued existence of activity that is essential to the security of the State and the Company will employ, at all times, Israeli air personnel, and in Israel, Israeli land personnel, that are trained and licensed as required for the operation of the essential assets - all in the number that is at least the number required for the continuous and simultaneous operation of all of the essential assets during an emergency or for a security need.

In addition, there are arrangements between the Company and the State regarding flights for the purposes of State security or at times of emergency and regarding flights for other special needs, including the consideration for them on a commercial basis.

The Commodities and Services Control Law, 5717-1957, confers upon the Minister, being thus authorized by the Government, the power to issue a "Personal Order" or a "General Order" to perform, inter alia, an "Essential Action" for the defense of the State, the security of the public, and for maintaining supplies or ordinary services. An action as mentioned above, includes, among other things, an obligation to operate an enterprise or any supervised service.

9.12 Material agreements

The acquisition of 787 aircraft

As part of the realization of the Company's procurement plan for large-bodied aircraft, the Company entered into agreements for the purchase and lease of aircraft, as well as agreements for the purchase of engines and the receipt of motor maintenance services as described in the Company's reports dated September 10, 2015 (Reference No. 2015--01-118524) October 29, 2015 (Reference Number 2015-01-144525), February 22, 2016

(Reference No. 2016-01-032578) and from September 12, 2016 (Reference No. 2016-01-122074) and as detailed below:

The purchase of Boeing 787s

On October 2015 the Company signed an agreement with Boeing for the acquisition of four new 787-9 Dreamliner aircraft and five new 787-8 Dreamliner aircraft (the "**Acquisition Agreement**" and the "**Aircraft**" or the "**Owned Aircraft,**" respectively). Pursuant to the Acquisition Agreement, the Company was granted terms allowing flexibility with respect to the dates of receipt of the Aircraft, in a manner that enables Boeing to make adjustments according to the Company's requirements as may be from time to time with respect to its aircraft fleet, including conversion rights related to other Boeing aircraft.

In addition, the Company was granted options to purchase seven additional 787-10 aircraft (“the **Option Aircraft**”), as long as their delivery date is no later than December 31, 2023. The Company paid non-refundable advance payments for the option planes at a non-material sum. In addition, in a situation in which the Company decides to exercise any of the Option Aircraft, on each exercise date the Company shall have the right to purchase an additional option to purchase a 787-10 aircraft, up to a total of six additional planes (“the **Additional Option Aircraft**”). The Company will be required pay a non-refundable advance payment near the date the aforesaid option is purchased. The Option Aircraft and the Additional Option Aircraft are expected to be received between 2020 and 2023.

It is noted that according to the Acquisition Agreement, the Company has the option of canceling the acquisition of some of the Aircraft, and the Option Aircraft and the Additional Option Aircraft have conversion rights for planes of other 787 series models. In addition, the Company has an option to finance backup from Boeing of up to seven aircraft under the conditions stipulated in the Agreement.

Leasing 787 aircraft

In addition to the Acquisition Agreement, the Company executed agreements with three foreign companies for the lease of five new 787-9 Dreamliners and four new 787-8 Dreamliners, of which two of the 787-8 aircraft will be leased to the Company within a sale and leaseback agreement, as described below (the "**Leased Aircraft**") for 12-year periods with extension options, and for the acquisition of an option for the lease of two new 787-10 Dreamliners (with conversion rights) as set forth below:

- ✓ In December 2015, the Company entered into agreements for dry lease of two new Boeing 787-9 aircraft with a first foreign company. The lease is for 12 years, and the Company has an early exit option after 10 years, subject to prior notice and exit fee, in accordance with the terms provided in the Agreement.
  The Company has an option to extend the lease agreement with respect to each aircraft, for periods of two years each time, up to a total period of six years or until the next C-Check inspection of the aircraft, by 12-month notice prior to the end of the Agreement.

  Additionally, the Company signed a memorandum of understanding for an option to lease two new Boeing 787-10 aircraft for a 12-year period (with conversion rights into a Boeing 787-9), exercisable until November 2018 (with rights to delay the exercise dates). In the event that the option is exercised, these aircraft are expected to be delivered to the Company during 2020 or 2021, subject to the availability of the manufacturer.

- ✓ In February 2016, the Company entered into agreements with a second foreign company for dry lease of a new Boeing 787-9 aircraft and two new Boeing 787-8 aircraft. The term of the lease is for 12 years, and the Company has an option to cancel the agreement with respect to the Boeing 787-8 aircraft after giving prior notice, according to the terms provided in the agreement. The Company has options to extend the lease agreement with respect to each aircraft, for periods of three years each, up to a total period of six years, with notice 24 months prior to the end of the Agreement.

- ✓ In September 2016, the Company signed, with a third foreign company, sale and lease back agreements with respect to two of the new 787-8 aircraft, which were acquired from Boeing as part of the Acquisition Agreement. According to the above agreements, the two aircraft purchased by the Boeing Company will be sold to the foreign company upon delivery from Boeing and will be leased back by the Company. The Company has the right to terminate the sale and lease back transactions upon the occurrence of certain conditions, as determined in the Agreement and subject to prior notice to the lessor. The Company is not expected to have material accounting implications in respect of the sale and lease back transactions. The Company also entered into a dry lease agreement for two new Boeing 787-9 aircraft with the same foreign company.

  It is noted that the lease of the aforesaid four aircraft is for 12 year periods, when regarding some of the aircraft, the Company has an early termination option after ten years, subject to providing prior notice and payment of exit fees based on the terms set forth in the agreements.

Upon completion of the lease and the sale and leaseback transactions described above, the Company shall own seven Dreamliner aircraft (four 787-9 aircraft and three 787-8 aircraft) and lease out nine Dreamliner aircraft (five 787-9 aircraft and four 787-8 aircraft). All 16 aircraft to be purchased and/or leased by the Company are expected to be available to the Company between the years 2017 to 2020, and join the Company's wide-body aircraft fleet, as they are expected to replace the Boeing 747-400 and 767-300 fleets.

Rolls Royce engines for 787 aircraft

In February 2016 the Company entered into agreements with the engine manufacturer Rolls-Royce, in connection with engines to be installed in the Owned Aircraft and Leased Aircraft, as set forth below:

Substitute Engines Purchase Agreement and Benefits Agreement related to the purchase of said engines – the agreement includes the purchase of substitute engines and an option to finance one substitute engine on the terms provided in the agreement. The agreement further includes maintenance reliability assurance (warranties) and performances (guaranties), including fuel consumption performances and MTBR guarantees (Time between Removals).

Engine Maintenance Agreement – pursuant to the agreement, both Owned Aircraft and Leased Aircraft will be provided with maintenance services. The Agreement is based on an All-Inclusive basis and includes coverage in respect of planned events, such as renovation of engines, and unplanned events (such as failures and bird strikes). The payment mechanism provided for in the Agreement is based on flight hourly service. The Maintenance Agreement is a long-term contract with a minimum term of 12 years with respect to Owned Aircraft and 10 years with respect to Leased Aircraft.

It should be further clarified that the annual expenses in respect of engine maintenance are current expenses similar to those paid by the Company in respect of existing aircraft engines, which will be replaced with the new Dreamliners, and that the annual engine maintenance expenses under the Engine Maintenance Agreement are not material in relation to the total annual expenses of the Company.

In March 2016 the Company issued a Request for Proposals ("RFP") to financing bodies for the funding of the substitute engines expected to be received by the Company in 2017 and 2018. The Company has suspended the examination of the proposals in view of the delay in receiving the replacement engines.

For details regarding the cost of the purchase of the aircraft, the engines for the aircraft, the replacement engines and replacement parts (including for the leased aircraft), see Note 9 of the Financial Statements. For details regarding advance financing agreements, see Note 13 to the Financial Statements.

In addition to the agreements into which the Company has entered within the framework of the Aircraft Acquisition Transaction described above, the Company has agreements concerning its employees and their rights (see Section 9.4 above), real estate lease agreements (see Section 9.1.1 above), aircraft lease and financing agreements (see Sections 7.11 and 8.10 above), various agreements with airline companies (see Sections 9.11.7 above and Section 9.13 below) and insurance agreements (see Section 9.2 above). Additionally, the Company is obligation for indemnification and insurance of the Company's officers. For details see Regulation 29(A) of Chapter D (Additional Details of the Corporation's Business) and Note 23 to the Financial Statements.

9.13 **<u>Cooperation agreements</u>**

The Company has entered into agreements with other airlines (Interline Agreements), allowing passengers on scheduled flights, and subject to certain restrictions, to use services of one airline with flight tickets issued by another airline. The Company also has Code Share agreements, enabling an air carrier to market flights of another air carrier as if they were its own.

The following are details of the code share agreements to which the Company is a party and that are in effect on the Date Near Approval of the Report:

- ✓ **Swiss International Airlines** - In March 2002, the Company signed a code share agreement with Swiss. According to the agreement, each company allocates the same number of flights to the other company on some of the flights it operates on the Tel Aviv-Zurich and Tel Aviv-Geneva routes, thereby enabling the two companies to increase the frequency of these flights.
- ✓ **Iiberia Airlines** - In October 2005, the company signed a code share agreement with Iberia Airlines. The agreement allows each company to sell flight tickets in its flight code on flights operated by the second company on the Tel Aviv-Madrid route.
- ✓ **American Airlines** - In November 2007, the company signed a code share agreement with American Airlines. The agreement allows the Company's customers to purchase

a combined ticket, in the Company code, for dozens of American Airlines destinations in North America through its European destinations, such as London, Rome and Paris.

In April 2016, the Company and American Airlines entered into an international special prorate agreement, effective as of June 2016. The agreement enables the Company to offer its passengers dozens of major destinations in North, Central and South America, following the Company's direct network of destinations, where the Company's customers will be able to enjoy an improved product on flights to these destinations in terms of the number of destinations, connection flights and product quality.

- ✓ **Air China** - In July 2009, the company signed a code share agreement with Air China. In February 2017, an amendment to the agreement came into effect, expanding the existing agreement between the parties and allowing the Company's customers to purchase a combined ticket in the Company code for four destinations in China (Hangzhou, Shanghai, Nanjing and Chengdu) via Beijing.
- ✓ **Sibir Airlines** - In November 2010, the company signed a code share agreement with Sibir. In November 2016 an amendment to the agreement came into effect, extending the existing agreement between the parties and enabling customers to purchase a combined airline ticket in the Company code for 13 additional destinations in Russia via Moscow, in addition to the 14 continuing destinations in Russia set forth in the agreement before the amendment.
- ✓ **Thai Airways -** In November 2012, the company signed a code share agreement with Thai. The agreement allows Thai to sell airline tickets in Thai's code and thus the Company benefits from Thai's sales.
- ✓ **Ethiopian Airlines -** In August 2013, the company signed a code share agreement with Ethiopian. The agreement allows the Company to sell airline tickets with the Company's code to Addis Ababa and to sell a combined flight ticket, in the Company code, to dozens of destinations in Africa via Addis Ababa.

  On October 3, 2013, an exemption was given by the Antitrust Commissioner for this Agreement (the "**Exemption**"). The Exemption was granted for three years (i.e. until October 3, 2016) or up to 30 days from the cancellation of the security restriction applicable to the Company on the Tel Aviv-Addis Ababa route. On July 14, 2016, the Company filed an application to extend the Exemption for an additional period. The Exemption request is pending before the Antitrust Authority ("the **Authority**"). At the same time, in January 2017, the Authority contacted the Company and requested its comments regarding the possibility that the parties acted without a valid exemption between September 2014 and September 2016. According to the

Authority, the exemption expired in September 2014 due to the apparent removal of the security limitation imposed on the Company on the Tel Aviv-Addis Ababa route at the time, to which the Exemption decision applied. The Authority stated that a financial sanction is being considered in this matter. The Company disagrees with the Authority's position and believes that although certain security restrictions were removed in September 2014, other security requirements remained in force, rendering the operation of the flights on this route unreasonable. As at the Date Near Approval of the Report, the Company is in the process of negotiations with the Authority in this regard, which have not yet been completed.

- ✓ **JetBlue -** In November 2014, the Company signed a code share agreement with JetBlue. The agreement enables the Company's customers to purchase a combined ticket, in the Company code, for dozens of other major destinations in North America, following the Company's direct network of destinations.
- ✓ **Aerolineas Argentinas -** In July 2015, the company signed a code share agreement with Aerolineas Airlines. The agreement allows the Company's customers to purchase a combined ticket, in the Company code, to Buenos Aires via the Company's destinations in Spain. As of the Date Near the Approval of the Report, the agreement was not implemented due to the non-approval of the new bilateral aviation agreement between Argentina and Israel.
- ✓ **Air Serbia -** In March 2016, the company signed a code share agreement with Air Serbia. The agreement enables the Company's customers to purchase a combined ticket, in the Company code, for various destinations in Balkan via Belgrade. It should be noted that the Company's customers benefit from accruing points of the Matmid Frequent Flyer Club for connecting flights that are carried out as part of the code share agreements as well.

The Company also signed memorandums of understanding, as detailed below:

- ✓ In June 2016, the Company signed a memorandum of understanding with **AeroMexico** before signing a code share agreement, which will enable the Company's customers to purchase a combined ticket, in the Company code, to Mexico via the Company's European and North American destinations.
- ✓ In February 2017, the Company signed a memorandum of understanding with **Qantas** before signing a code share agreement, which will enable the Company's customers to purchase a combined ticket, in the Company code, to Austria via the Company's destinations in the Far East (Bangkok and Hong Kong) and Africa (Johannesburg).

The Company also has various operational agreements with a number of airlines that include, *inter alia*, technical operating arrangements, lease arrangements, aircraft maintenance and replacement part agreements, mutual assistance in emergencies, the supply of aviation equipment and more. The Company also has agreements with airlines regarding lounges, collaboration in customer clubs, accounting for the use of connecting flights, registration of bookings and transport agreements (passengers or cargo).

9.14 **Legal proceedings**

As of December 31, 2016, legal claims totaling approximately USD 757 million were brought against the Company (including tax assessments), for which the Company allocated a provision of about USD 17.8 million, based on the opinion of the legal advisors of the Company.

In addition, non-quantified claims were also brought against the Company. The provision in the Financial Statements mentioned above, includes also provisions for non-quantified claims based on the estimates of the Company's Management.

For details of the material claims against the Company or its subsidiaries, see Note 15 to the Financial Statements.

Further to the Company’s reports dated December 28, 2016 (reference no.: 2016-01-144295) and December 29, 2016 (reference no.: 2016-01-145363), in December 2016, the Company’s offices received assessment notices on behalf of the Securities Authority, Ramla Tax Assessor (the “**Tax Assessor**”), further to the withholdings audit conducted for the Company regarding the calculation of withholding salary tax and employee expenses for the years 2011 and 2012, based on which the Company was required to pay a total of NIS 33 and NIS 28 million, respectively (about USD 9 and USD 7 million, respectively, excluding linkage differentials and interest). The Company rejects the claims of the Tax Assessor and filed an objection to the assessments. Assessments have not yet been received for 2013 and thereafter (in which no material change occurred in the Company’s pattern of activity, in the matters discussed in the assessments as stated). For additional details, see Note 15 of the Financial Statements.

9.15 **Goals and business strategy**

As part of exercising the Company's long-term strategy, inter alia, for reducing its aircraft fleet age and coping with competition, the Company has implemented the Wide-Body Aircraft Acquisition Program, and in this context, the Company entered with Boeing and other aircraft leasing companies, into agreements for the purchase and lease of 16 new

787-8 and 787-9 Dreamliners, which are expected to be received by the Company in 2017-2010 and are expected to replace the Company's 747-400 and 767-300 fleets. Within the framework of the purchase agreement executed with Boeing, the Company was granted options to purchase additional aircraft, the exercise thereof will enable the Company to significantly expand the network of routes in the future and consider the replacement of the Boeing 777 aircraft fleet.

For further details regarding the aircraft purchase and lease agreements and other agreements into which the Company entered in the framework of the Acquisition Program, see Section 9.12 above and Note 9 to the Financial Statements.

The implementation of said Wide-Body Aircraft Acquisition Program creates a new infrastructure for the Company's wide-body aircraft fleets, bringing with it the promise of renewal and operational enhancement. The implementation of the new Aircraft Acquisition Program is expected to generate significant technological improvements for the Company as well as significant improvement in the product and the service provided by the Company, an increase in the Company's competitive capacity vis-à-vis its competitors and considerable savings of aircraft current operation and maintenance. The savings in variable operating expenses in expected to be reflected, inter alia, in fuel consumption reduction, and the savings in maintenance is expected to be reflected in a reduction in maintenance activities (in accordance with the manufacturer's instructions) and 15%-20% savings in the costs arising therefrom.

To ensure proper integration of the new aircraft, the Company established the "Dreamliner" Administration, which is responsible to manage the project and its various stages, and consists of a representation of all the divisions of the Company. The Administration operates to ensure the integration of the aircraft in compliance with the agreements and within the predefined budget limits. It is noted that the Company is in the midst of preparing for the absorption of the new aircraft, which integrates all of the Company’s core areas and includes, *inter alia*, maintenance preparation, training and qualification of the Company’s various sectors and suitable industrial preparation and logistical equipment.

In 2016, the Company coped with various factors that affected the Company's operations, including the geopolitical situation, security events that took place during 2016, the increased competition and the crisis with the pilots sector and the implications thereof.

In addition to the above, the following is a description of the Company's main activities for the implementation of its strategic objectives, as carried out in 2016:

a. During 2016, the Company continued to adjust its operations, *inter alia,* by increasing frequencies and capacity and adapting the commercial operation model to the models used in Europe. In this framework, the Company operates low cost flights under the "UP" airline brand, which are intended to provide a response to the commercial models customary in Europe and the world in the low cost field, as described in Section 7.8.3 above. The Company operates flights in this format to five destinations in Europe. The flight tickets include a basic group of services and the possibility of adding additional services for a fee, similar to the format used by many airlines in the world.

b. During the first quarter of 2016, the Company received three new 737-900ER Boeing aircraft. Upon receipt of the same aircraft, the Company completed the purchase and absorption of eight aircraft of this model. The aircraft of this model operate to destinations at a short and medium distance.

c. “Matmid Frequent Flyer Club” - During 2016, the Company continued its process of recruiting Matmid Frequent Flyer Club members and issuing branded Fly Card and Fly Card Premium credit cards through financial institutions as described in Section 7.6.4 above. The branded credit cards grant their holders unique benefits according to the type of card and the volume of activity therein, all in accordance with the commercial terms established between the parties. These benefits include, *inter alia,* the accumulation of perpetual passenger points in respect of transactions in branded credit cards. During 2016, the Company entered into a cooperation agreement with the Electra Group. For additional details, see Section 7.6.4 above.

   In addition, during 2016, the Company entered into an agreement with a company fully held by Phoenix Insurance Company Ltd. for the establishment of an insurance agency. For additional details, see Section 7.4 above.

   It should be noted that the Company is examining the cooperation of the club with an international hotel aggregator, whereby the club's customers will be able to accumulate points when making an order through the said aggregator, and to pay for the reservation through frequent flyer points.

   The Company is examining, inter alia in view of the regulatory changes expected in the credit industry in Israel, and for the benefit of the Club members, the possibility of entering the consumer credit industry for club members by means of cooperation with a financial body as well as the possibility of entering the credit market through a partnership with a credit card company.

d. In March 2016, the company Cockpit was established, which is a private company wholly owned by the Company, that is active in development and entrepreneurship and coordinates the activities of "Cockpit", the innovation program to accelerate and support start-ups from Israel and abroad in the fields of aviation and tourism. For additional details, see Section 9.7.1 above.

e. Examining the development of additional and supplementary sources of income for flight activity, *inter alia*, in tourism, expansion of kosher catering activities in Israel and abroad through cooperation with an international body, sale of maintenance services to third parties and examination of various cargo projects. Tamam won the IAA tender to build and operate a building, in place of the existing structure, to supply kosher food to airplanes for 25 years. The construction of a new and advanced building for Tamam will allow Tamam to expand its activities substantially in the field of airplane and off-airplane food, and the Company estimates that this will allow Tamam to be a leading company in Israel in the food industry. For additional details, see Section 9.7.2(b) above. It should be noted that, in the field of tourism, various possibilities for development and entrepreneurship through cooperation with entities in the aviation and tourism industries are examined, inter alia, by means of establishing an independent wholesale tourism company, merger with a tourism company or acquisition of an existing tourism company/ tourism wholesale company. The focus on this area will enable to provide the customer with the missing link in the chain of value, while supplementing aviation-related tourism products. For details regarding negotiations to examine the possibility of a merger between Israir Airlines & Tourism Ltd. and Sun d'Or, see Section 9.7.2(A) above.

f. Adjustment of production means to the environment of demand and to the profitability of the routes, by adapting a more efficient capacity and configuration, aiming to achieve optimization of the network of routes.

g. Continued improvement of customer service, while providing an appropriate response to different populations and offering various services to customers, as well as a significant product upgrade, with an emphasis on the luxury classes and on improving its suitability to the needs of the business customer and taking customer conservation actions, both upon booking seats and during the flight.

h. Continued cost savings and efficiency trend - the Company implements an internal organizational program, which includes identification of financial savings resources within the various areas of the Company's operations and a follow up of the actual implementation of savings so identified, increase of income and the continuing of the Company's general efficiency process, in particular in the areas of logistics and procurement, sales costs, efficiency of operation of air and ground crews and maintenance management. The Company continues to examine the business structure appropriate for different operations in order to achieve process efficiency and value overflow for the Company, inter alia, by the possibility to act as a separate legal entity in independent and unique areas of operations, such as the Frequent Flyer Club.

i. A. Continued implementation of technological systems, including technological systems in the field of commerce; improvement of the Company's website and increase of the direct sale and the Company's additional sales channels. In 2016, the Company continued the installation of an in-flight communications system (streaming) in the Company's aircraft. The system includes an in-flight entertainment service, and in 2017 the Company is expected to install the service in additional aircraft.

j. Continued comprehensive treatment in the field of security and environment, including hazards such as air pollution and noise, and placing itself under continued scrutiny.

k. Investment in the field of corporate responsibility and community relations as well as continued extensive cooperation with various entities by contributing to the community and to the environment as well as continued cultivation of the human resource and excellence within the Company.

l. Continued implementation of the internal enforcement program in the field of securities and corporate law as well as an internal enforcement program in the field of antitrust, both aiming to ensure compliance with and enforcement of law-abiding norms, and other rules of conduct within the Company, its officers and employees, and to ensure compliance of the Company and its individuals with these rules.

m. Continued investment in human resources, inter alia, through the expansion of training activities to all the Company's employees and formation of training courses in the field of management, designed for the Company's mid-level executives. The Company also continued the implementation of employees' remuneration and incentives. In this regard, it shall be noted that in 2016 the Company continued to develop results-based measuring and incentive programs, and currently 20% of the Company's employees are affected by such measuring and incentive programs.

The manner of implementation of the business strategy presented above and the results expected from the implementation thereof, are forward-looking information, as defined in the Securities Law, based on the Company's assumptions, estimates and predictions regarding its business operations environment, which may change, all or part thereof, from time to time, and thus affect the possibility of its implementation. Therefore, the actual results, in whole or in part, may not materialize, or only partially materialized or be materially different from the results estimated, derived or implied from such information, inter alia, for the reasons detailed below, given that as of the Report Date, there is no certainty as to the form of such actions or the ability to execute them, inter alia, due to the need for various regulatory approvals.

The implementation of the strategic targets may be affected by changes in the geopolitical, economic and security situation in the area, which may have impact both on the ability to operate flights to certain destinations and on jet fuel prices, which constitutes a major component of the Company's expenses. Further, the implementation of the strategy objectives may be contingent upon the existence of appropriate financial resources for the realization of decisions on development and equipment. In addition, regulatory provisions, maintaining working relationships within the Company, aggravation of competition and changes in the network of routes and in the aircraft fleet, may affect the ability to execute the strategic objectives.

9.16 **Expected development in the coming year**

As a member of the global aviation industry, the Company faces exogenous financial factors which include, inter alia, the slowdown in the pace of global growth, crisis in the Euro Bloc, jet fuel prices, currency and/or interest rates as well as the geopolitical situation in the area.

In 2017, the Company is expected to continue to deal with an increase in competition, including an increase in the supply of flights offered by existing airlines and the entering of new airlines, including Cathay Pacific, which is expected to operate 4 weekly flights as of the end of March 2017 on the Tel Aviv - Hong Kong route, as well as with a growth in low cost operations on routes to and from Israel. The Company will continue to examine on a regular basis the adaptation of its operations to the trends and developments evolving in the business-economic environment of the company and in the global aviation industry. Such trends and changes require a thorough and continuous examination of the Company's operations, including the composition and profitability of the Company's network of routes with respect to passengers and cargo, the launch of new routes, and the adaptation of flight schedules and fares in accordance with the market and competition situation.

Additionally, the Company intends to continue to examine to develop additional income sources, including income sources to supplement the Company's flight operations as described in Section 9.15 above, among others, by entering the field of consumer credit in favor of the Club members by means of cooperation with a financial body, and entering the credit market through a partnership with a credit card company.

Implementation of the Company's objectives shall be done by paying attention, inter alia, to the method of implementing the Company's Wide-Body Acquisition Program and coping ability, its preparation for the intensifying competition and the strive towards improving the business results in 2017, that, by improving the income mix, improving the return, implementing organizational efficiency procedures and cutting costs.

The information regarding expected development in the coming year, is a forward-looking information, as defined in the Securities Law. Such information is based, inter alia, on the Company's estimates, forecasts or intentions as of the Report Date. Therefore, developments during the coming year, all or part thereof, may be materially different from the developments estimated, derived or implied from this knowledge, as a result of numerous factors, including factors set out in Section 9.15 above and Risk Factors set forth in Section 9.18 below.

9.17 **Financial information regarding segment reporting**

For details regarding segment reporting, see Note 20 to the Financial Statements.

9.18 **Discussion of risk factors**

Like other airline companies, the Company's operations is affected by external and internal factors liable to cause material changes (positive or negative) to its profitability. Risk factors may be divided into macro risks, segmental risks and risks that are unique to the Company. The main risk factors are set forth below:

Macro risks

9.18.1 Political or security events or terrorist activity

Political or security events or terror attacks in the world or in the area have an immediate impact, to the worst, on the demand for passenger and cargo transport, thus affecting jet fuel prices and the Company's economic situation and volume of operations. The risk is that the Company's revenues will be adversely affected as a result of security and geopolitical events, in Israel or in the country of destination.

9.18.2 Exposure to currency risks

The majority of the Company's income and expenses is in foreign currency or linked thereto (mainly US Dollars). The Company is exposed to the increase in the shekel value against the US Dollar in connection with current salary expenses and other liabilities denominated in NIS in the Company's balance sheet, mainly in respect of termination of employer-employee relationship and a provision for vacation. The appreciation of the NIS against the US Dollar increases the Company's current expenses and further increases, in US Dollar terms (with no impact on the cash flow), in the Company's liabilities due to termination of employer-employee relationship.

In addition, there is a natural internal protection for other foreign currencies (British, Euro, Rand, etc.), which is performed by comparing payments and receipts in each currency. Since the volume of receipts is higher than the volume of payments in foreign currencies, the Company is exposed to these currencies (mainly against the Euro). Therefore, the Company is examining the need to invest in derivative financial instruments to reduce the exposure created.

For details regarding the actions taken by the Company to hedge against exposure to currency risks, see Section B1 of the Board of Director's Report and see Note 18 to the Financial Statements.

9.18.3 Changes in the economic situation

The aviation and tourism sectors are sensitive to changes in economic activity that affect the demand for passenger and cargo transport. The structure of expenses in the aviation industry, which includes a high component of fixed costs, makes it difficult to implement the process of adjusting the Company's supply to the changes in the short-term demand. During periods of slowdown in the economic activity, for various reasons, the demand for air transport is reduced, excess capacity is created, and employees and flight equipment are not fully exploited. As a result, the Company's economic condition may deteriorate, as reflected in the Company's business results.

9.18.4 Outbreaks of epidemics and natural disasters

External factors, such as natural hazards, fire and earthquakes, epidemics etc., may cause harm to the continuity of the Company's operations. Furthermore, the outbreak of epidemics and natural disasters have an adverse effect on passenger traffic to the disasters areas and therefore may have a negative impact on the Company's business results.

9.18.5 Exposure to variable interest rates

The Company finances most of its investments by means of long-term credit provided by banking institutions. The Company's loans and most of its deposits are in US Dollars. Some of the Company's loans bear variable interest and therefore, changes in interest rates may have an impact on the Company's financing expenses and cash flow. In order to reduce the exposure to said risk factor, part of the loans taken by the Company are fixed-interest loans. For details regarding the actions taken by the Company to protect itself from the exposure to variable interest rates, see Section B1 of the Board of Director’s Report. For additional details, see Note 18 of the Financial Statements.

Industry risks

9.18.6 Jet fuel prices

Jet fuel is a significant component in the operating expenses of an air carrier. Jet fuel prices are subject to sharp fluctuations. The Company's profitability may be materially affected due to a change or substantial fluctuations in jet fuel prices. The Company takes actions to hedge part of the forecasted jet fuel consumption. This policy may change, depending on the circumstances. The Company has cash flow exposure due to the requirement to provide pledged deposits. As a result of the large share of jet fuel in the operating expenses of the Company, any increase in jet fuel prices adversely affects the Company's operating expenses and its business results. For details, see Section 9.5.1 above. For details regarding the hedging policy and the actions taken by the Company to protect against changes in jet fuel prices, see Section B1(3) of the Board of Director’s Report and Note 18 to the Financial Statements.

9.18.7 Changes in competition

The aviation sector is characterized by a high level of competition, which intensifies in times of excess capacity. The entry of other airline companies into the market, including the entry of additional scheduled foreign carriers into the Israeli market or the capacity growth of existing foreign carriers, the entrance of additional Israeli carriers into the market as well as the appointment of other Israeli carriers as designated air carriers (in the field of passengers and cargo), the entry of additional charter airlines and low-cost airlines into the market and the provision of operation certificates to additional Israeli airlines in the field of passengers and cargo, lead to aggravation of competition in the aviation industry in Israel, thus creating excess capacity and decrease in the price level of passenger and cargo transportation, and may reduce the Company's share of operations in the industry and adversely affect the Company's business results. This trend of increased competition has intensified in recent years, upon the entry of new airlines and the increase in capacity and frequency of airlines operating in the Israeli market (for details see Section 7.1.10 and 7.8.3 above), as well as an increase in the market share of low-cost airlines, which had an adverse impact on the old airlines with a higher production cost structure. Special emphasize should be given to the increase in the activity of foreign airlines that are members of the three largest airline alliances in the world, which operate in the Israeli market with operational and commercial cooperation, based on non-Israeli regulation (including competition laws applicable in Europe) which allows them to enter into code share agreements, mergers and acquisitions and significant commercial joint ventures. In addition, changes in international agreements, including the aviation agreement between Israel and the EU (the Open Sky Agreement), might affect the Company's operations.

9.18.8 Effect of seasonality

The Company's operations is seasonal in nature and focuses on peak periods (see Section 7.9 above). Tourist traffic, mainly in summer seasons and towards the holidays (Jewish and Christian) is higher than the annual average. Additionally, the cargo transport segment is also characterized by seasonal fluctuations (for details see Section 8.8 above). Since the component of capital and fixed costs is significant in relation to the total costs of the Company, any disruption to the operations during high season (e.g. due to political and security events) or the inability to obtain alternative aircraft, even in a relatively short term, may have a material adverse effect on the financial results of that year

9.18.9 Government decisions regarding aviation and licensing of the Company as an air carrier

a. A change in the Government policy regarding the appointment to appoint the Company as a designated carrier with respect to all or part of the routes on which the Company currently serves as a designated carrier, may affect the financial results of the Company. Additionally, the Company's operations is contingent upon obtaining a license from the regulator in the aviation field (e.g. Air Operation Certificate and Repair Station Certificate), whose terms are determined in accordance with the provisions of the law and regulations and supervised by the CAAI and therefore, may affect the position of the Company and its ability to carry out its assignments and even adversely affect its financial results.

b. The Company's air carrier operating licenses and the traffic rights granted to it are contingent on having the substantial ownership and effective control held in the hands of Israelis. Failure to comply with the provisions relating to the identity of the Company's shareholders may damage the operating licenses of the Company and the traffic rights granted to it by the State.

9.18.10 Activity in an industry in which the fixed cost structure is high

The Company operates in the aviation field where the structure of fixed costs is relatively high and the profitability margins are relatively low. Therefore, even moderate changes in the level of income or expenses may directly affect the existence of profit or loss.

9.18.11 Noise and environmental restrictions on the execution of flights

Any change in the restrictions on operating hours at Ben Gurion Airport or other airports to or from which the Company operates, and any additional restriction or prohibition on the operation of aircraft due to pollution, noise or other causes, may have a material impact on the manner of operation of the Company and accordingly, on its financial results.

9.18.12 Damage to flight safety or flight security

9.18.12.1 In order to ensure flight security, the Company maintains security arrangements in accordance with the instructions of the competent government authority. In order to ensure flight safety, the Company complies with guidelines and instructions of the relevant authorities, including manufacturer's instructions and the CAAI guidelines. Damage to the Company's flights and/or customers and/or facilities and/or employees, as a result of a flight security event or flight safety failure, may have a significant adverse effect on the Company's activity, inter alia, due to damage to reputation, loss of income and customers and the Company's exposure to legal claims.

9.18.12.2 During 2016, the Company completed the implementation of the IATA safety standards audit, known as IOSA - IATA Operational Safety Audit. During the year 2016, the Company successfully passed the IOSA audit and requirements, and accordingly, the Company's safety certification was renewed for another two years (until October 2018). For further details, see Section 11.9.10 above.

9.18.13 Aviation regulation

The Company's operations and its ability to expand the scope and layout of operations, depend, inter alia, on different regulatory approvals granted by authorities in Israel and worldwide. Lack of appropriate certification and failure to comply with international and local standards may incur an increase in the Company's expenses, competitive disadvantage vis-a-vis the Company's competitors and damage to the continuity of its operations.

For details regarding regulatory arrangements, see Section 9.11.2 below.

Risks unique to the Company

9.18.14 Flight security costs

In 2013, an updated Government Regulation was adopted, whereby the State funds the majority (97.5 %) of Israeli airlines' security expenses. Changes in the percentage of State participation in the Company's security expenses, non-compliance with said Government Resolution in full, changes in the scope of safety measures the Company will use (due to security events or attempted terrorist attacks) as well as in the event the Company is forced to cease or limit its flights to a certain destination or is unable to expand its operations to additional destinations for security reasons, may have a material effect on the financial results of the Company.

9.18.15 Work relations

Any interruption in activity due to sanctions or strike in an air carrier causes loss of income and damage to customer confidence. The situation in the industry and the growing competition in the industry require ongoing efforts to streamline the Company and improve service to the customers. These are contingent on stable relations in the Company, on the employees' identification with the Company and on the willingness to cooperate and understand with the management.

It is not inconceivable that efficiency measures that include structural changes, a reduction in the number of employees (with an emphasis on permanent employees) and a reduction in salary costs will cause a shock, even if for a short period of time, in the delicate fabric of labor relations in the Company, which may cause damage in the immediate term and harm in the longer term to the Company’s reputation, and may have a material adverse effect on the business results for that year and thereafter. In addition, it may be difficult to exploit business opportunities and cope with changes due to restrictions in labor agreements. For details of the employment relations between the Company's management and the pilots sector, see Section 9.4.6 above.

9.18.16 Restrictions on receipt of credit

The Company has commitments to some of the long-term credit providers to maintain an appropriate collateral ratio between the outstanding credit balance and the collateral pledged to the Bank. Additionally, loan agreements for loans taken by the Company provides the bank with the right to call for immediate repayment of the balance of the loans provided by that bank if, in the opinion of the bank, based on reasonable criteria, an adverse change in the financial condition of the Company, its operations or business has occurred in a manner that endangers or may endanger the ability to repay the credit to the bank. A decrease in the market value of the collateral and/or call for immediate repayment of the Company's loans provided by banking institutions, may adversely affect the financial results of the Company. In addition, some of the loan agreements taken by the Company include the right to demand immediate repayment of the balance of the loan to the same bank upon the occurrence of certain events, such as the execution of a merger or the transfer of control in the Company.

Antitrust

In light of the Israeli Antitrust Laws, including the need for a prior approval of the Antitrust General Director for certain agreements, the competitiveness of Israeli carriers, the Company included, may be harmed, and it may have an adverse effect on the financial results of the Company due to regulatory restrictions on of international agreements within the areas of the Company's operations or the non-approval of such agreements (existing or new) by the Antitrust Authority. The differences between the antitrust laws applicable in Israel and the antitrust laws applicable worldwide may affect the competitiveness capacity of Israeli airlines, particularly in view of mergers, acquisitions and airline alliances which are common in the global aviation industry.

For further details regarding the effect of antitrust laws on the Company's operations, including the issue of a monopoly, see Section 9.11.2 above.

9.18.17 Legal proceedings

The Company is a party to legal proceedings, including actions which the court has been requested to recognize as class actions in Israel, as a result of which the Company may incur considerable amounts of money that cannot always be estimated, and in respect of which no provision has been made in the Company's Financial Statements on a regular basis. The outcome of these proceedings may have a material impact on the Company following their consequences. For details, including regarding tax assessments received at the Company’s offices, see Section 9.14 below.

9.18.18 Limitations due to certain provisions in the Special State Share

Restrictions related to maintaining minimum flight capacity, and the State's ability to demand an increase of the minimum flight capacity that the Company must maintain, reduce operational flexibility and impose heavy duties (competence assurance) with respect to essential assets, as defined in the Company's articles of association. The indemnification under these circumstances does not cover all of the Company's expenses. In addition, by virtue of the State's authority under the Government Companies Law, the Government Companies Order (Declaration of a Vital Interest of the State of Israel in El Al Israel Airlines Ltd.), 5765-2004 was published in 2004, which states that the State has a vital interest in connection with the Company as described in Section 9.11.3 above.

9.18.19 Dependence on supplier

All aircraft in the Company's possession are manufactured by Boeing. The suspension of Boeing's operations will cause temporary operational difficulties. The Company is materially dependent on Boeing for both spare parts and for engineering support.

The 777 aircraft fleet owned by the Company and the 787 aircraft, which are scheduled to be delivered to the Company during the years 2017-2020, are equipped with Rolls-Royce engines. The Company has a significant dependence on the engine manufacturer in terms of current maintenance and supply of spare parts for engines.

The Company's computerized system for booking, flight management and inspection is the Amadeus system. Amadeus's unilateral cessation of operations in violation of the agreement would result in temporary operational difficulties. The Company is materially dependent on Amadeus both for the execution of orders and for the management of the seat inventory on its flights.

9.18.20 Dependence on routine activity at the home port (Ben-Gurion Airport)

Most of the Company's activities are carried out at its base airport, Ben Gurion International Airport. Therefore, any interruption or disruption of the routine activity at Ben Gurion Airport and/or changes in the policy for grant of takeoff and landing permits at major airports where the Company operates, may have a material adverse effect on the Company's operations. For details regarding the decision of the Minister of Transport and Road Safety dated January 21, 2014, see Section 9.10.2 of the Company's 2014 Periodic Report.

Another significant change in the operating hours at Ben-Gurion Airport may have a material effect on the Company's operational ability and its financial results.

9.18.21 Flights on Sabbath and Jewish holidays

The Company does not carry out flights on the Sabbath and Jewish Holydays. For details regarding the understanding reached between the Company and the representatives of the Rabbinical Committee for the Sanctity of Sabbath, see Section 10.7 above. Failure to comply with the understandings reached with respect to flights on the Sabbath and Jewish Holydays, or a change in the Company's policy on this subject, may result in a conflict with this sector of customers, which is liable to affect the Company's results due to a consumer boycott.

9.18.22 Information systems and information security

The Company's ongoing operations, business operations and the service it provides are based on information systems and databases. Some of the Company's information systems at the end of their life cycle are not included in the Company's work plan for replacement. The Company has completed the construction of a computer backup facility in case of total failure in the main computer room. In addition, the Company is preparing a comprehensive plan for information security in response to an increase in the risk of cyber-attacks. Until completion of the preparations in the aforementioned areas, there is a risk of malfunctions and disruptions in the Company's information systems operations, which may lead to the disabling of critical systems or the lack of sufficient support for them for certain periods of time.

The following table presents a segmentation of the risk factors described above, by nature (macro risks, segmental risks and risks unique to the Company), which were classified based on the estimates of the Company's management according to the scope of their impact on the Company's business as a whole – major, moderate or minor effect. The Company's estimate of the risk rating was determined while taking into consideration the probability of the occurrence of the event and the amount of damage that might be caused to the Company upon occurrence of the event.

	Degree of effect of the risk factor on activity on the Group		
	Major effect	**Moderate effect**	**Minor effect**
Macro risks			
Political, security or terrorist activities	V		
Exposure to currency risks		V	
Changes in the economic situation		V	
Natural forces and outbreaks of epidemics		V	
Exposure to variable interest rates			V
Industry risks			
Jet fuel prices	V		
Changes in competition	V		
Effect of seasonality		V	
Government decisions regarding aviation and licensing the Company as an air carrier	V		
Activity in an industry in which the fixed cost structure is high		V	
Noise restrictions and environmental protection		V	
Damage to flight safety or flight security	V		
Aviation regulation		V	
Risks unique to the Company			
	Major effect	**Moderate effect**	**Minor effect**
Flight security costs		V	
Work relations	V		
Restrictions on receipt of credit		V	
Antitrust	V		
Municipal status of Ben Gurion Airport			V
Legal proceedings	V		
Restrictions due to the provisions of the Special State Share			V
Dependence on supplier		V	
Dependence on regular activity at the home port (Ben-Gurion Airport)			V
Flights on Shabbat and Israel Holidays			V
Information systems and information security		V	

El Al Israel Airlines Ltd.

Board of Director's Report on the State of the Corporation's Affairs For the year ending December 31, 2016

a. Explanations of the Board of Directors on the State of the Corporation's Business:

a1. General and key data

We are pleased to submit the Board of Director's Report on the State of the Corporation's Affairs for the year ending December 31, 2016.

The Company serves as the leading air carrier of the State of Israel in most of the international routes operating to and from Israel. The Company's main operations involve the transport of passengers and cargo, including baggage and mail, on (mostly) regular flights and on chartered flights between Israel and foreign countries.

In addition, the Company is engaged in providing maintenance services at its hub airport, in the sale of duty-free products, and through affiliates in related activities, which primarily involve the production and supply of food for airlines and the management of a number of travel agencies overseas. For information regarding the Group's sectors of activity, see Note 20 of the Company's financial statements.

The business environment in which the Company operates is the international and civil aviation and tourism industry to and from Israel, which is characterized by seasonality and a high level of competition, intensifying during periods of excess capacity and high sensitivity to the economic, political and security situation in the country and the world.

Key date for the year-long period ending December 31 (in millions of dollars):

	2016	2015	Change
Operating revenues	2,038	2,054	(1%)
Operating expenses	(1,642)	(1,593)	3%
Gross profit	396	461	(14%)
EBITDA	287	331	(13%)
Profit before taxes on income	93	145	(35%)
Profit for the year	81	107	(24%)

a2. Review of the developments in the business environment and operational metrics

a2.1 Review of the business environment in which the Company operates

For the year ending December 31:

Traffic at Ben Gurion Airport:

The following charts describe the developments of the traffic at Ben Gurion Airport of both passengers and cargo, divided by inbound tourism and outbound residents, and regarding the cargo, divided by imports and exports. In 2016, the trend of growth in passenger traffic at Ben Gurion Airport continued, mainly due to the continued upward trend in the movement of Israelis traveling abroad, accompanied, this year, by an increase in the number of tourists entering Israel as well - occurring mainly in the last quarter of the year, and representing a change in trend compared to previous years. In the field of cargo, as well, there has been an increase in the scope of imports and exports.

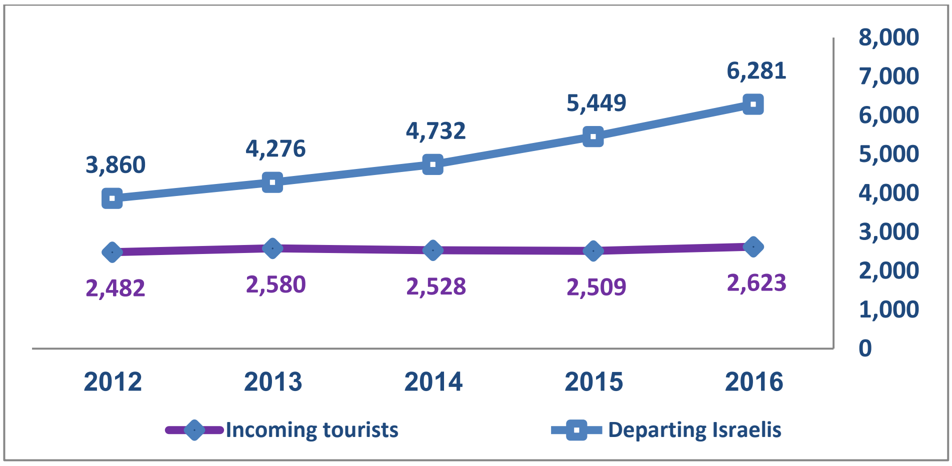
Cargo and passenger traffic at Ben Gurion Airport:

	2016	2015	Change	
	Thousands		Thousands	%
Incoming tourists *	2,623	2,509	114	5%
Departing Israelis *	6,281	5,449	832	15%
Cargo import - tons **	170.6	154.1	16.4	11%
Cargo export - tons **	139.9	134.2	5.7	4%

*Source: the Central Bureau of Statistics.

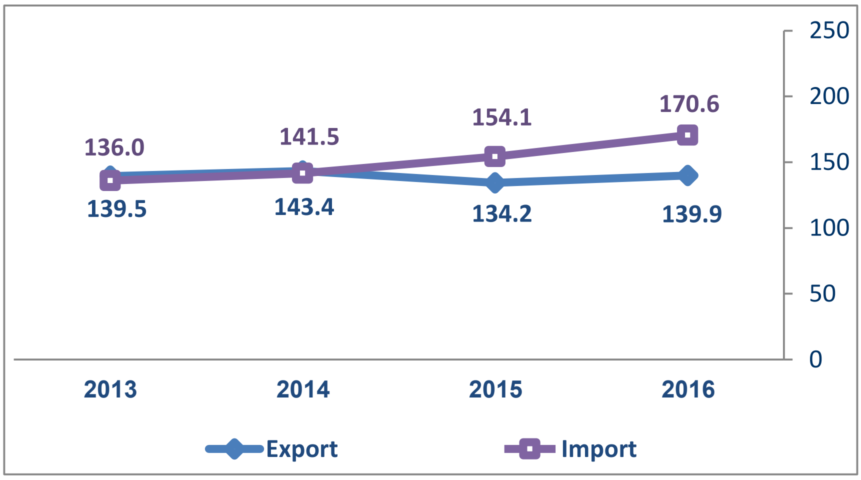
** Not including cargo in transit.

Traffic of tourism inbound to Israel and outbound residents (in thousands):



*Source: the Central Bureau of Statistics

Imports and exports of cargo by air to and from Israel (in thousands of tons):

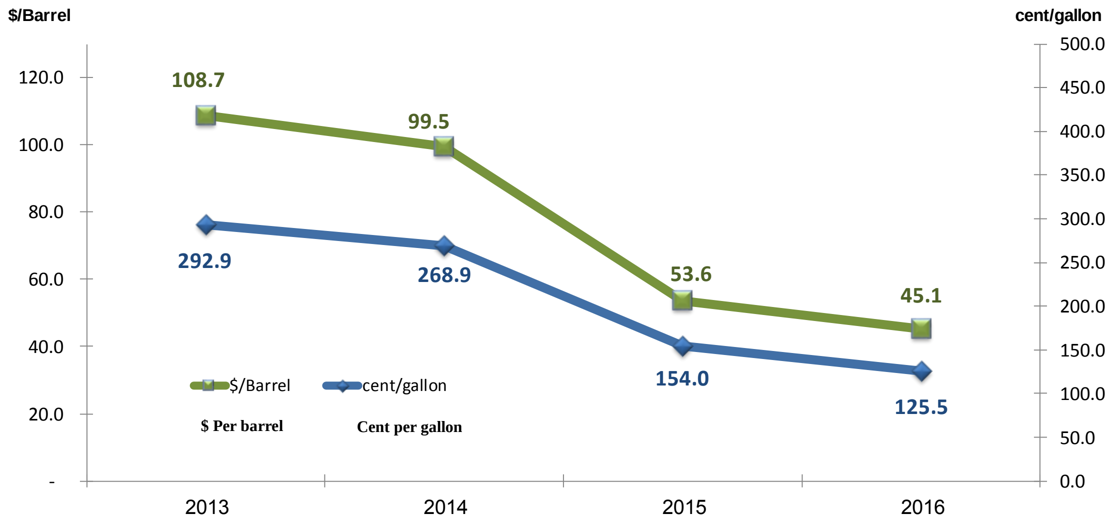


* Source: Airport Authority

Jet fuel:

In 2016, the trend of decline in jet fuel prices continued compared to the prices prevailing in 2015; however, the rate of decline slowed significantly, as can be seen in the figure below. Regarding the development of jet fuel prices after the date of the Statement of Financial Position, see Part E below.

Development of the average jet fuel and crude oil prices in the market:



For a period of three months ending on December 31

	2016	2015	Change	
	Thousands		Thousands	%
Incoming tourists *	718	621	97	16%
Departing Israelis *	1,367	1,084	283	26%
Cargo import - tons **	44.2	39.9	4.3	11%
Cargo export - tons **	36.2	34.5	1.7	5%

a2.2 The Company's operating metrics and market shares

For the year ending December 31:

	2016	2015	Change
Passenger leg (scheduled and chartered) - in thousands	5,513	4,981	10.7%
RPK (scheduled) - in millions	21,068	19,898	5.9%
ASK (scheduled) - in millions	25,072	23,883	5.0%
Load factor (scheduled)	84.0%	83.3%	0.9%
The Company's market share (scheduled and chartered)	32.6%	32.5%	0.2%
Flown cargo, in thousand tons	91.6	91.7	(0.1%)
Revenue tons kilometers (RTK) - in millions	477.2	487.4	(2.1%)
Weighted flying hours (including leased equipment) - in thousands *	180.7	171.9	5.1%
Average revenue per RPK - in cents**	8.2	8.6	(5.0%)
Aircraft in operation - end of period - number of units	43	41	2
Average age of owned fleet at the end of the period - in years	12.6	13.1	(0.5)

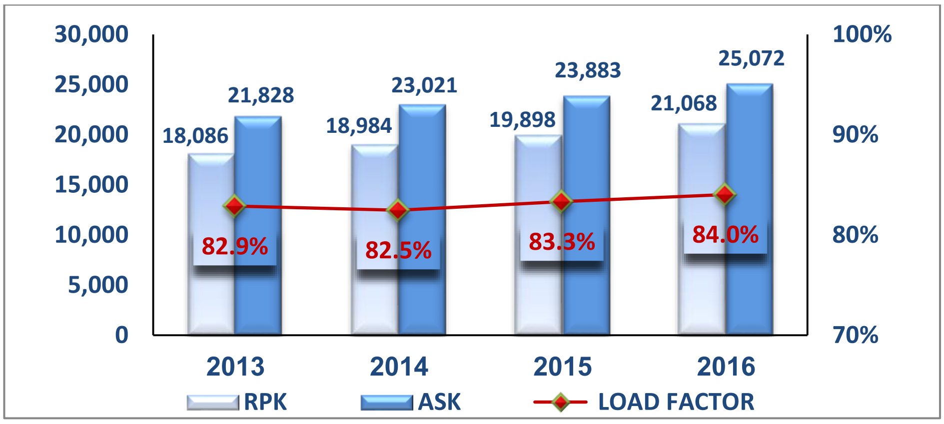
* Weighted flight hours in terms of the Boeing 767.

** Passenger revenue and related revenue for regular flights and net changes in foreign exchange rates.

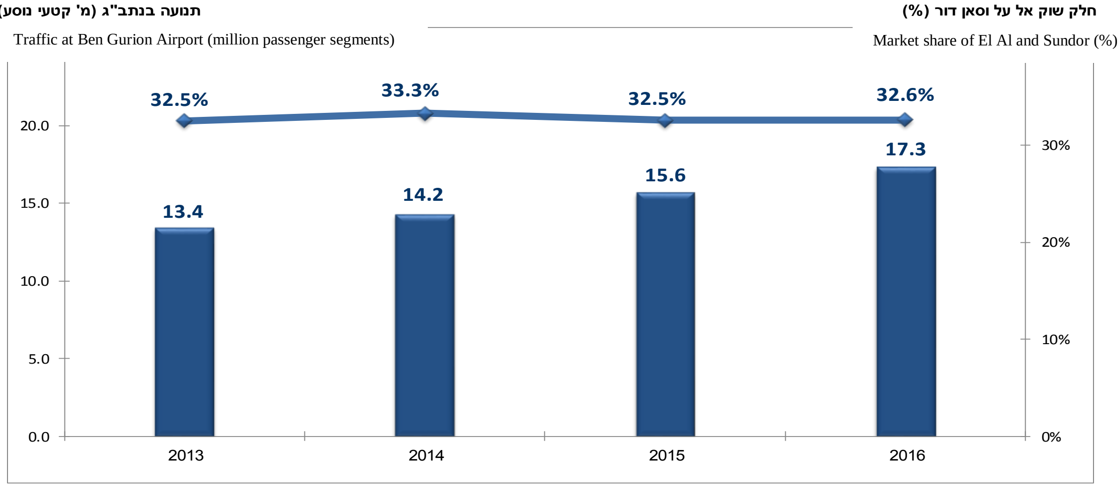
The data indicates a significant growth in the passenger segments flown by the Company and the passenger-KM flown (RPK), leading the occupancy rate to also grow by 0.9% compared to the previous year, despite a significant rise in the Company's supply of seats (ASK).

In addition, the data above indicates that the Company's market share was preserved, compared to the previous year, in a market that increased significantly as a result of the significant increase in traffic at Ben Gurion Airport.

Operational metrics (in millions)



Traffic at Ben Gurion Airport and the market share of El Al and Sundor



* Source: Airport Authority

Legend:

Passenger segment - one-way flight voucher.

RPK - Revenue Passenger Kilometer - the number of paying passengers multiplied by the airborne distance.

ASK - Available Seat Kilometer - the number of seats offered for sale multiplied by the airborne distance.

RTK - Revenue Ton Kilometer - the weight in tons of the aircraft cargo for payment, multiplied by airborne distance.

Passenger Load Factor (passenger occupancy) - passenger-KM traveled, expressed as a percentage of the available seats-km.

Weighted flight hours - the weighting value of the planes: Boeing 767 = 1.00; Boeing 747 = 2.00; Boeing 777 = 1.6; Boeing 737 = 0.6. These weighting values were determined based on the estimated total expenditure of each aircraft type and are consistently used to calculate the weighted time of flight as an indicator of the volume of aviation activity.

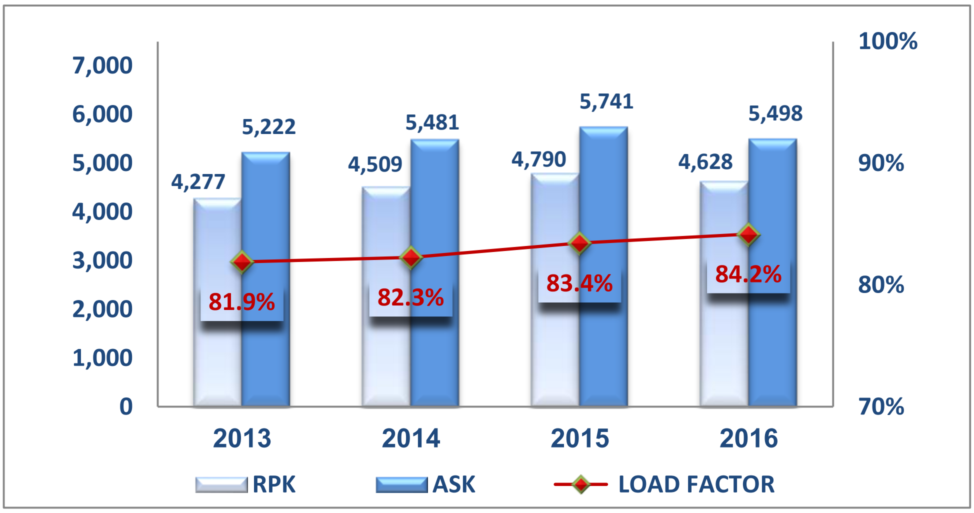
For a period of three months ending on December 31:

	2016	2015	Change
Passenger leg (scheduled and chartered) - in thousands	1,196	1,151	3.9%
RPK (scheduled) - in millions	4,628	4,790	(3.4%)
ASK (scheduled) - in millions	5,498	5,741	(4.2%)
Load factor (scheduled)	84.2%	83.4%	0.9%
The Company's market share (scheduled and chartered)	29.9%	33.9%	(11.9%)
Flown cargo, in thousand tons	21.4	22.8	(6.2%)
Revenue tons kilometers (RTK) - in millions	111.8	122.2	(8.5%)
Weighted flying hours (including leased equipment) - in thousands *	39.7	41.6	(4.5%)
Average revenue per RPK - in cents**	8.4	8.3	0.8%

* Weighted flight hours in terms of the Boeing 767.

** Passenger revenue and related revenue for regular flights and net changes in foreign exchange rates.

During the three months that ended December 31, 2016, we can see that the Company's operational metrics decreased compared to last year, despite the significant increase in activity in the annual comparison; this is primarily due to disruptions in the Company's operations as a result of action taken by the Company's pilots, as discussed in Note 14.l. to the financial statements, which resulted, *inter alia*, in cancellations and disruption of flights.



a3. Analysis of the business results of the Company

Presented below are the Company's income statements, including the turnover rate and the rate of change compared to last year. Also presented are the explanations and the main trends affecting the Company's results in 2016, compared to the previous year.

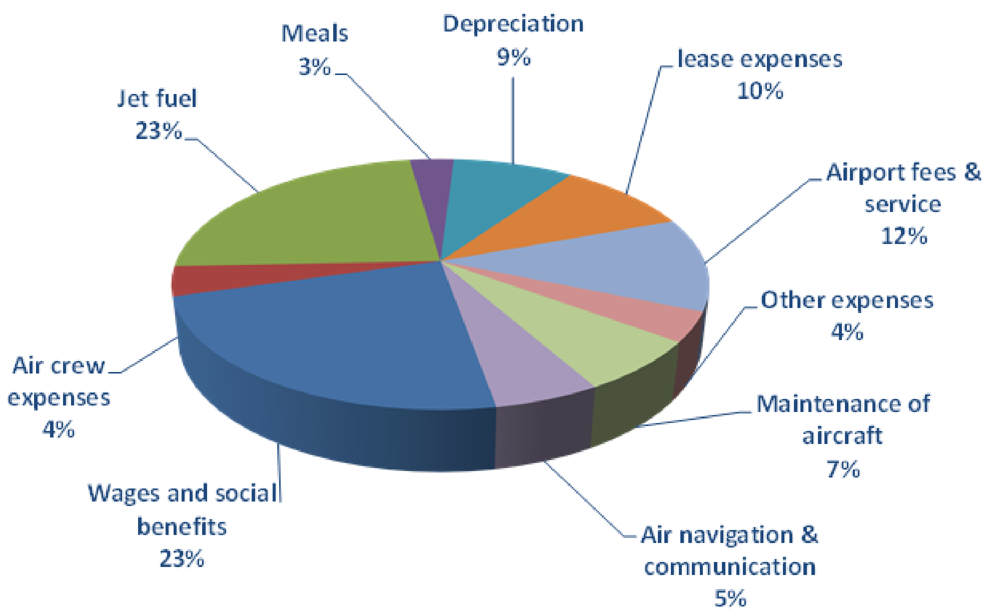
For the year ending December 31:

	2016		2015		Change	
	USD thousands	% of turnover	USD thousands	% of turnover	USD thousands	%
Operating income	2,038,428	100%	2,054,041	100%	(15,613)	(0.8%)
Operating expenses	(1,642,417)	(80.6%)	(1,592,844)	(77.5%)	(49,573)	3.1%
Gross profit	396,011	19.4%	461,197	22.5%	(65,186)	(14.1%)
Sale expenses	(192,565)	(9.4%)	(194,911)	(9.5%)	2,346	(1.2%)
Management and general expenses	(94,799)	(4.7%)	(93,237)	(4.5%)	(1,562)	1.7%
Other net income (expenses)	1,959	0.1%	(3,282)	(0.2%)	5,241	
Profit from ordinary activity	110,606	5.4%	169,767	8.3%	(59,161)	(34.8%)
Net financing expenses	(23,127)		(26,533)		3,406	
The Company's share of the profits of associated companies and revaluation of options for them	5,981		1,357		4,624	
Profit before income tax	93,460		144,591		(51,131)	
Income tax	(12,766)		(38,057)		25,291	
Profit for the year	80,694		106,534		(25,840)	

Operating income - Operating income decreased in 2016 by USD 16 million (0.8%) compared to 2015. Revenue from passenger flights increased by 0.1% while revenue from cargo decreased. The income from passenger flights was affected by two opposite trends - on the one hand, the continued trend of decrease in the prices of plane tickets due to the increased competition and the impact of the decrease in fuel prices, and on the other hand, a substantial increase in the number of passengers flown by the Company and the number of passenger-km (RPK) due to increased activity. In addition, the Company's income from passengers was detrimentally impacted following the erosion of the exchange rate of currencies in which some of the Company's sale transactions are performed, compared to the dollar. In addition, passenger revenues in 2016 were hurt by disruptions in the crewing of the Company's flights, which resulted from a crisis involving the pilots (and continued intermittently throughout the year) as detailed in Note 14.l. to the financial Statements. The Company's revenue from cargo decreased by 11.4%, mainly due to a decrease in yield per ton-km and a decrease in the number ton-kilometers (RTK) flown, on account of increased competition.

Operating expenses - The operating expenses increased in 2016 by USD 50 million (about 3.1%) compared to 2015, after savings of USD 95 million in aviation fuel expenses as explained below. The gross increase of about USD 145 million stems primarily from an increase in activity, increases in wages and increases in leasing costs on account of disruptions in the crewing of flights arising from the crisis with the pilots and the need to find alternative solutions in connection therewith, primarily the wet lease of aircraft (lease of an aircraft and its crew), and an increase in depreciation expenses arising mainly from an increase in the deployment of the Company's aircraft and a change to the estimate of the residual value of the 777 aircraft, as explained in Note 2.a.9 of the financial statements.

Distribution of operating expenses for the year 2016



Jet fuel expenses:

The Company's jet fuel expenses, including the impact of hedging, declined by USD 94.7 million (about 20%) compared to expenses in 2015 as a result of a decrease in jet fuel prices, which was partially offset by an increase in aviation fuel consumed due to increased volume of activity of the Company.

The table below reflects the impact of the jet fuel expenses on the Company's results, including the impact of hedging transactions (in USD millions):

	2016	2015	Difference
	USD millions		
Jet fuel expenses for the period (before the effect of hedging)	354.0	409.4	(55.4)
Impact of hedging transactions on the income statement	32.0	71.3	(39.3)
Total jet fuel expenses (including the impact of hedging)	386.0	480.7	(94.7)

For additional details regarding the hedging of the jet fuel prices, see Section b1(3) below. For additional details for the impact of the derivatives on the financial statements, see Note 18 of the financial statements.

Sales expenses - Sales expenses decreased by USD 2.3 million (about 1.2%) compared to 2015, primarily due to the reduction in distribution costs.

General and administrative expenses - General and administrative expenses increased by USD 1.6 million (about 1.7%) compared with 2015, mainly due to an increase in professional services and allocations for legal claims.

Other Income (Expenses) - The improvement in results, amounting to USD 5.2 million, is mainly attributable to capital gains from the sale of a 737-700 model aircraft and the sale of the Company's holding in Holiday Lines, which were recognized during 2016, compared to expenses for an early retirement program recognized in 2015.

Financing expenses - The net financing expenses amounted to USD 23.1 million compared to USD 26.5 million in 2015. The decrease is mainly due to a one-time payment of commission in 2015 and a decrease in the exchange in 2016 compared to 2015.

Income taxes - The income taxes in the reported year amounted to USD 12.8 million, compared to about USD 38.1 million in 2015. The decrease is due to the decrease in income before income taxes and the effect of the decrease in the corporate tax rate on deferred taxes (a benefit of USD 11 million).

Profit for the period - The profit before tax in 2016 amounted to about USD 93.5 million, and profit after tax, some USD 80.7 million (constituting about 4.0% of the turnover) compared to profit before tax of about USD 144.6 million in 2015, and profit after tax of about USD 106.5

million (about 5.2% of the turnover). The change in profit is attributed primarily to the increase in operating expenses, for the reasons listed above, which was accompanied by a certain decrease in the turnover. It should be noted that said impacts on the Company's profit after taxes were moderated as a result of the tax break associated with the change in the corporate tax rate, as stated above.

For a period of three months ending on December 31:

	2016		2015		Change	
	USD thousands	**% of turnover**	**USD thousands**	**% of turnover**	**USD thousands**	**%**
Operating income	460,774	100%	476,290	100%	(15,516)	(3.3%)
Operating expenses	(396,270)	(86.0%)	(379,079)	(79.6%)	(17,191)	4.5%
Gross profit	64,504	14.0%	97,211	20.4%	(32,707)	(33.6%)
Sale expenses	(46,300)	(10.0%)	(49,886)	(10.5%)	3,586	(7.2%)
Management and general expenses	(26,884)	(5.8%)	(25,371)	(5.3%)	(1,513)	6.0%
Other income, net	1,123	0.2%	1,663	0.3%	(540)	(32.5%)
Profit (loss) from ordinary activity	(7,557)	(1.6%)	23,617	5.0%	(31,174)	
Net financing expenses	(6,086)		(7,308)		1,222	
Company's share of the profits of associated companies, net of tax	967		(96)		1,063	
Profit (loss) before taxes on income	(12,676)		16,213		(28,889)	
Tax benefit (income tax)	10,246		(3,984)		14,230	
Profit (loss) for period	(2,430)		12,229		(14,659)	

Operating income - Operating income declined by USD 15.5 million (about 3.3%) in the reporting period relative to the same period last year, while passenger revenues decreased in the amount of USD 9.9 million (2.4%) and cargo revenues decreased by USD 7.0 million (about -16.9%). The decrease in passenger revenues stemmed from a decrease in passengers-km (RPK), from the reasons stated above, and from the erosion of the exchange rate of currencies in which the Company's sale transactions are performed compared to the dollar. In addition, the decrease in passenger revenues derived from the disruptions in flights crewing. Regarding cargo revenues, there was a decrease in yield per ton-km and a decrease in the number ton-kilometers (RTK) flown, on account of increased competition.

Operating expenses - The operating expenses increased during the reporting period by USD 17.2 million (about 4.5%) compared to the same period the previous year, after savings of about USD 9.6 million in the Company's aviation fuel expenses. The gross increase in the amount of USD 26.8 million arose primarily as a result of disruptions in the crewing of flights as a result of the crisis with the pilots, which worsened and reached its peak in this quarter, and the need to find alternative solutions in connection with same, primarily the wet lease of aircraft by the Company, as well as an increase in depreciation expenses.

Sales expenses - In the sale expenses, a decrease of about 7.2% occurred compared to the same period last year, arising mainly from a decrease in the distribution and advertising expense.

General and administrative expenses - General and administrative expenses increased by about 6.0% compared with the same period last year, mainly due to an increase in professional services and consultations and allocations for legal claims.

Financing expenses - The net financing expenses amounted to about USD 6.1 million compared to about USD 7.3 million in the same period the previous year. The decrease is mainly due to a one-time payment of commission recognized in 2015 and a decrease in the exchange rate.

Income taxes - The tax benefit in the reported period amounted to about USD 10.2 million. The tax benefit includes income received due to the reduction in the corporate tax rate from 25% to 23% (in the period forecasted on the date the turnover of the timing differentials, for which the deferred taxes were recognized), in the amount of USD 7 million. In the same period the previous year, tax expenses were recorded in the income in the amount of USD 4.0 million.

Loss for the period - The loss before taxes in the reported period amounted to about USD 12.7 million (loss after taxes of about USD 2.4 million, constituting about 0.5% of the turnover) compared to profit before tax of about USD 16.2 million in the same period the previous year (profit after taxes of about USD 12.2 million, about 2.6% of the turnover).

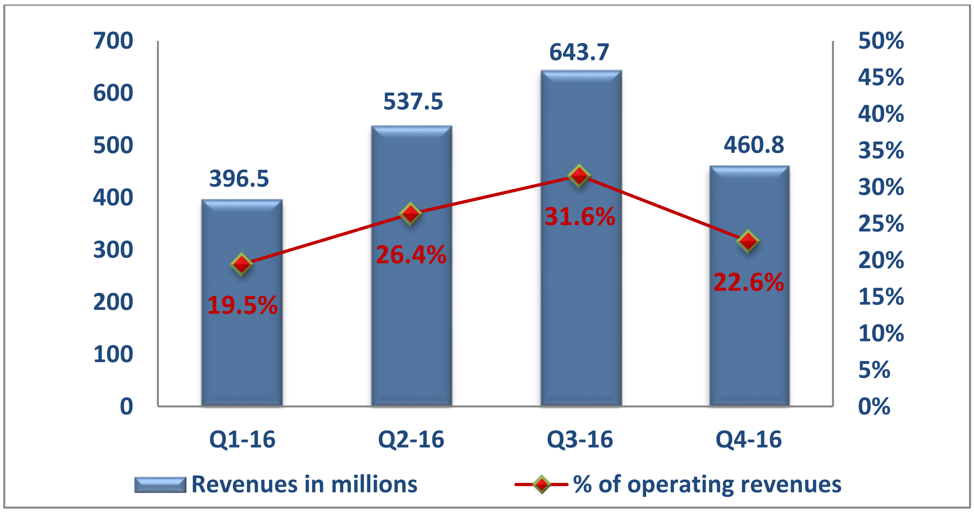
a4. Sector Reporting

Regarding the analysis of income and expenses based on sector of activity, see Note 20 of the financial statements of December 31, 2016.

a5. Seasonality

The Group's activity is impacted by seasonality and intensifies in peak periods. Large-scale movement of Israeli residents departing for abroad takes place mainly in the summer months and holiday seasons, and large movements of tourists entering Israel takes place in the summer months and before Jewish or Christian holidays or vacations in the countries of origin.

Income distribution over the quarters and their portion of turnover in 2016 (in USD millions)



a6. Cash flows

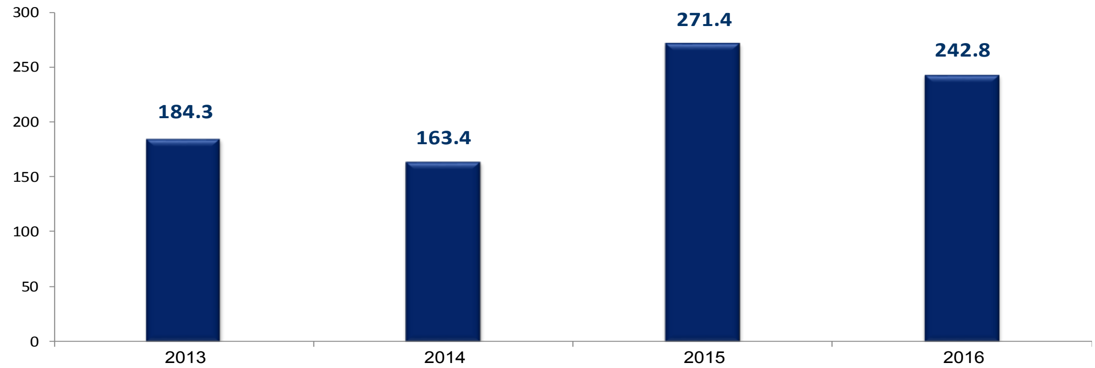
Cash flows for the year ending December 31, 2016, compared to those of 2015, are as follows:

	January - December		
	2016	2015	Change
	USD thousands		USD thousands
Cash flow arising from current operations	242,840	271,418	(28,578)
Cash flows used for investment activities	(112,877)	(164,137)	51,260
Cash flows used for financing activities	(61,095)	(50,156)	(10,939)
Effect of exchange rate fluctuations on cash balances held in foreign currency	(780)	862	(1,642)
Increase in cash and cash equivalents	68,088	57,987	10,101

Cash flow from current operations

In 2016, the Company had a positive cash flow from current activities in the amount of USD 242.8 million compared to positive cash flows from current activities in the amount of USD 271.0 million last year. The decrease in cash flows from current operations in the amount of USD 28.6 million arose primarily from a decrease in the Company's profit before taxes, as explained above. It should be noted that cash flow from current operations for 2015 was negatively impacted by payment of jet fuel derivatives and exchange rates in the amount of about USD 28 million, which were not reflected in the Company's income statement (because they were not recognized for accounting as hedging instruments).

Development of cash flow from current operations for years 2013-2016 (in USD millions):



Cash flows for investment activities

In 2016, the Company invested USD 112.9 million, net, in investment activities. The investment in fixed assets and intangible assets amounted to a total of USD 172.8 million (primarily the purchase of three 737-900 aircraft, advances on the purchase of 787 aircraft and their engines, and the purchase of parts and accessories). Conversely, the Company generated cash as a result of the release of short-term deposits in the amount of about USD 41.7 million, in consideration for the sale of two 737 aircraft for a sum of USD 16 million, and consideration from an investee company amounting to USD 2 million.

In 2015, the Company invested USD 164.1 million, net, in investment activities. The investment in fixed assets and intangible assets amounted, in 2015, to a total of about USD 136.9 million (primarily payments on account of the purchase of 737-900 aircrafts and the purchase of parts and accessories). The increase in investment in fixed assets in 2016 is attributed to the deepening investment in the equipment program, as detailed in Note 9.d. of the financial statements, which was slightly offset by a decline in investment in the 737-900 model aircraft (three of which were accepted by the Company in 2016, compared to four in 2015).

Cash flows for financing activities:

In 2016, the Company used a cash flow in the amount of USD 61.1 million, net, for financing activities, of which the Company repaid loans in the amount of USD 185.3 million and paid a dividend in the amount of USD 33.4 million. On the other hand, the Company received net loans (less recruitment costs) amounting to USD 157.8 million. See also Note 13 to the financial statements, regarding loans from other bank corporations.

In 2015, the Company used USD 50.2 million, net, for financing activities. In this period, the Company paid back loans in the amount of about USD 125.1 million, and paid a dividend in the amount of USD 24.7 million. On the other hand, the Company received net loans (less recruitment costs) amounting to USD 100.7 million.

a7. Financial state, cash balances and working capital of the Company

	December 31, 2016	December 31, 2015		December 31, 2016	December 31, 2015
	USD thousands			USD thousands	
Current assets	435,069	394,281	Current liabilities	800,120	838,030
Non-current assets	1,281,882	1,269,868	Non-current liabilities	632,780	628,184
			Capital	284,051	197,935
Total	**1,716,951**	**1,664,149**	**Total**	**1,716,951**	**1,664,149**

The following are the main changes to the sections of assets, liabilities and capital as of December 31, 2016 compared to December 31, 2015:

Current assets:

The Company's current assets as of December 31, 2016 amounted to a total of USD 435.1 million, an increase of about USD 40.8 million compared to December 31, 2015. The increase arose mainly from an increase in the cash balances compared to the balance of cash at the end of 2015 (see the cash flow analysis above), which was partially offset against a decrease in the short-term deposits section, and from improvement in the fair market value of jet fuel derivatives (see Note 18 of the financial statements).

Current liabilities:

The Company's current assets as of December 31, 2016 amounted to a total of USD 800.1 million, a decrease of USD 37.9 million compared to December 31, 2015. This decrease was mainly due to the improvement in the fair value of jet fuel derivatives (see Note 18 to the financial statements), as well as a decrease in current maturities of long-term loans, which were partially offset by an increase in the advances on ticket sales section, as a result of an increase in the sale of tickets (yet to be exercised) in the last period of the year, compared to the same period for the previous year.

Working capital:

As of December 31, 2016, the Company has a working capital deficit in the amount of USD 365.1 million, compared to a deficit of USD 443.7 million as of December 31, 2015. It is noted that a material part of the deficit in the working capital does not reflect short-term cash flows, as explained below. The current ratio of the Company as of December 31, 2016 increased to about 54.4% compared to 47.0% as of December 31, 2015.

The working capital deficit as of December 31, 2016 includes two essential elements which are included under current liabilities of the Company and are characterized by cyclical business activities, but the Company does not require sources of cash flow in the short term to repay them: advances from sale of tickets and frequent flyer miles, whose clearance is performed through the provision of future flight services, and a commitment to employees for vacation, which is expected to be paid over several years, but is classified as a short-term liability in accordance with the GAAP. Moreover, as mentioned in Note 13 to the financial statements, loans in the aggregate amount of about USD 78 million, with original maturity dates during April and July 2017, and which are therefore presented as short term liabilities, were spread out, since the date of the statement of financial position, over a period of about 4 years, and will thus be classified, as of the first quarter of 2017, as non-current liabilities.

Non-current assets:

The non-current assets as of December 31, 2016 amounted to a total of USD 1,281.9 million, an increase of USD 12.0 million compared to the balance thereof as of December 31, 2015, mainly as a result of the continued investment in the equipment program for aircraft of the Boeing 787 model, and the absorption of three 737-900 aircraft over the course of 2016, as stated in Note 9.e to the financial statements, less the current depreciation.

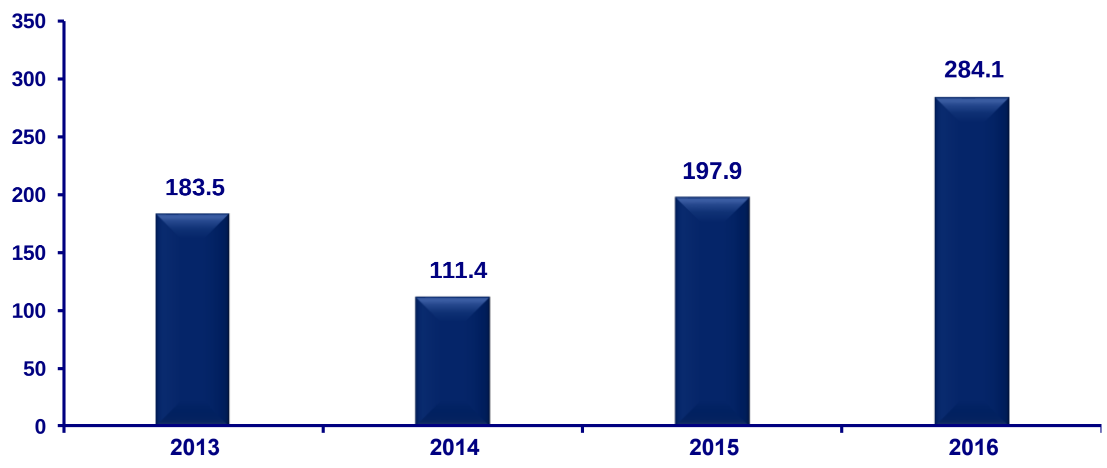
Non-current liabilities:

The Company's non-current liabilities as of December 31, 2016 amounted to a total of USD 632.8 million, on a similar scope to the balance as of December 31, 2015. Liabilities were affected by a decrease in outstanding loans (see Note 13 to the Company's financial statements), which was offset by an increase in deferred tax liability as a result pre-tax profit for the year, offset by the effect of the decrease in the corporate tax rate.

Capital:

The total capital as of December 31, 2016 amounted to USD 284.1 million. The increase amounting to USD 86.1 million compared to capital as of December 31, 2015 arose mainly from the profit for the period, which was partially offset by a dividend announced and paid during this period, on the order of USD 33.4 million, as well as from the impact of the derivative instruments of the Company on the capital reserves, in the amount, net of tax, of USD 48.0 million (increase), offset by the impact of the liabilities for employee benefits on the capital reserves in an amount, net of tax, of USD 9.6 million.

Developments in the capital as of December 31 (USD millions):



Material loans and credit limits of the Company:

In accordance with the guidelines of the Securities Authority in the matter of "reportable credit event," the Company has determined that the materiality threshold for detail of material loans is 5% of the total consolidated balance sheet of the Company and 10% of the total loans of the corporation.

In accordance with the criteria determined as stated above, in the reported period, there were no material changes in the material loans of the Company, as set forth in Appendix A of the Board of Director's Report of December 31, 2016.

For additional details as to the loans of the Company and its compliance with the financial limitations and covenants, see Note 13c. to the financial statements of December 31, 2016.

b. Exposure to Market Risks and their Management

b1. Qualitative report of exposure to market risks and their management

b1. (1) General - description of the market risks to which the Company is exposed

The following details the market risks to which the Company is exposed:

Exposure to changes in the price of jet fuel - the price changes of jet fuel, which is a key component of the Company's operating expenses, have a material impact on the Company's profitability. The Company believes that, at the current level of activity, any change of one US cent per gallon of jet fuel price for a whole year affects fuel expenses by approximately USD 2.5 million. The Company takes protection measures to reduce the exposure, as set forth in Section b1(3) of the Board of Director's Report, below.

Exposure to changes in interest rates - about 38% of long-term Company loans are at variable interest rates. Therefore, an increase in the LIBOR interest rate may impact the Company's profitability. In terms of the current loans, any increase of 1% in the LIBOR interest during an entire year will increase the financing expenses of the Company by about USD 3.8 million.

Currency exposure - Most of the revenues and expenditures of the Company are in the US dollar (the Company's functional currency), excluding shekel expenses, which are mainly salary expenses and payments to local suppliers in Israel. Accordingly, a change in the rate of the shekel against the dollar affects the Company's shekel expenses in dollar terms. The Company believes that at the current level of activity, every 1% addition in the exchange rate of the shekel against the dollar during an entire year, increases the Company's annual expenses by approximately USD 5 million. The Company takes protection measures to reduce the exposure, as set forth in Section b1.(5) of the Board of Director's Report, below. In addition, the Company has insignificant exposure to the Euro and other currencies.

Exposure in the long-term loan framework - in accordance with the provisions of some of the loan agreements, the Company is required to comply with a minimum ratio between the market value of the aircraft and the balance of the loans that are secured by the same aircraft. Additionally, the Company is required to meet a number of conditions, in the absence of which it may face immediate payment of the loans. The Company's exposure to market risks in this regard arises from the changes that occur to the market value of aircraft around the world. For additional details, see Note 13.C of the financial statements as of December 31, 2016.

b1.(2) The Company's policy in the management of market risks, the parties responsible for their management, means of supervision and policy implementation

Regarding the Company's policy in the management of market risks and the parties responsible for their management, means of supervision and policy implementation, see Note 18 to the financial statements as of December 31, 2016.

b1.(3) Hedging jet fuel prices

The Company performs financial transactions to protect against changes to the jet fuel prices, in accordance with the policy explained in Note 18 of the annual financial statements as of December 31, 2016.

As of December 31, 2016, the Company had a number of engagements for the purpose of hedging jet fuel prices in a scope estimated at about 44% of the expected consumption in the next 12 months. In addition, the Company has hedged about 20% of the expected consumption for 2018. The net fair value of the total jet fuel hedging instruments as of December 31, 2016 is a positive amount of USD 21.7 million. For details regarding changes that occur in the prices of jet fuel after the reporting date, see Section 2.e of the Board of Director's Report, below.

b1.(4) Hedging interest on loans

As of the reporting date, about 38% of the balance of the loans received by the Company are with undefined variable interest and about 62% of the balance of the loans are with fixed interest for a period of up to about 12 years.

The Company operates in accordance with the policy explained in Note 18 of the annual financial statements as of December 31, 2016. During the third quarter of 2016, the Company engaged in an interest hedging transaction in the scope of principal of about USD 106 million.

b1.(5) Hedging exchange rates

The Company performs transactions for hedging the currency exposure existing following changes to the shekel rate against the dollar, in accordance with the policy explained in Note 18 to the annual financial statements as of December 31, 2016. These transactions are recognized for accounting purposes as hedging transactions.

The Company has a number of financial transactions that are intended to protect the Company from a decrease in the exchange rates of the dollar against the shekel by July 2017. The net fair value of the total jet fuel hedging instruments as of December 31, 2016 is a positive amount of USD 0.2 million.

As of December 31, 2016, the Company is hedged at a scope of about 14% of the scope of anticipated exposure for the next 12 months.

For details regarding the changes that occurred in the shekel-dollar exchange rate, see section 3.e of the Board of Director's Report, below.

b1.(6) Report on the sensitivity analysis

The following describes the models for examining the sensitivity of the fair value of the various financial instruments:

1. Hedging exchange rates - Exchange rate hedging transactions that the Company conducts are performed using financial instruments with banks in Israel and abroad.

   The underlying assets for these transactions are foreign exchange rates for the dollar/shekel, as determined by Bank of Israel. Dollar-shekel exchange rate hedging transactions are executed in order to hedge the cash flow exposure to the shekel, as detailed in Section b1.(5), above.

   The annual scope of exposure is some NIS 1,700 million. Transactions to hedge this exposure, in accordance with policy, are monthly, coinciding with the dates for the conversion of dollars into shekels for the payment of wages and suppliers in Israel.

   The Company's transactions at the end of 2016 are of the FORWARD variety, according to which the Company fixes the exchange rate to the date on which it is required to perform a currency conversion. Calculation of the fair value of these transactions is done based on mathematical formulas for pricing derivatives in known models.

2. Hedging jet fuel - Jet fuel is the most essential component of the Company's expenses.

   Jet fuel hedging transactions performed by the Company involve trading in financial instruments with the some of the leading banks and financial entities in Israel and the world that operate in this market.

   The underlying assets for these transactions are jet fuel and crude oil on various markets, which serve as the basis for determining the price of jet fuel the Company actually pays; mainly, the jet fuel prices in the Mediterranean pool - Jet Aviation FOB Med. In addition to this market, the Company purchases jet fuel according to its price in other markets, mainly Singapore, the US Gulf Coast and West Gramercy.

   Jet fuel is a necessary raw material for the Company's operations - the Company must purchase the raw material for the purposes of conducting flights, and there is no substitute or room to maneuver between the cost of this raw material and that of other raw materials. The price of jet fuel is extremely volatile.

   The market price of jet fuel is determined according to several parameters, including:

   The crude oil price, which is influenced by market expectations and supply and demand. The supply of oil and petroleum products is limited by physical factors and infrastructure (oil reserves, infrastructure, production, refining, storage, transport, etc.) as well as by geopolitical actors and factors and the effects of the cartel of the major oil producers (OPEC countries).

Volatility of the price - Owing to the close proximity between the limited supply and the demand, any change or expected change in one of these factors incurs large fluctuations in the price (such as the level of economic activity and global growth, wars and terror attacks, strikes and failures at large refineries around the world, international relations and so forth).

Seasonal demand for various petroleum distillates, including jet fuel (there is high demand in the winter for heating oil, and high demand in the summer for gasoline for cars. Similarly, transportation costs vary according to the seasonal risks of maritime transport).

The cost of production and infrastructure constraints - Refinery prices vary according to the different constraints of the oil refining industry and refining infrastructure, storage and transportation of oil and petroleum products is limited, the cost of their development very high, and the expansion of same can take many years (the construction of a refinery takes about 5-7 years).

A) Sensitivity of weighted balances to changes in the dollar/shekel exchange rate - USD thousand:

	Profit (loss) from the changes			Profit (loss) from the changes	
	Increase of 10%	Increase of 5%	Fair value	Decrease of 5%	Decrease of 10%
	4.230	4.037	3.845	3.653	3.461
	NIS/USD	NIS/USD	NIS/USD	NIS/USD	NIS/USD
Cash and cash equivalents	(3,897)	(2,041)	42,868	2,256	4,763
Shorts term deposits	(788)	(413)	8,669	456	963
Receivables and other debtors	(2,826)	(1,480)	31,084	1,636	3,454
Long term deposits	(63)	(33)	696	37	77
Assets for employee benefits	(5,395)	(2,826)	59,349	3,124	6,594
Total financial assets	(12,970)	(6,794)	142,666	7,509	15,852
Short term credit and current maturities	17	9	(187)	(10)	(21)
Payables and service providers	3,651	1,912	(40,161)	(2,114)	(4,462)
Accounts payable and credit balances - current	47	25	(522)	(27)	(58)
provisions	1,335	699	(14,688)	(773)	(1,632)
Liabilities for employee benefits - current	7,419	3,886	(81,610)	(4,295)	(9,068)
Loans from bank corporations and others	3	2	(36)	(2)	(4)
Liabilities for employee benefits - non-current	4,407	2,308	(48,475)	(2,551)	(5,386)
Total financial liabilities	16,880	8,842	(185,679)	(9,773)	(20,631)
Linkage balance sheet exposure due to excess Financial liabilities of financial assets	3,910	2,048	(43,013)	(2,264)	(4,779)

B) Sensitivity of hedging NIS/dollar exchange rate

	Loss from the changes			Profit from the changes	
	Increase of 10%	Increase of 5%	Fair value	Decrease of 5%	Decrease of 10%
	In exchange rate	In exchange rate	NIS/USD	In exchange rate	In exchange rate
	4.230	4.037	3.845	3.653	3.461
Shekel-dollar FORWARD transactions intended for protection	(6,830)	(3,578)	205	3,954	8,348

C) Sensitivity of weighted balances to changes in the euro/dollar exchange rate - USD thousand:

	Profit (loss) from the changes			Profit (loss) from the changes	
	Increase of 10%	Increase of 5%	Fair value	Decrease of 5%	Decrease of 10%
	1.046	0.998	0.951	0.903	0.856
	EUR/USD	EUR/USD	EUR/USD	EUR/USD	EUR/USD
Cash and cash equivalents	(521)	(273)	5,735	302	637
Shorts term deposits	(1)	(1)	14	1	2
Receivables and other debtors	(1,154)	(605)	12,698	668	1,411
Total financial assets	(1,677)	(878)	18,447	971	2,050
Payables and service providers	1,838	963	(20,220)	(1,064)	(2,247)
Accounts payable and credit balances	8	4	(86)	(5)	(10)
Liabilities for employee benefits - current	137	72	(1,503)	(79)	(167)
Liabilities for employee benefits - non-current	62	32	(678)	(36)	(75)
Total financial liabilities	2,044	1,071	(22,487)	(1,184)	(2,499)
Linkage balance sheet exposure due to excess Financial assets over financial liabilities	367	192	(4,040)	(213)	(449)

D) Sensitivity to changes in the prices of jet fuel over inventory (dollar/gallon) - USD thousands

	Profit from the changes			Loss from the changes	
	Increase of 10%	**Increase of 5%**	**Fair value**	**Decrease of 5%**	**Decrease of 10%**
	1.764	**1.683**	**1.603 ***	**1.523**	**1.443**
	USD/Gallon	**USD/Gallon**	**USD/Gallon**	**USD/Gallon**	**USD/Gallon**
Jet fuel inventory	717	359	7,170	(359)	(717)

* The price of jet fuel based on the weighted average, ranging over a period of three months ending on December 31, 2016.

E) Sensitivity of jet fuel hedging to changes in the prices of jet fuel - in USD thousands:

According to the principles of the model, grouping was performed in respect of the jet fuel hedging instruments that respond similarly to market factors, since there was no material loss of information required for understanding the Company's exposure to the market risks as a result of the grouping. On January 5, 2009, a change of about 14% occurred in the prices of jet fuel; therefore, the following sensitivity analysis also includes a change of 15% in the prices of jet fuel.

	Profit from the changes				**Loss from the changes**		
	Increase of 15%	**Increase of 10%**	**Increase of 5%**	**Fair value**	**Decrease of 5%**	**Decrease of 10%**	**Decrease of 15%**
	1.759	**1.682**	**1.606**	*** 1.530**	**1.453**	**1.377**	**1.300**
	USD/Gallon	**USD/Gallon**	**USD/Gallon**	**USD/Gallon**	**USD/Gallon**	**USD/Gallon**	**USD/Gallon**
Jet fuel hedging transactions recognized as protection	27,131	17,784	8,718	21,734	(8,311)	(16,132)	(23,433)

* Price of jet fuel in the Mediterranean pool as of December 31, 2016, based on which the fair value of the jet fuel hedging transactions of the Company is calculated.

F) Sensitivity in hedging interest to changes in the market interest rates - USD thousands:

	Profit from the changes				**Loss from the changes**		
	Increase of 100% in the rate of interest	**Increase of 10% in the rate of interest**	**Increase of 5% in the rate of interest**	**Fair value ***	**Decrease of 5% in the rate of interest**	**Decrease of 10% in the rate of interest**	**Decrease of 100% in the rate of interest**
IRS transaction - designated for protection	4,768	483	241	980	(242)	(484)	(4,848)

*The fair value is calculated based on LIBOR interest in the market as of December 31, 2016: LIBOR for three months -0.95%.

b2. Linkage basis report

The following is a linkage basis report on a consolidated basis as of December 31, 2016:

	In USD or linked Elio	In Israeli currency NIS	EUR or linked Elio	In another foreign currency or linked Elio	Non-financial items	Total
	USD thousands					
Current assets						
Cash and cash equivalents	128,528	42,868	5,735	3,625	-	180,756
Shorts term deposits	21,907	8,669	14	288	-	30,878
Receivables and other debtors	109,640	31,084	12,698	13,122	-	166,544
Derivative financial instruments	17,754	205	-	-	-	17,959
Expenses in advance	-	-	-	-	20,592	20,592
Inventory	-	-	-	-	18,340	18,340
Non-current assets						
Long term deposits	17,598	696	-	-	-	18,294
Long term investments	-	-	-	-	23,830	23,830
Fixed assets and intangible assets	-	-	-	-	1,169,563	1,169,563
Derivative financial instruments	4,960	-	-	-	-	4,960
Expenses in advance	-	-	-	-	5,582	5,582
Assets for employee benefits	304	59,349	-	-	-	59,653
Total assets	300,691	142,871	18,447	17,035	1,237,907	1,716,951
Current liabilities						
Short term credit and current maturities	(180,712)	(187)	-	-	-	(180,899)
Payables and service providers	(68,221)	(40,161)	(20,220)	(7,053)	-	(135,655)
Accounts payable and credit balances	(58,920)	(522)	(86)	(330)	-	(59,858)
Provision	(3,158)	(14,688)	-	-	-	(17,846)
Derivative financial instruments	-	-	-	-	-	-
Liabilities for employee benefits	(10,993)	(81,610)	(1,503)	(1,500)	-	(95,606)
Income in advance	-	-	-	-	(310,256)	(310,256)
Non-current liabilities						
Loans from bank corporations and others	(426,488)	(36)	-	-	-	(426,524)
Liabilities for employee benefits	(16,690)	(48,475)	(678)	(7,966)	-	(73,809)
Accounts payable and credit balances	(4,499)	-	-	-	-	(4,499)
Deferred taxes	-	-	-	-	(86,218)	(86,218)
Income in advance	-	-	-	-	(41,730)	(41,730)
Capital	-	-	-	-	(284,051)	(284,051)
Total liabilities and equity	(769,681)	(185,679)	(22,487)	(16,849)	(722,255)	(1,716,951)
The excess of assets over liabilities (excess of liabilities over assets)	(468,990)	(42,808)	(4,040)	186	515,652	-

The following is a linkage basis report on a consolidated basis as of December 31, 2015:

	In USD or linked Elio	In Israeli currency NIS	EUR or linked Elio	In another foreign currency or linked Elio	Non-financial items	Total
	USD thousands					
Current assets						
Cash and cash equivalents	53,389	50,299	4,401	4,579	-	112,668
Shorts term deposits	70,717	8,543	-	-	-	79,260
Receivables and other debtors	107,652	29,417	13,293	11,030	-	161,392
Derivative financial instruments	-	1,467	-	-	-	1,467
Expenses in advance	-	-	-	-	22,999	22,999
Inventory	-	-	-	-	16,495	16,495
Non-current assets						
Long term deposits	10,786	702	-	-	-	11,488
Long term investments	-	-	-	-	19,370	19,370
Fixed assets and intangible assets	-	-	-	-	1,171,454	1,171,454
Expenses in advance	-	-	-	-	1,211	1,211
Assets for employee benefits	40	66,305	-	-	-	66,345
Total assets	242,584	156,733	17,694	15,609	1,231,529	1,664,149
Current liabilities						
Short term credit and current maturities	(189,547)	(3,679)	-	-	-	(193,226)
Payables and service providers	(67,586)	(36,056)	(22,546)	(7,736)	-	(133,924)
Accounts payable and credit balances	(67,711)	(455)	(167)	(1,853)	-	(70,186)
Provision	(1,941)	(8,537)	-	-	-	(10,478)
Derivative financial instruments	(39,474)	-	-	-	-	(39,474)
Liabilities for employee benefits	(15,656)	(82,078)	(1,507)	(1,405)	-	(100,646)
Income in advance	-	-	-	-	(290,096)	(290,096)
Non-current liabilities						
Loans from bank corporations and others	(439,037)	(293)	-	-	-	(439,330)
Liabilities for employee benefits	(20,101)	(51,120)	(664)	(7,126)	-	(79,011)
Derivative financial instruments	(2,712)	-	-	-	-	(2,712)
Accounts payable and credit balances	-	(4,437)	-	-	-	(4,437)
Deferred taxes	-	-	-	-	(60,567)	(60,567)
Income in advance	-	-	-	-	(42,127)	(42,127)
Capital	-	-	-	-	(197,935)	(197,935)
Total liabilities and equity	(843,765)	(186,655)	(24,884)	(18,120)	(590,725)	(1,664,149)
The excess of assets over liabilities (excess of liabilities over assets)	(601,181)	(29,922)	(7,190)	(2,511)	640,804	-

c. Aspects of Corporate Governance:

c1. Charitable Contributions and Community Work

El Al assigns a great deal of importance to making charitable contributions and assisting the needy and the community. As part of its activities, the Company contributed a total of USD 810,000 in cash and cash equivalents in 2016.

Over the course of 2016, El Al continued its long-standing tradition of giving back to the community and even expanded the scope of its social activity. As a result of this work, the Company maintained its status in the Platinum category of the Ma'aleh ratings for 2016.

The activity continued to focus mainly on the following subjects:

1. El Al employee volunteer activities for various populations, including at-risk children, special-needs children, people with disabilities and the infirm, as well as volunteer work by Company employees in educational projects such as Together Teachers and Young Entrepreneurs, expanding volunteer activity within the framework of Nahalat Eran – Aleh Negev, and continuing to employ students of the Nachalim professional school in EL Al.
2. In addition, volunteer activity has continued in the form of public relations work for Israel abroad by air crew, pilots and flight attendants, while staying abroad as part of the Ambassadors Project, which is being conducted successfully in conjunction with the Foreign Ministry, the Jewish Agency and the Stand With Us organization.
3. Support with money or money-equivalents, for the community:
    a. By management – within the framework of the Contributions Committee, the Company contributes donates sums of money, and in addition contributes assistance in the form of money equivalents, such as dozens of hot meals daily, free flight tickets and transport of special cargo free of charge.

    b. In addition, El Al has donated to organizations assisting the mentally disabled (AKIM, Etgarim, Pitchon Lev, Larger than Life, the Israeli Youth Diabetes Association).

    c. El Al has adopted the soldiers of the IDF's 202nd Battalion as part of the AWIS adopt a Warrior program.

    d. Within the framework of the Globally Club, El Al transfers points for the purchase of flight tickets to the Make-a-Wish Foundation to fulfill the wishes of young cancer patients, to the AWIS in order to assist lone soldiers in visiting their families abroad and to Taglit project in order to bring Israeli youths to Israel. In 2016, the Company expanded its activity through the CEO Fund for the Community.

    e. By the employees themselves – whether in money or money-equivalents (home electrical appliances, clothing, books, games, etc.) to preschools for special-needs children, at-risk children's homes and more.
4. In 2016, the Company published its corporate responsibility report for 2014/2015.

5. With regards to diversification of employment, the Company invested in a number of projects in 2016, the central one being the opening of an engineers' class for metro-mechanics at the Ort-Yad Singalovski, in cooperation with the Ministry of Economy, Joint Israel and the Futures Fund. Upon graduation, the students are absorbed into the Company's Upkeep and Engineering Division. Most of the students are immigrants from Ethiopia.

c2. Directors with Accounting and Financial Capabilities

For information regarding the experience and education of the directors the Board of Directors considered to have possessed accounting and financial in the reported year – see Regulation 26 in part D of this periodic report.

c3. Disclosure about Internal Auditor of Reporting Corporation

1. Information Regarding the Internal Auditor and Compliance with Conditions

1.1. **Name of Auditor:** Gil Berr.

1.2. **Beginning of term in office:** June 1 2009.

1.3. Qualifications: accountant, with a degree in accounting and business administration and certified in public administration and auditing (with honors). Holds CIA (Certified Internal Auditor – U.S.) and CRISC (Certified in Risk and Information Systems Control) certificates. Has some twenty years' experience in internal auditing, financial statements auditing, risk management and in consulting. Until his appointment Mr. Berr was a partner in Cost Forrer Gabbai & Kasierer (Ernst & Young) and was responsible for auditing and risk management. Within this framework he served as internal auditor for various companies and organizations. In addition, he serves as a regular lecturer Ben Gurion University, Haifa University and at the Ono Academic College in the field of risk management and internal auditing. In addition, serves as a director at the Internal Auditor's Association (IIA) and as a member of the Ilan Audit Committee.

The Internal Auditor meets all compliance requirements set in Section 3(a) of the Internal Auditing Law, 5752-1992.

The Internal Auditor is in compliance with Section 46(b) of the Companies Law, 5759-1999 and Section 8 of the Internal Auditing Law, 5752-1992.

1.4. The Internal Auditor has no holdings in Company securities or holdings in any related body in the reported year.

1.5. Starting from the date of his appointment, the Internal Auditor has had no business connections of any sort with the audited corporation or with any related body, with the exception of serving as Internal Auditor of Group subsidiaries.

1.6. The Internal Auditor is employed by the Company as a full-time Company employee.

2. The Internal Auditor's Appointment

2.1. The appointment of the internal auditor was approved by the Audit Committee on its April 21, 2009 meeting and by the Company's Board of Directors on its April 30, 2009 meeting, and after considering the Auditor's education, skills and experience in corporate auditing and risk management to material degrees.

2.2. The Auditor was given duties and authorities in accordance with the Company's auditing procedure, the directives of which are based on the laws of the State of Israel. Pursuant to this, the Internal Auditor was tasked with proposing a work plan, to be carried out in accordance with the Company’s auditing plans and to distribute, in writing, reports containing findings, conclusions and recommendations.

3. The Internal Auditor's Supervisor

The Internal Auditor is subordinated at the Company to the Chairman of the Board of Directors and the CEO of the Company, in accordance with the Company's bylaws.

4. Work plan

4.1. The Internal Auditor's work plan is on a yearly basis.

4.2. The Internal Auditor's work plan is determined based upon the following considerations:

4.2.1. The risk embodied in an area of activity and profitability of the Company.

4.2.2. The effect of the area on the safety and security of passengers, employees and aircraft. Company profitability, passenger service, and regulation.

4.2.3. The existence of appropriate controls, applicability and efficiency in the audited area.

4.2.4. Proposals of VPs and department managers.

4.2.5. Previous audit findings and pace at which the recommendations submitted were implemented.

4.2.6. The need for follow-up in order to ensure a proper auditing process.

4.3. Establishment of the work plan involves the Chairman of the Company's Board of Directors, the members of the Audit and Remuneration Committees and the Company CEO.

4.4. The work plan proposal is received on a yearly basis from by the Chairman of the Company's Board of Directors, the members of the Audit and Remuneration Committees and the Company CEO. All of them approve the proposal in accordance with Section 149 of the Companies Law, 5759-1999.

4.5. The work plan allows the Internal Auditor to exercise his judgment in deviating from the plan.

4.6. The Company Auditor is present at Board meetings in which material transactions are approved.

5. Audits Overseas or for Subsidiaries

The Company Auditor also serves as the Internal Auditor for all active subsidiaries, and, therefore, the Auditor's work plan takes these companies into account. The Auditor's work plan also includes inspections of the Company's activity abroad.

6. Treatment of Complaints Pertaining to Flaws in the Management of the Company's Business

The Company Auditor was assigned the task of concentrating and presenting to the Audit Committee the method of treatment of complaints by Company workers regarding flaws in the manner in which it conducts its business. For this purpose, a regular mechanism has been established at the Company to handle these matters. The subject is studied and reviewed on a regular basis.

7. Scope of Employment

7.1 The Internal Auditor is employed full time by the Company and subordinate to him are seven full time auditors.

7.2. 16,000 audit work hours were invested in the Company and its subsidiaries in Israel and abroad in 2016, as follows:

The scope of employment is determined in accordance with the audit work plan, which is determined in accordance with the scope and complexity of the Company's various activities.

Work hours for the Company's activity in Israel	Work hours for the Company's activity abroad *	Work hours due to investee corporations **	Total
11,450	3,300	1,250	16,000

* 70% of the Company's work hours for activities abroad were carried out in Israel.

** Audits were carried out for 3 subsidiaries. (Including an investee abroad).

8. Conducting the Audit

8.1. The Company's Internal Auditor conducts his work in accordance with the Companies Law, 5759-1999, the Internal Auditing Law, 5792-1992 and generally accepted professional standards.

8.2. The Chairman of the Board and Audit Committee Chair hold a monthly meeting with the Internal Auditor regarding his work and regarding the professional standards according to which the Auditor operates.

8.3. The Audit Committee holds meetings in which it discusses the Internal Auditor's work and the audit standards.

8.4. Prior to the approval of the yearly audit plan, the Chairman of the Board and Audit and Remuneration Committee Chair meets with the Internal Auditor to discuss the standards according to which the work plan was formulated, following which the audit committee discussed the proposed yearly audit plan and the standards according to which the proposal was formulated and approves it.

8.5 Furthermore, during the reported year a discussion was held in the Audit Committee, in the presence of the Internal Auditor and without the presence of company officers who are not committee members, to check for the presence of flaws in the corporation's business management.

9. Access to Information

The Internal Auditor has unfettered, continuous and direct access to any document or information held by the Company and its subsidiaries, in Israel and abroad, or by any of its employees, as well as access to any ordinary or computerized information listings, to any database and to any automatic data processing system in the Company, including for financial data, as noted in Section 9 of the Internal Auditing Law, 5752-1992.

10. Internal Auditor Report

10.1. The audit reports are submitted in writing.

10.2. The Internal Auditor prepared 40 audit reports in 2016. The audit reports were submitted to the Chairman of the Board, the members of the Audit and Remuneration Committee of the Board of Directors, and to the Company's CEO.

10.3. In 2016, the Audit Committee convened 14 times to discuss the internal audit reports, on the following dates: January 18, February 3, February 23, March 20, April 3, April 17, May 17, June 19, July 7, August 16, September 18, October 27, November 13, December 25.

11. Board of Director’s Evaluation of the Internal Auditor's Activity

In the opinion of the Board of Directors, the scope, nature and continuity of the internal auditing activities and work plan are reasonable under the circumstances, and they achieve the internal audit objectives of the corporation, as they relate to all of the Company’s material and key activities.

12. Remuneration

12.1. The compensation of the Internal Auditor is based on the salary and associated benefits (including a bonus according to the Company’s officer remuneration policy) granted members of the senior management group and in accordance with the remuneration policy. Total remuneration for 2016 is 1,148,000 NIS.

12.2. In the opinion of the Company's Board of Directors, the compensation given to the Internal Auditor and his components do not impair his ability to apply his independent judgment in carrying out his assignments, *inter alia*, in view of the fact that the audit work is performed by the Internal Auditing Department, which features several Internal Auditors.

c4. Disclosure Regarding Independent Auditors' Fees

Below are the Company's fee expenses to the accounting firm of Brightman Almagor & Co.
for auditing, tax services and other services provided by them:

	Audit and tax services	
	Hours	USD Thousands
2016	10,030	513
2015	9,564	507

These fees were approved by the Company's Board of Directors and are reasonable and acceptable, according to the nature of the Company and the extent of its activities.

c5. Remuneration of Interested Parties and Senior Executives

On December 1, 2016, a special meeting of the Company’s shareholders approved the remuneration policy for the Company’s executives for three years (2017-2019). For the Company’s remuneration policy for 2017-2019, see the report of the summons of the shareholder meeting that the Company published on October 27, 2016 (reference no. 2016-01-068523).

On April 28, 2016, a special meeting of the Company’s shareholders approved an update to Company CEO’s terms of employment, as follows: raising the Company CEO’s salary to a total of NIS 130,000, retroactively as of January 1, 2016, and amending the rate of the deferred remuneration in respect of the CEO, so that it would be decreased from 45% and stand at 30%, similarly to those of the other senior executives. Furthermore, the meeting of the shareholders approved the payment of a special bonus to CPA Nimrod Borowitz, the Company’s VP of Business Development, Long-term Planning and Equipment. Nimrod is the son of David Borowitz (the husband of Ms. Tamar Moses Borowitz, the Deputy Chairman of the Company’s Board of Directors and one of the controlling shareholders of Knafayim) and the nephew of Prof. Israel (Izzy) Borowitz, one of the controlling shareholders in Knafayim (reference no. 2016-01-055996).

On January 8, 2014, a special meeting of the Company’s shareholders approved, *inter alia*, the amendment of the Management Services Agreement of the Company's Board Chairman, Mr. Amikam Cohen, as detailed in the report of the summoning of the meeting of the Company’s shareholders published by the Company on December 2, 2013 and in the report correcting the summoning of the meeting, published by the Company on December 30, 2013 (reference no. 2013-01-112759).

c6. Internal Enforcement Plan

In December 2011 the Company’s Board of Directors approved, after receiving the recommendations of the Corporate Governance Committee, the key points of the Company’s internal enforcement plan in the field of securities and corporate law (hereinafter: “the Internal Enforcement Plan”).

The Internal Enforcement Plan expresses the Company’s recognition of the importance of compliance with the law on behalf of Company employees, executives, Board members and relevant service providers, and concentrates the Company's policy on the subject of preventing and treating violations, including a policy for the evaluation of the damages of violations and preventing their recurrence.

The goal of the Internal Enforcement Plan is to assimilate and enforce norms in matters of observing the law, ethical rules and other codes of behavior by the Company, its executives and its employees and therefore to confirm compliance with securities law on behalf of the Company and by individuals working at it.

The Enforcement Plan includes means for the internal identification of potential violations and failures, the purpose of which, *inter alia*, is to locate and correct failures, improve reporting processes, identify and treat cases of conflict of interest, prevent the leak of internal information out of the Company and to prevent prohibited influence on trade in Company shares. To be clear, the internal enforcement plan may serve as a tool employed by the CEO and the Board of Director in the fulfillment of their oversight obligation, and may be held in the Company’s favor in the event of any violation of securities law.

The Internal Enforcement Plan adopted by the Company includes an outline for the activities of the Company’s internal enforcement array and key procedures, including: the Board of Director’s work procedure; the procedure for defining the positions and authorities of the Audit Committee; the procedure for transactions with related parties; the Board of Director’s conflict of interest procedure; the executive remuneration procedure; the reporting (non-financial) procedure; internal information procedure; the delivery of information to the media and to the capital markets and the procedure for training Board members.

The Company's Board of Directors approved and adopted the Internal Enforcement Plan and its central procedures, and, at the recommendation of the CEO, appointed the Company’s legal counsel Adv. Omer Shalev, as the Company’s internal enforcement supervisor (hereinafter: “the Supervisor”).

Over the course of 2016, the Supervisor continued to perform various actions as part of the implementation of the enforcement plan among Company workers and executives, including training on the subject of internal enforcement provided by the Supervisor to workers and executives at the Company, its subsidiaries and at entities providing service to the Company. Spontaneous inspections were carried out to examine the implementation of enforcement procedures.

The Supervisor provides the members of the Corporate Governance Committee, as part of the Enforcement Supervisor’s Report, a description of the actions taken over the course of the reported period as part of the implementation and assimilation of the Enforcement Plan, a review of compliance incidents and the measures taken to deal with such incidents and prevent the recurrence of similar cases in the future, as well as an updates file on legislative amendments, Securities Authority instructions and material decisions made as part of legal proceedings in the field of securities law and corporate law.

Furthermore, in September 2014, the Company’s Board of Directors approved an Internal Enforcement Plan in the antitrust field, which includes an outline for the activity of internal enforcement at the Company and key procedures in the Company’s areas of activity. Implementation and adoption of an effective enforcement plan contributes to increasing awareness among workers and executives of the requirements of the Antitrust Law and the enforcement policy of the Antitrust Authority, and in accordance with attempts to reduce exposure to claims against the Company, employees and executives. This also constitutes a framework for fruitful cooperation between the Antitrust Authority and the Company. In addition, effective implementation of the Enforcement Plan shall favor the officers in the event of criminal liability, so long as it has been proven that the violation was unknown to the accused officer and that the Company has taken all reasonable measures to ensure that the Antitrust Law was observed.

The Company's Board of Directors appointed Adv. Omer Shalev, the legal counsel and supervisor for the enforcement plan in the field of securities law and corporate law, as supervisor for internal enforcement in the antitrust field. As part of the assimilation of the enforcement plan in the antitrust field, in 2016, the supervisor provided training to Company workers and executives and spontaneous audits were performed to examine implementation of enforcement procedures.

d. Disclosure Provisions with Regard to Financial Reporting by the Corporation:

d1. Disclosure on Critical Accounting Estimates

The implementation of accounting standards by Company management upon preparing financial statements occasionally involves various assumptions, assessments and estimates influencing levels of assets and liabilities and the business results reported in the financial statements. Some of the assumptions, assessments and estimates are critical to the financial position or operating results reflected in the Group's financial statements, due to their materiality, the complexity of the calculations or the likelihood uncertain matters will be realized. For details on the material estimates employed by the Company, see Note 2c to the December 31, 2016 financial statements.

d2. Disclosure on Value Assessment

In accordance with Regulation 8.b.(i) to the Securities Regulations (Periodic and Immediate Reports), 5730-1970, the following are details regarding the valuations of the aircraft fleet, prepared by the Company as of March 31 2016:

Work Performed	Valuation date	Relevant Standard	Working Method	Fair Value	Value in Use for El Al	Recoverable Sum – Whichever is Higher for El Al	Depreciated Cost in Books
in USD millions							
Examination of depreciation of the Company’s aircraft fleet (29 aircraft owned, in addition to 10 aircraft leased)	Mar 31, 2016	IAS 36, Impairment of Assets	Discounted cash flow (DCF)	830	1,380	1,380	994

For the full valuation, see the quarterly report of March 31 2016, published on May 26, 2016 (reference no.: 2016-01-035079). Since the publication of the valuation of the comprehensive value of the aircraft fleet attached to the Board of Director’s Report for the first quarter of 2016, and until the publication of this report, no changes have occurred that may, according to the Company’s estimates, alter the conclusion of in the valuation according to which no impairment shall be made in the books of the aircraft covered by the valuation. For additional details, see Notes 2.c.(5) and 9.a.(5) of the financial statements.

d3. The Subjects to which the Company's Independent Auditors Draw Attention in their Opinion on the Financial Statements

For detail regarding exposure to the certification of lawsuits as class actions and the Company’s exposure to these class actions, see Note 15 to the financial statements of December 31, 2016.

e. Additional information:

Disclosure regarding Changes in the Economic Environment, the Implications of the Capital Market Crisis, Market Risks and Special Events

1. The international aviation industry is affected by the political and security situation and by unusual events, such as the outbreak of epidemics and natural disasters in the world in general, and in specific areas, in particular, as well as by the economic situation in Israel and around the world.

   The following are changes occurring to jet fuel prices and NIS exchange rates from the end of the quarter until immediately prior to the publication of the December 31, 2016 financial statements:

2. As of the reporting date, the market price of the jet fuel (before fees and supplier profits), weighted in accordance with the markets in which the Company purchases jet fuel, was about 156.5 cents per gallon, and, as of the date near the approval of this report, this price was about 143.2 cents per gallon, which reflects a decrease of about 8%. It should be noted that jet fuel expenses constitute around 19% of the Company's revenue turnover, and therefore changes in price may have a material impact on its financial results. At the same time, the fair value of jet fuel hedging instruments shall be set in accordance with price changes which occurred since the report date, and the completion of accounting for some of the transactions. As of December 31, 2016, the Company had agreements for hedging jet fuel prices, at a scope estimated at 44% of expected consumption for 2017, and 20% for 2018. Subsequent to the balance sheet date, the Company performed additional financial transactions to protect it from increased jet fuel prices in accordance with its hedging policy, and as of a date near the publication of this report, it is hedged at a rate of 40% of the expected consumption for the next 12-month period, as well as 30% for the period between March, 2018 and December, 2018.

3. Prior to the publication of the financial statements, the dollar weakened against the shekel at a rate of around 5%, relative to the reporting date. The Company has hedging transactions for the shekel-dollar exchange rate (see Section b.1.(5) of the Board of Director’s Report, above), the fair value of which may change in accordance with the changes to the exchange rates. It should be noted that the impact on the exchange rates on the business results of the next quarter will be determined in accordance with the exchange rates that actually occurred in the quarter, generally and at its end (December 31, 2017).

Amikam Cohen **Chairman of the Board**	**David Maimon** **CEO**

March 21, 2017

Appendix A to the Report of the Board of Directors on the State of the Corporation's Affairs for the Period Ending December 31 2016

The Company's Material Loans as of December 31, 2016

					Repayment schedule					
Lender characteristics	Loans for the finance of aircraft	Scope of loans (USD thousands)	Outstanding balance (USD thousands)	Sureties	Interest	Frequency of principal and interest repayments	Scope of principal repayment (USD thousands)	Balloon balance (USD thousands)	Loan start date	Final repayment date of the loan
American capital markets guaranteed by EXIM	737-900	188,894	144,628	Four 737-900 aircraft	Fixed- 2.623% - 2.45%	Quarterly	3,935	-	Nov 26, 2013	Jun 25, 2026
Foreign banking corporation	777-200	278,718	105,720	Two 777-200 aircraft	Variable Libor + margin - 0.01% -0.8% -	Quarterly	5,065	42,079	Jul 23, 2007	Jul 23, 2019

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Auditors' Report to the Shareholders of

El Al Israel Airlines Ltd.

On the Matter of the Inspection of Components of Internal Controls of Financial Reporting In Accordance with Section 9.b.(c) of the Securities Regulations (Periodic and Immediate Reports), 5730-1970

We have audited components of internal controls over financial reporting of El Al Israel Airlines Ltd. and its subsidiaries (hereinafter together: "the Company") as of December 31, 2016. These control components have been determined as explained in the following paragraph. The Company's board of directors and management are responsible for maintaining effective internal controls over financial reporting, and for evaluating the effectiveness of the internal controls over financial reporting which is included in the periodic report for the date in question. Our responsibility is to express our opinion on the internal control elements of the Company's financial reporting based on our audit.

Components of internal control of financial reporting inspected were determined according to Audit Standard 104 of the Institute of Certified Public Accountants in Israel "Inspection of Components of Internal Controls for Financial Reporting" and its amendments (hereinafter: "Audit Standard 104"). These components are, excluding subsidiaries: (1) organization-level controls, including controls of the process of preparing and closing financial reporting and general controls of information systems; (2) controls of passenger revenues from the sale of flight tickets; (3) controls of frequent flyer club; (4) controls for fixed assets - aircraft, engines and spare parts; (5) controls for fuel expenses; (6) controls for salary expenses for employees in Israel (with the exception of senior employees and executives); (7) controls for actuary calculations for Israeli employees (with the exception of senior employees and executives) (all of the above together are referred to as the "Audited Control Components").

We have conducted our audit in accordance with Audit Standard 104. According to this standard, we were required to plan the audit and carry it out with the aim of identifying the inspected control components and achieve a reasonable level of assurance as to whether these control components were upheld effectively in all material respects. Our audit included obtaining an understanding of the internal controls over financial reporting, evaluations of the risk of the presence of any material weakness in the inspected control components, as well as testing and evaluating those control components based on the evaluated risk. Our audit, regarding those control components, also included additional procedures that we believed to be necessary under the circumstances. Our audit referred solely to the audited control components, unlike an internal audit on all processes material to financial reporting, and therefore our opinion refers to the audited control components only. Furthermore, our audit did not refer to mutual influences between audited and unaudited control components and therefore, our opinion does not bring such negative impacts into account. We believe that our audit provides a sufficient basis for our opinion in the context described above.

Due to their understandable limitations, internal controls over financial reporting in general, and components thereof in particular, may fail to prevent or discover a misrepresentation. Likewise, conclusions regarding the future on the basis of any present effectiveness assessment may be exposed to the risk that the controls become

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inappropriate due to changes in circumstances or that the application of the policy or the procedures changes to the worse.

In our opinion, the Company has upheld in an effective manner, in all material respects, its audited control components as of December 31, 2016.

We have also conducted an audit, in accordance with generally accepted Israeli auditing standards, of the Company's Consolidated Financial Statements for December 31, 2016 and 2015 and for each of the three years of the period ending December 31, 2016 and our report, published March 21, 2017, includes our unreserved opinion of those Financial Statements, as well as directing attention to exposure of the Company to class actions, based on our audit and on the reports of the other auditing accountants.

Brightman Almagor Zohar & Co.
Accountants
Member Of Deloitte Touche Tohmatsu Limited

Tel Aviv, March 21, 2017

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Auditors' Report to the Shareholders of

El Al Israel Airlines Ltd.

We have audited the attached consolidated statements of financial position of El Al Israel Airlines Limited (hereinafter the "Company") as of December 31, 2016 and 2015 and the consolidated statements of profit and loss, comprehensive profit, changes to capital and cash flows for each of the three years in the period ending December 31, 2016. These Financial Statements are the responsibility of the Company's board of directors and management. Our responsibility is to express our opinion on these financial statements based on our audits.

We did not audit the financial statements of consolidated subsidiaries, the assets of which included in the consolidation represent approximately 0.3% and 0.3% of total consolidated assets as of December 31, 2016 and 2015, and whose income included in consolidation constitute 1%, 0.9% and 1.1% of total consolidated income for the years ending December 31, 2016, 2015 and 2014, respectively. Furthermore, we did not audit the financial statements of an associated company on an equity basis, the investment in which amounted to a total of USD 15,093,000 and USD 13,965,000 as of December 31, 2016 and 2015, respectively, and the Company's share of its results for the year ending December 31, 2016, 2015 and 2014 amounted to a total of USD 1,646,000, USD 821,000 and USD 874,000, respectively.

The financial statements of these companies were audited by other accountants, the statements of whom have been produced to us and our opinion, inasmuch as it refers to sums included for the companies, is based other reports from these other accountants.

We conducted our audit in accordance with generally accepted Israeli auditing standards, including standards set in the Accountants Regulations (Accountant's Method of Operation), 5733-1973. These Standards require that we plan and perform the audit with the aim of obtaining reasonable assurance that the Financial Statements are free of any material misstatement. An audit includes examining, on a sample basis, evidence supporting the amounts and disclosures in the financial statements. The audit also includes an examination of the accounting rules implemented and of the material estimates made by the Company's board of directors and management, as well as an evaluation of the propriety of presentation on the Financial Statements as a whole. We are of the opinion that this audit, and the reports of the other accountants, provide an adequate basis for the provision of our professional opinion.

In our opinion, based on our audits and the reports of other accountants, the Financial Statements referred to above adequately reflect, in all material respects, the financial status of the Company and its subsidiaries as of December 31, 2016 and 2015 and the results of their operations, changes to their equity and their cash flows for each of the three years in the period ending December 31, 2016, in accordance with International Financial Reporting Standards ("IFRS") and with the provisions of the Israeli Securities Regulations (Annual Financial Statements), 2010.

Without qualifying the above conclusion, we direct your attention to the following:

- To that stated in Note 15b to the Financial Statements regarding exposure to the approval of lawsuits as class actions and the Company's exposure to these class actions.

We have also audited, in accordance with Audit Standard 104 of the Institute of Certified Public Accountants in Israel "Inspection of Components of Internal Controls for Financial Reporting," and its amendments, components of internal controls of the Company's financial reporting as of December 31, 2016, and our March 21, 2017 report includes an unreserved opinion regarding the effective existence of those components.

Brightman Almagor Zohar & Co.
Accountants
Member of Deloitte Touche Tohmatsu Limited
Tel Aviv, March 21, 2017

תל אביב - משרד ראשי	טריגר פורסייט	משרד רמת-גן	משרד ירושלים	משרד חיפה	משרד באר שבע	משרד אילת
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El Al Israel Airlines Ltd.
Consolidated Statements of Financial Position

	Note	As of December 31 2016 USD thousands	As of December 31 2015 USD thousands
Assets			
Current assets			
Cash and cash equivalents	3	180,756	112,668
Shorts term deposits	4	30,878	79,260*
Customers and other receivables	5	166,544	161,392
Derivative financial instruments	18	17,959	1,467
Expenses in advance	6	20,592	22,999*
Inventory	7	18,340	16,495
Total current assets		435,069	394,281
Non-current assets			
Long-term deposits	4	18,294	11,488*
Long-term investments	8	23,830	19,370*
Fixed assets and intangible assets	9	1,169,563	1,171,454
Derivative financial instruments	18	4,960	-
Long-term expenses in advance	6	5,582	1,211*
Assets for employee benefits	14	59,653	66,345
Total non-current assets		1,281,882	1,269,868
Total assets		1,716,951	1,664,149

(*) Reclassified. See Note 22.

The notes to the Consolidated Financial Statements constitute integral parts hereof.

El Al Israel Airlines Ltd.
Consolidated Statements of Financial Position

	Note	As of December 31 2016 USD thousands	As of December 31 2015 USD thousands
Liabilities and capital			
Current liabilities			
Short-term credit and current maturities	13	180,899	193,226
Suppliers and service providers		135,655	133,924
Accounts payable	11	59,858	70,186
Provisions	15	17,846	10,478
Derivative financial instruments	18	-	39,474
Liabilities for employee benefits	14	95,606	100,646*
Unearned revenue	12	310,256	290,096
Total current liabilities		800,120	838,030
Non-current liabilities			
Loans from bank corporations and others	13	426,524	439,330
Liabilities for employee benefits	14	73,809	79,011*
Derivative financial instruments	18	-	2,712
Long-term payables		4,499	4,437
Deferred tax liabilities	16	86,218	60,567*
Unearned revenue	12	41,730	42,127
Total non-current liabilities		632,780	628,184
Total liabilities		1,432,900	1,466,214
Capital	17		
Share capital		155,012	155,012
Premium and capital reserves		279,379	240,556
Loss balance		(150,340)	(197,633)*
Total capital		284,051	197,935
Total liabilities and capital		1,716,951	1,664,149

*Immaterial adjustment of comparative numbers

Amikam Cohen - Chairman of the Board of Directors	David Maimon - CEO	Dganit Palti - CFO

Date of approval of the financial statements: Ben Gurion Airport, March 21, 2017.

The notes to the Consolidated Financial Statements constitute integral parts hereof.

El Al Israel Airlines Ltd.

Consolidated Profit and Loss Statements

	Note	For the year ended December 31 2016	2015	2014
		USD thousands	USD thousands	USD thousands
Operating income	19.a.	2,038,428	2,054,041	2,081,303
Operating expenses	19.b.	(1,642,417)	(1,592,844)	(1,802,661)
Gross profit		396,011	461,197	278,642
Sale expenses	19.c.	(192,565)	(194,911)	(202,140)
Management and general expenses	19.d.	(94,799)	(93,237)	(100,811)
Other net income (expenses)	19.e.	1,959	(3,282)	11,525
		(285,405)	(291,430)	(291,426)
Profit (loss) from ordinary activity		110,606	169,767	(12,784)
Financing expenses	19.f.	(24,210)	(26,820)	(27,471)
Financing income	19.g.	1,083	287*	225*
Net financing expenses		(23,127)	(26,533)	(27,246)
The Company's share of the profits of associated companies and revaluation of options for them		5,981	1,357*	1,743*
Profit (loss) before taxes on income		93,460	144,591	(38,287)
Tax benefit (income tax)	16	(12,766)	(38,057)	10,227
Net income (loss) for the year		80,694	106,534	(28,060)
Profit (loss) per one ordinary share par value NIS 1 (In dollars):				
Profit (loss) per basic and diluted share		0.16	0.21	(0.06)
The weighted average number of shares (in thousands) used in calculating earnings (loss) per share:				
Basic and diluted		495,719	495,719	495,719

* Reclassified - revaluation of Maman options.

The notes to the Consolidated Financial Statements constitute integral parts hereof.

El Al Israel Airlines Ltd.

Consolidated Statements of Comprehensive Profit

	For the year ended December 31		
	2016	2015	2014
	USD thousands	USD thousands	USD thousands
Profit (loss) for year	80,694	106,534	(28,060)
Other comprehensive income:			
Amounts that are not classified in the future to profit or loss:			
Loss from the re-measurements of a defined benefit plan, net of tax	(9,603)	(984)	(258)
Amounts that are classified in the future to profit or loss:			
Exchange rate differences for translation of foreign operations	408	(137)	(2,448)
Profit (loss) for hedging cash flows, net of tax	40,418	5,346	(41,298)
Profit (loss) for hedging cash flows - time value, net of tax	7,600	(2,672)	-
Total other comprehensive profit (loss) for the year	38,823	1,553	(44,004)
Total comprehensive profit (loss) for the year	119,517	108,087	(72,064)

The notes to the Consolidated Financial Statements constitute integral parts hereof.

El Al Israel Airlines Ltd.

Consolidated Statements of Changes in Equity

	For the year ended December 31, 2016								
	Share capital	Premium on shares	Capital reserve from transactions with the former controlling shareholder	Capital reserve for cash flow hedging	Capital reserve for cash flow hedging - time value	Capital reserve for translation differences of foreign operations	Capital reserve for remeasurement of the net liability for a defined benefit	Profit (loss) balance	Total
	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands
Balance as of January 1, 2016	155,012	35,554	237,122	(27,882)	(2,672)	(983)	(583)	(197,633)*	197,935
Profit for the year	-	-	-	-	-	-	-	80,694	80,694
Other comprehensive income (loss)	-	-	-	40,418	7,600	408	(9,603)	-	38,823
Total comprehensive profit (loss) for the year	-	-	-	40,418	7,600	408	(9,603)	80,694	119,517
Dividends paid (see Note 17)	-	-	-	-	-	-	-	(33,401)	(33,401)
Total capital as of December 31, 2016	155,012	35,554	237,122	12,536	4,928	(575)	(10,186)	(150,340)	284,051

*Immaterial adjustment of comparative numbers

The notes to the Consolidated Financial Statements constitute integral parts hereof.

El Al Israel Airlines Ltd.

Consolidated Statements of Changes in Equity

(Continued)

	For the year ended December 31, 2015									
	Share capital	Premium on shares	Capital reserve from transactions with the former controlling shareholder	Capital reserve for share-based payment transactions	Capital reserve for cash flow hedging	Capital reserve for cash flow hedging - time value	Capital reserve for translation differences of foreign operations	Capital reserve for remeasurement of the net liability for a defined benefit	Profit (loss) balance	Total
	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands
Balance as of January 1, 2015	155,012	28,007	237,122	7,547	(33,228)	-	(846)	401	(279,427)*	114,588
Profit for the year	-	-	-	-	-	-	-	-	106,534	106,534
Other comprehensive income (loss)	-	-	-	-	5,346	(2,672)	(137)	(984)	-	1,553
Total comprehensive profit (loss) for the year	-	-	-	-	5,346	(2,672)	(137)	(984)	106,534	108,087
Expiration of stock options	-	7,547	-	(7,547)	-	-	-	-	-	-
Dividends paid (see Note 17)	-	-	-	-	-	-	-	-	(24,740)	(24,740)
Total capital as of December 31, 2015	155,012	35,554	237,122	-	(27,882)	(2,672)	(983)	(583)	(197,633)*	197,935

*Immaterial adjustment of comparative numbers

The notes to the Consolidated Financial Statements constitute integral parts hereof.

El Al Israel Airlines Ltd.

Consolidated Statements of Changes in Equity

(Continued)

	For the year ended December 31, 2014								
	Share capital	Premium on shares	Capital reserve from transactions with the former controlling shareholder	Capital reserve for share-based payment transactions	Capital reserve for cash flow hedging	Capital reserve for translation differences of foreign operations	Capital reserve for re-measurement of the net liability for a defined benefit	Profit (loss) balance	Total
	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands
Balance as of January 1, 2014	155,012	28,007	237,122	7,547	8,070	1,602	659	(254,520)	183,499
Immaterial adjustment of comparative numbers	-	-	-	-	-	-	-	3,153	-
Balance as of January 1, 2014 after immaterial adjustment of comparative numbers	155,012	28,007	237,122	7,547	8,070	1,602	659	(251,367)	186,652
Loss for the year	-	-	-	-	-	-	-	(28,060)	(28,060)
Other comprehensive loss	-	-	-	-	(41,298)	(2,448)	(258)	-	(44,004)
Total comprehensive loss for the year	-	-	-	-	(41,298)	(2,448)	(258)	(28,060)	(72,064)
Total capital as of December 31, 2014	155,012	28,007	237,122	7,547	(33,228)	(846)	401	(279,427)	114,588

The notes to the Consolidated Financial Statements constitute integral parts hereof.

El Al Israel Airlines Ltd.

Consolidated Statements of Cash Flows

	For the year ended December 31		
	2016	2015	2014
	USD thousands	USD thousands	USD thousands
Cash flow from current operations			
Profit (loss) for year	80,694	106,534	(28,060)
Adjustments required to present cash flows from operating activities - Appendix A	162,146	164,884	191,503
Cash arising from current operations, net	242,840	271,418	163,443
Cash flows for investment activities			
Acquisitions of fixed assets (including general engine renovations and payments on account of aircraft)	(159,835)	(136,239)	(173,966)
Proceeds from sale of fixed assets	16,071	913	8,666
Investment in intangible assets	(12,926)	(672)	(3,031)
Change in deposits	41,735	(28,139)	(30,275)
Proceeds from the sale of Holiday Lines	2,078	-	-
Cash used for investment activities, net	(112,877)	(164,137)	(198,606)
Cash flows from (for) financing activities			
Payment for the costs of raising loans	(367)	(3,876)	(9,293)
Receipt of loans from bank corporations and others	158,137	104,547	148,599
Payment of loans from bank corporations and others	(185,315)	(125,105)	(143,513)
Increase (decrease) in short-term credit, net	(149)	(982)	12,796
Dividends paid	(33,401)	(24,740)	-
Cash arising from (used for) financing activity, net	(61,095)	(50,156)	8,589
Effect of exchange rate fluctuations on cash balances held in foreign currency	(780)	862	(4,885)
Increase (decrease) in cash and cash equivalents	68,088	57,987	(31,459)
Balance of cash and cash equivalents at beginning of year	112,668	54,681	86,140
Balance of cash and cash equivalents at end of year	180,756	112,668	54,681

The notes to the Consolidated Financial Statements constitute integral parts hereof.

El Al Israel Airlines Ltd.

Consolidated Statements of Cash Flows

	For the year ended December 31		
	2016	2015	2014
	USD thousands	USD thousands	USD thousands
Appendix A -			
Income and expenses that do not involve cash flows:			
Depreciation and amortization (including disposals for accessories, out-of-use components and consumption of consumables)	175,924	161,108	142,158
Deferred taxes, net	12,078	37,721	(10,399)
Increase (decrease) in liabilities for employee benefits and provisions	(8,807)	10,442	(17,167)
Capital gain on sale of fixed assets, net	(1,680)	(2,043)	(5,457)
Change in derivatives (other than through other comprehensive income)	851	(28,976)	29,150
Expenses (income) from exchange rate differences on cash and cash equivalents	780	(862)	4,885
Capital from early repayment of loan (see Note 13)	(1,263)	-	-
Investment in capital gains from the sale of Holiday Lines (see Note 8)	(1,164)	-	-
Other changes (mainly revaluation of Maman options)	(5,244)	(1,085)	(937)
Changes in operating assets and liabilities:			
Decrease (increase) in customers and other receivables	(12,249)	(12,436)	8,451
Decrease (increase) in prepaid expenses	(1,964)	(1,883)	833
Decrease (increase) in inventories	(1,845)	4,088	3,215
Increase (decrease) in trade payables	(13,034)	(8,110)	25,351
Increase in unearned revenue	19,763	6,920	11,420
	162,146	164,884	191,503

Appendix B - Payment and Receipt of Interest, Taxes and Dividends Paid or Received and Classified Under Cash Flow from Operating Activities[1]

	2016	2015	2014
Interest payments	17,338	15,877	16,422
Interest receipts	1,095	176	225
Tax payments - advances for excess expenses	372	276	517
Dividend receipts	682	576	184

The notes to the Consolidated Financial Statements constitute integral parts hereof.

[1] The Company classifies cash flows for interest and dividends it received as well as cash flows for interest paid as cash flows used for or derived from operating activity.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 1 - General

El Al Israel Airlines Ltd. mainly operates in the field of transport of passengers and cargo, including luggage and mail, on scheduled flights (mostly) and charter flights between Israel and foreign countries.

In addition, the Company is engaged in providing maintenance services at its home airport, sale of duty-free products and - through investees - in related activities, mainly production and supply of airline meals and management of several travel agencies abroad. For information on the Group's operating segments, see Note 20.

Passenger traffic through Ben Gurion Airport (BGN) is characterized by a high level of seasonality. Most activity is during summer months, peaking July-September. Winter months (January-March) are characterized by low passenger activity levels.

In the matter of signing an agreement with aircraft manufacturer the Boeing Company (hereinafter: "**Boeing**") for the purchase of 787-9 and 787-8 aircraft, as well as signing agreements with aircraft leasing company, according to which the Company would lease additional planes of the same models, see Note 9d.

Regarding actions taken by the Company's pilots, which according to the Company constituted illegal sanctions, and regarding agreements signed therewith during December 2016 and February 2017, see Note 14.l. below.

Note 2 - Basis of Preparation of the Financial Statements

a. Statement regarding the implementation of International Financial Reporting Standards (IFRS) and Securities Regulations:

The Company's Financial Statements have been prepared in accordance with International Financial Reporting Standards (hereinafter: the "IFRS Standards") and interpretations thereof issued by the International Accounting Standards Board (IASB), and in accordance with the Securities Regulations (Annual Financial Statements), 5760-2010 (hereinafter – "the Financial Statement Regulations").

In accordance with Article 4 of the Periodic and Immediate Reports Regulations, the Company did not include separate financial information to these Financial Statements as per Article 9c of the Securities Regulations (Periodic and Immediate Reports), 5730-1970, in light of the negligible influence the investees' financial statements have on the Company's Consolidated Financial Statements. The criteria used by the Company in this decision are the scope of data of the subsidiaries from the Company's total assets, revenues, profits and cash flows from current activities (under 5%).

b. The Company's functional currency and foreign currency:

The Company's Consolidated Financial Statements and those of each of its subsidiaries are prepared in the currency of the primary economic environment in which they operate (hereinafter – the "Functional Currency"), while the Group's consolidated Financial Statements are presented in dollars – the Company's Functional Currency, as this currency is used to denote most of the Company's income and expenses, including the purchase and financing of its aircraft.

Transactions executed in currencies other than said company's Functional Currency are recorded at the exchange rates effective as of the transaction date. At the end of each reporting period, financial items denominated in other currencies are translated using the exchange rate effective as of that date. Exchange rate differences are recognized in the Statement of Profit and Loss in the period in which they were generated (except for exchange rate differences for investees – see Note 21b).

Note 2 - Basis of preparation of the Financial Statements (cont.)

c. Accounting considerations and critical estimates:

(1) General:

In applying the Company's accounting policy, the Company's management is, at times, required to exercise considerable accounting discretion with regard to estimates and assumptions used in determining the value of assets and liabilities in the Financial Statements. These estimates and related assumptions are based on past experience and other factors deemed relevant. Actual results may differ from these estimates.

(2) Contingent liabilities and provisions (including tax deductions):

In order to examine the exposures arising from claims filed against the Company, including tax deductions, filed by the Tax Authority, as well as the determination of the probability of their realization to the Company's detriment, the Company's management relies on the opinion of legal and professional counsel. After the Company's counsel have formed their legal opinion and the Company's probability with regard to the matter of the claim, whether the Company would have to bear its outcome or may postpone it, the Company's management estimates the amount to be included in the financial statements, if any, based on the Company management's best estimate regarding the sum needed to clear the obligation. The results of the proceedings may be different from the estimates of the Company's management, and thus materially impact its financial state and the results of the Company's operations.

For details regarding the contingent liabilities and provisions as of December 31, 2016, see Note 15.

(3) Employee benefits

The present value of the Company's severance pay liability for some of its Israeli employees, for vacation payment for all Israeli employees, as well as for other benefits including pension plans for some local Company employees in the U.S. and UK, is based on large amounts of data determined based on actuarial estimate, using actuary assumptions. Changes in actuarial assumptions may impact the appraised value of the Company's liabilities for payment of the benefits as stated. Accordingly, the Company reviews the actuarial assumptions that are used in calculating the various commitments. For details of the actuarial assumptions and a sensitivity analysis of the same, see Note 14.

(4) Useful lifespan and residual values of fixed assets and parts

Company aircraft and engines are amortized throughout their useful lifespan, taking their residual value into account. As stated in Note 9 below, the estimate of the useful lifespan of the Company's planes and engines, as well as their residual values, is determined in accordance with management's plans and estimates regarding the manner of use of the aircraft fleet as well as in accordance with market estimates regarding the sums of sale of equipment upon removal from service, among other things, on the basis of aircraft price lists published from time to time.

Actual changes in the balance of useful lifespan and/or the residual value may lead to material changes in the Company's depreciation rates and depreciation expenses.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 2 - Basis of preparation of the Financial Statements (cont.)

c. Critical accounting discretion and key sources of uncertainty in estimates: (cont.)

(5) Examination of impairment:
As stated in Note 9 below, in estimating value in use, the Company estimates future cash flows expected to arise from extended use of the Company's aircraft and their realization at the conclusion of the usage period, and deducts them to their current value using a discount rate reflecting the operational risk of the aircraft fleet based on the Company's weighted discount rate.

Regarding the key assumptions used in calculating the cash flow capitalization, see Note 9(a)(5). Material differences in these estimates, or in part of them, may impact the value of the recoverable sum of these aircraft.

(6) Frequent flyer clubs:
In order to calculate the balance of unearned revenues for frequent flyer points accumulated as of the report date and yet unused, the Company relies on the sales prices of the various products to which these points can be converted, while taking into account the number of points that need to be converted in order to purchase those products in exchange for points, and on the Company's experience regarding the point utilization forecast.

Changes in the management's estimates regarding the value of a point and the point's non-exercise rate may impact the timing of recognition of income from the sale of flight tickets.

d. New financial reporting standards published and their interpretations:

(1) IFRS 15 - "Revenues from Contracts with Customers":
The new standard, which will enter into binding force regarding annual reporting periods beginning on January 1, 2018 or thereafter, sets forth a comprehensive and uniform mechanism that regulates the accounting treatment of income arising from contracts with customers. The core principle of the standard is that recognition of income will reflect the transfer of merchandise or services to customers in an amount representing the economic benefits that the entity expects to receive in consideration for the same. To do so, the standard provides that recognition of revenues will take place when the entity transfers to the company the merchandise and/or services listed in the agreement therewith such that the customer obtains control of the same merchandise or services, subject to the fulfillment of the performance obligations in the agreement.

To do so, the standard sets forth five stages for the application of this principle, which will be listed below with regarding to their anticipated impact as well, if any, on the Company's accounting policy regarding revenue recognition.

1. Identification of the agreement (or agreements) with the customer - does not constitute a change compared to the present accounting policy.
2. Identification of the performance obligations in the agreement - see Sections B, C and D below.
3. Determination of the transaction price - see Section D below.
4. The allocation of the transaction price to the performance obligations - see Sections A and D below.
5. Recognition of revenue when the entity completes the performance obligation - see Section B and C below.

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 2 - Basis of preparation of the Financial Statements (cont.)

d. New financial reporting standards published and their interpretations: (cont.)

(1) IFRS 15 - "Revenues from Contracts with Customers": (cont.)

The following are the future effects that may arise from the application of the of the standards:

a. Attribution of revenue to a frequent flyer club - in accordance with the existing standards (IFRIC 13) and as set forth in Note 12 below, the Company attributes the sales consideration attributed to this component based on the fair value of the points granted to the customers. In accordance with the new standard, the transaction price for the performance obligations must be attributed based on the **ratio** of the sale prices of the various products when they are sold on a standalone basis. In light of the same, the Company expects to allocate a smaller part of the total sales consideration for the component of the frequent flyer points, which is expected to cause a decrease in the liability balance for the points of the Company's Matmid Frequent Flyer Club and on the other hand to allocate a larger part of the total sales consideration for the plane ticket component, such that the revenue for the flight component is expected to be in an amount higher than today.

b. The sale of points to partners - at this stage, the Company is examining the impact of the provisions of the standard on the marketing elements inherent in such transactions (see also Note 12 below).

c. Handling / change fees - in accordance with the existing standard, the Company recognizes revenue for handling / change fees in connection with plane tickets as immediate revenue. In accordance with the new standard, the handling / change fees do not meet the definition of a separate performance obligation, and therefore will be recognized as revenue on the flight date. This is expected to lead to a delay in the timing of revenue recognition for this component and to increase the balance of unearned revenue in the statement of financial position.

d. Customer compensation - in accordance with the new standard, compensation for customers is recognized as a type of change of contract. Therefore, compensation to customers in the form of airline tickets, for example, will be recognized as a separate performance obligation that must also be allocated the original transaction price, while they are currently recognized as an expense. Therefore, a relative part of the plane ticket price will be reduced from the revenue recognized and will be allocated to liability for the future flight. This will lead both to a delay in the timing of the revenue recognition from flights in which the customer is entitled to compensation as stated and to a reduction in the Company's revenue against a decrease in the Company's expenses. Furthermore, compensation provided to customers in cash will be allocated from the Company's revenue as a change in transaction price.

e. Cargo revenue - in accordance with the existing standard and as set forth in Note 12 below, when the provision of the service is sold by the Company but executed by other airlines ("interline"), the revenue is presented on a net basis, meaning, the Company collects the proceeds arising from the entire transaction, transfers to the other airline its share, and records income for the difference between them alone. In accordance with the new standard, regarding cargo revenue, it is expected that this revenue will be presented on a gross basis, meaning the sale to the customer will be recognized as full income, while the payment to the other airline will be recognized as an expense. If the provisions of the new standard had been implemented on cargo revenue in 2016, the Company's revenue turnover would be expected to grow by about USD 6 million against an increase in the same amount in the operating expenses. It is noted that regarding revenue from passenger flights, no change is expected in this regard compared to the existing standard.

f. Transaction costs - in accordance with the existing standards and as set forth in Note 6 below, the Company refers to commissions paid to agents as transaction costs, which are recognized as unearned revenue when incurred and reduced to profit and loss on the flight date. In accordance with the new standard, the transaction costs will also include commissions paid to the credit card companies as well as amounts paid to the Company's various distribution systems (amounts that are currently recognized as an immediate expense). Additionally, the new standard allows for practical relief whereby all of the aforesaid amounts can be recognized (including the agent fees) as an immediate expense. Accordingly, if the Company does not

Note 2 - Basis of preparation of the Financial Statements (cont.)

d. New financial reporting standards published and their interpretations: (cont.)

choose the practical relief as stated above, the Company expects to delay the timing of the recognition of part of its sales expenses.

The Company does not have financial covenants whose compliance would be impacted from the application of the new standard, and does not expect that the application of the standard will impact any given engagements of the Company.

It is emphasized that the information presented in this note regarding the estimates of the effects of the initial application of the standard constitutes an estimate by the Company based on the Company's understanding of the provisions of the standard at this stage. The quantitative data that will be included in the financial statements for the period of initial application may be different from the Company's estimates at this stage.

In addition, the standard sets forth extensive disclosure obligations regarding contracts with customers, the significant estimates and the changes thereto, in order to allow the readers of the financial statements to understand the nature, quantity, timing and reliability of the revenue and the cash flows of the Company. In this regard, the Company will review the manner of implementation of the disclosure provisions listed in the standard on the nature of its activities and determine the disclosure required from the same.

During 2017, the Company will deepen the examination of the provisions of the standard, form the policy regarding the matters that arise therefrom, estimate the quantitative impact of the application of the standard more accurately, and if required, update the disclosure regarding the effects of the implementation in its future reports.

As a rule, the standard will be applied retroactively; however, the option is provided to select certain adjustments within the transition provisions of the standard regarding its application in previous reporting periods, *inter alia*, the possibility of not amending the comparative numbers (but to adjust the retained earnings for the beginning of the period in which the standard will be applied). During 2017, the Company will formulate its accounting policy regarding the transitional provisions, including in connection with the method of initial implementation selected by the Company, and update the disclosures accordingly.

(2) IFRS 16 - "Leases":

The new standard, which will take effect as of January 1, 2019 or thereafter, provides that leases (on the part of the lessee) will be treated in a manner similar to the purchase of an asset (excluding leases for periods of less than one year that are immaterial to the company), such that the discounted value of the future lease fees will be recorded as a "right to use the asset," which will be included in the statement of financial position, in the section of non-current assets, and be reduced to profit and loss over the lease term against the recording of a financial liability that reflects a loan from the lessor, which will be measured at reduced cost based on the effective interest method.

In light of this, all of the aircraft leases of the Company that are currently treated as operating leases, as well as certain additional leases such as structures, including the campus area in Ben Gurion Airport, which is leased by the Company from the Airport Authority, facilities and vehicles, which are leased by the Company, will be recognized upon the standard's implementation as assets and liabilities in the Company's statement of financial position.

At this stage, the Company is examining the impact of the provisions of the standard on its financial statements. The following are details of the expected main impacts, as estimated at the time being:

- A substantial increase in the scope of the Company's assets and liabilities following the registration of all of the Company's lease transactions as the acquisition of rights to use on the asset side against the obligation to pay lease fees on the liabilities side. Depending on the state of the Company's leasing as of the reporting date, the application of the provisions of the standard as of this date would lead to an increase in the Company's liabilities (before tax) of about USD 270 million to USD 310 million, and to a similar or lower increase on the asset side (depending on the transitional provisions implemented by the Company). In the event that the increase in assets is lower, the difference will be expressed as a decrease in equity (retained earnings) of the Company.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 2 - Basis of preparation of the Financial Statements (cont.)

d. New financial reporting standards published and their interpretations: (cont.)

(2) IFRS 16 - "Leases": (cont.)

- While the above is true regarding the state of the leases as of the reporting date, on the implementation date of the standard, the Company will be in the midst of the completion of the entire procurement transaction detailed in Note 9.d. below, such that the provisions of the standard in accordance with the Company's estimate at this preliminary stage will lead to a very substantial increase in the state of assets and liabilities, in an estimated scope of between USD 1 billion to USD 1.1 billion, with respect to the statement of financial position that the Company would present after this transaction in the absence of the implementation of the new standard.
- The new standard has a material impact on the Company's profit and loss statement as well. While according to the existing standard (IAS 17), the lease expenses are recognized in a straight line over the lease term, based on the new standard, the lease expenses will be recognized as a reduction of the right to use the asset and as financing expenses for the financial liability. In light of the fact that the effective interest method leads to recognition of a higher expense at the beginning of the lease term and a lower one towards its end, a change in the timing of recognition of the asset as stated is expected to have a material impact on the Company's results, which is currently examined by the Company and will be quantified later. As stated, this impact is expected to increase due to the procurement plan of new leased aircraft (see Note 9.d below), which have a substantial lease cost.
- A decrease in the lease expenses that are currently included in the operating expenses in the profit and loss statement against the increase in the amortization and depreciation expenses (reduction of the right of use) in the operating expenses and an increase in financing expenses due to the interest involved in the liability for lease fee payments will lead to an increase in gross profit, profit from ordinary activity and the Company's EBITDA, which are currently examined by the Company and will be quantified below.
- According to the existing standard (IAS 17), the cash flows for the Company's leases are classified as cash flows from operating activities. According to the new standard, the lease payments constitute, effectively, payment of financial liabilities vis-a-vis the lessor, and therefore, the standard is expected to lead to an increase in the cash flows from operating activity of the Company due to the classification of the principal component in the lease payments as cash flows for financing activities. The interest component in the lease payments will continue to be classified in the current activity in accordance with the Company's accounting policy regarding the classification of interest paid in operating activities.

It is emphasized that the information presented in this note regarding the scope of the effects of the initial application of the standard constitutes an estimate by the Company based on initial mapping only regarding the Company's lease agreements and are based on the Company's undertaking of the provisions of the standard at this stage. The quantitative data that will be included in the financial statements for the period of initial application may be different from the Company's estimates at this stage.

The Company does not have financial covenants whose compliance would be impacted from the application of the new standard, and does not expect that the application of the standard will impact any given engagements of the Company. During 2017, the Company will continue to examine the implications of this standard on its financial statements, including the capitalization rates, assessments of their impacts on the exit or extension options of the lease agreements on the lease terms, the measurement of the quantitative impact of the repayment terms of the assets leased and the like. If necessary, the Company will update the disclosures regarding the effects of the implementation in its future reports. Additionally, the Company will form its accounting policy regarding the transitional provisions based on which the new standard will be implemented, and consequently, will quantify the impact as of the date of the standard's initial application. At this stage, the Company anticipates that it will adopt the provisions of the standard on its required application date, i.e. in the financial statements of the first quarter of 2019. Regarding the future lease fees that are expected to be paid by the Company for its existing leases (including lease agreements of the 787 aircraft that were signed but have not yet started), see Note 10.d.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 3 - Cash and cash equivalents

Cash and cash equivalents include bank deposits available for immediate withdrawal as well as limited term deposits the use of which is unrestricted and/or lacks defined designation, and whose term to maturity, at the time of investment, is no greater than three months. Deposits with a redemption date on the investment date that exceeds three months and is no greater than one year are classified under short-term deposits.

Composition:

	As of December 31	
	2016	**2015**
	USD thousands	**USD thousands**
Cash and bank balances	44,864	80,612
Cash equivalents	135,892	32,056
Total cash and cash equivalents	180,756	112,668

Note 4 - Deposits

Composition:

	As of December 31	
	2016	**2015**
	USD thousands	**USD thousands**
Shorts term deposits	20,289	60,000
Deposit provided by the Company as a security for a banking institution. See Note 13.c	1,425	8,030
Deposit for surplus in payables fund (1)	8,485	8,361
Deposits provided by the Company as a security for aircraft lease agreements	494	2,687*
Other	185	182
Total shorts term deposits	30,878	79,260
Long-term bank deposits	696	702*
Deposits provided by the Company as a security for aircraft lease agreements	17,598	10,786*
Total long-term deposits	18,294	11,488

(*) Reclassified. See Note 22.

(1) A NIS deposit deriving from the proceeds of option exercises (Series 1) the Company received as part of the Company’s offering process, as described in Note 14.c.(2).

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 5 - Customers and other receivables

a. Accounting policy

The Company's customers are reviewed for indications of impairment on each balance sheet date. Such impairment occurs when there is objective evidence that as a result of one or more event, the chances of collecting on the customer's debt have been impaired. Such evidence may include, *inter alia,* significant financial difficulties on behalf of the debtor or failure to meet current payments.

During impairment, the book value of the customers is amortized while using a provision account for doubtful debts. The provision is calculated specifically (the Company does not make a general provision due to materiality). When the Company estimates that the same debts are not ultimately collectible, the debts are written off against the provision account.

b. Composition:

	As of December 31	
	2016	**2015**
	USD thousands	**USD thousands**
Customers:		
Open accounts (see (3) below)	95,871	105,083
Credit card companies	32,868	28,767
	128,739	133,850
Less - provision for doubtful debts (most of them over 90 days)	(5,630)	(7,903)
	123,109	125,947
Other debtors (see Section e. below)	43,435	35,445
Total customers and other receivables	166,544	161,392

(1) The average credit for Company services provided is 27 days (in 2015: 26 days).

(2) The average debt period of customer debts the repayment date of which has passed as of December 31, 2016 is 57 days (as of December 31, 2015 – 42 days).

(3) The Group has, in general, several types of customers in Israel and abroad: IATA agents (agents that pay through the IATA bank clearance system) and business customers (private customers that purchase tickets through payments in cash or credit cards). The credit rating of IATA agents is established in accordance with the bank clearance system (BSP for passenger agents and CASS for cargo agents abroad). The bodies in question require bank guarantees for these agents in accordance with IATA rules. In addition, the Company holds insurance for the credit risk of IATA agents in Israel as well as credit risk insurance for some of its business customers. These insurance policies do not cover all the Company's exposure to credit risk.

In determining the reasonability of the payment of customer debts, the Group examines changes in the quality of the customer's credit as of the date of granting the credit and until the reporting date. The total credit risk is limited in light of the large customer base, and its division into various sectors and geographical areas.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 5 - Customers and other receivables (cont.)

c. The age of customer debts that exceed the determined days of credit and for which no provision for doubtful debts was included:

	As of December 31	
	2016	2015
	USD thousands	USD thousands
0-90 days	6,330	2,651
Over 90 days	1,734	986
Total	8,064	3,637

d. Movement in provision to doubtful debt:

	As of December 31	
	2016	2015
	USD thousands	USD thousands
Balance at beginning of year	7,903	7,511
Loss from impairment for customers, net	1,212	1,361
Amounts of doubtful debts written off	(3,485)	(969)
Balance at end of year	5,630	7,903

e. Other receivables:

	As of December 31	
	2016	2015
	USD thousands	USD thousands
Governmental institutions	10,614	10,491
Deposits with service providers	2,975	3,062
Receivables for sale of aircraft	-	7,340
Receivables for overhaul of leased engines	14,640	3,108
Other receivables	15,206	11,444
	43,435	35,445

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 6 - Expenses in advance

Agent commissions referring to revenues not yet recognized (including for Frequent Flyer points) are included in the Financial Statements under "expenses in advance," and will be recognized as sale expenses in the profit and loss statement concurrent with the recognition of revenue from the flights for which commissions were paid. Regarding IFRS 15, see Note 2d(1) above.

Composition:

	As of December 31	
	2016	**2015**
	USD thousands	**USD thousands**
Current:		
Fees for unused air tickets	11,972	14,564
Fees for Matmid Frequent Flyer Club points	1,693	1,384
Aircraft leasing	3,331	3,581
Other	3,596	3,470
	20,592	22,999*
Non-current:		
Aircraft leasing	4,327	-
Fees for Matmid Frequent Flyer Club points	1,255	1,211
	5,582	1,211*

(*) Reclassified. See Note 22.

Note 7 - Inventory

Composition:

	As of December 31	
	2016	**2015**
	USD thousands	**USD thousands**
Jet fuel consumption	7,170	4,497
Materials and foodstuffs	5,974	6,537
Chemicals	3,959	3,749
Duty-free goods	1,237	1,712
	18,340	16,495

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 8 - Long-term investments

a. Composition:

	As of December 31	
	2016	2015
	USD thousands	USD thousands
Associates companies (see section B below)	22,371	17,821
Investments at fair value (see section C below)	1,459	1,549
Total	23,830	19,370*

* Reclassified See Note 22.

b. Investments in associates:

An associate is an entity in which the Company has a material influence, but does not control. Material influence is the power to participate in decision-making with regard to financial and operational policies of the associated company. In testing the existence of material control, potential voting rights, which can be realized or immediately converted to the shares of the held entity, are taken into account. The Company holds 15% of the shares of "Cargo and Handling Terminals Ltd." (Maman). Since the Company has options for shares of Maman that may lead to holdings of 25% of Maman's shares if exercised (see also the note related to affiliates, 23.c.(4)b(2)), and the Company is entitled to exercise them immediately and have a material impact, the Company recognizes Maman as an associated company.

The Group examines the presence of signs of impairment in this investment in accordance with the existence of objective evidence of the fact that the future cash flows expected from the investment were impaired and since its shares are traded on the Tel Aviv Securities Authority, an examination is done based on the changes in the price of Maman's shares.

Component of the investments accounted for based on the equity method:

	As of December 31	
	2016	2015
	USD thousands	USD thousands
Maman for shares	15,093	13,965
Maman for options	7,261	2,925
Holiday Lines (1)	-	914
Other	17	17
Total	22,371	17,821

(1) In November 2016, the Company sold its holdings (20%) in Kavi Hofsha Ltd. in consideration for a total of USD 2.1 million. Additionally, there is contingent consideration of an immaterial amount that will be received under certain conditions. For this transaction, the Company recognized capital gains under other income in the profit and loss statement in the amount of USD 1.2 million. See Note 19.e.

c. Fair value investments:

The investments include (in addition to investment in Sita to the sum of USD 1.2 million) investment ventures, which operate in conjunction with the Company, and in return the Company holds capital instruments in these ventures (mainly start-up companies). These investments are part of the comprehensive "Cockpit" venture, which is an arm of the Company intended to serve as an incubator for investment ventures touching upon the field of aviation, both in terms of financial support and in terms of cooperation with the Company in order to promote the venture. During 2016, the Company established the subsidiary "Cockpit Innovation Ltd." which will coordinate this activity. See Note 21 below as well.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 9 - Aircraft, flight equipment, other fixed assets and intangible assets

a. Accounting policy for the reduction and impairment testing of the Company's aircraft and flight equipment:

(1) General:

The Company's fixed assets largely consist of the Company's planes and flight equipment (such as parts and accessories, spare engines and so on). In addition to these, the fixed assets include the Company's buildings and facilities, transportation equipment, furniture and computers. Fixed asset items are presented in the balance sheet at cost, net of accumulated amortization.

(2) Amortization of the Company's aircraft and engines:

The Company's aircraft are amortized while being separated into two components – the fuselage and the component of the general renovation cost ("overhaul") of the aircraft engine, called "potential." The fuselage, including the part of the engine that is not potential, is amortized on a straight line over its anticipated useful life while taking into account the expected residual value at the end of the period, as it appears on the accepted aircraft price lists, which estimate the value of the aircraft for the year in which the management expects the Company's use of the same aircraft to end. The engine potential is amortized based on the actual engine hours compared to the expected engine hours until the date of the next overhaul (or the date on which the engine ceases to be used, as applicable).

In cases where the Company has entered into engine overhaul agreements of an insurance nature, the Company records expenses as specified in the insurance agreements, and the cost of general overhaul is incurred by the insurer. In these cases, the potential component is not amortized, so that the separate component is its expected residual value at the end of the engine's projected period of use. Despite the above, note that when the expected residual value for these engines decreases, the potential value is amortized for the difference based on the actual engine hours compared to the expected hours, until the date on which the engine ceases to be used.

The residual values, depreciation methods and useful life are reviewed by the Company's management on an ongoing basis. Changes in these estimates are accounted for "prospectively."

In light of the procurement plan set forth in Section d. below, a change has occurred in the projected dates in which airlines and engines in the 747 and 767 fleet owned by the Company will cease to operate. In addition, during 2016, the Company updated the estimate of the residual value of the 777 aircraft, subject to indications perceived in the market and in accordance with the accepted aircraft prices. In light of all of the above, the Company recognized additional depreciation expenses during the year in the amount of USD 6.7 million.

Below are the average annual depreciation rates of the vehicle fleet compared to cost (after reducing the residual value) for 2016:

Vehicle fleet	Average annual depreciation rate	Comments
737	5.1%	
747	10.7%	1
777	6.3%	
767	25.9%	2

(1) The relatively high depreciation rate arises from the plan for discontinuing use of this fleet, as stated above.

(2) The high depreciation rate for this fleet arises from the two aircraft owned by the Company in this fleet being acquired towards the end of their useful lives.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 9 - Aircraft, flight equipment, other fixed assets and intangible assets (cont.)

a. Accounting policy for the reduction and impairment testing of the Company's aircraft and flight equipment: (cont.)

(3) Accessories and spare parts:
The cost of accessories and spare parts included in the fixed assets is determined using the weighted moving average method. Accessories and spare parts attributed to a specific fleet are amortized over the average remaining life time of said fleet. Accessories and spare parts not attributed to a specific fleet are amortized according to the balance of the average life time of the Company's entire aircraft fleet.

(4) Establishment and maintenance costs of the Company's aircraft:
The cost of the aircraft includes all of the costs involved in purchasing the plane, including absorption costs. Additional costs borne by the Company after the absorption of the aircraft will be recognized in costs of the Company's aircraft, in the event that they constitute an asset that will be used by the Company in a number of periods (such as general engine overhauls or costs that lead to additions or significant upgrades to the aircraft's performance or form). Regular maintenance costs including engine overhauls that are not general overhauls as stated are charged to the profit and loss statement upon creation.

(5) Examination of impairment and estimate of the recoverable amount:
At the end of the entire reporting period, the Company examines whether there are any indications testifying to an impairment of the Company's aircraft fleet constituting, as a whole, a single cash generating unit. The Company's management believes that the positive cash flows arising from the Company's aircraft fleet are not independent of the cash flows of other fleets, since the Company's aircraft fleet fly, in many cases, to the same destinations to which aircraft from other fleets travel, and therefore are largely alternatives and in any case all constitute part of the Company's network of routes that it manages as a whole.

The examination of impairment primarily consists of a review of the difference between the book value of the aircraft fleet and their price list prices published every six months. A significant worsening in the contribution of the aircraft fleets or their residual values, and material changes in the Company's weighted cost of capital are also indications of impairment. If any such indications exist, the fleet's recoverable amount is estimated in order to determine whether impairment must be recognized, and the amount thereof.

The recoverable amount is the higher of the fair value of the fleet (generally, the aircraft price lists) and the value in use thereof. In estimating value of use, the Company estimates future cash flows expected to arise from use of the aircraft (projected contribution) and their realization at the conclusion of the usage period (with the help of price lists as stated), and deducts them to their current value using a discount rate reflecting the operating risk of the aircraft fleet based on the Company's weighted discount rate.

As of March 31, 2016, indicators of impairment were identified in the Company's aircraft fleet due to the difference that existed between the price list prices of the Company's aircraft fleet and their book value. Therefore, the Company made an estimate of the value in use of the aircraft fleet as stated above.

The main assumptions used in the calculation of the value in use as of March 31, 2016 are:

(1) The expected contribution from the aircraft fleet was based on the actual results in the first quarter of 2016, the estimated results for the second quarter (which retroactively were not materially different from the actual results) and the budget for the second half of the year (less conceptual tax, see also below regarding the impact of the difference between the Company's budget and actual results), projected forward across the economic life span of the aircraft fleet, in accordance with the projected economic parameters in the forecast period. The cash flow from the Company's aircraft fleet is for a defined and final period of time, until the planned date on which the existing aircraft will cease to be used.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 9 - Aircraft, flight equipment, other fixed assets and intangible assets (cont.)

a. Accounting policy for the reduction and impairment testing of the Company's aircraft and flight equipment: (cont.)

(5) Examination of impairment of the Company's aircraft and estimate of recoverable amount: (cont.)

Due to the fact that the valuation of the use as stated was performed for the Company's existing aircraft, and in light of the fact that a large part of the Company's existing wide-body aircraft fleet will be replaced with Boeing 787 aircraft (see section d. below), which constitutes a material and extraordinary investment during the Company's business, in a manner that will substantially change the nature of the cash flows expected to arise from the aircraft fleet, including the composition of income and expenses, cash flows expected to arise from the same future aircraft were not taken into account, including the expected investments in their purchase and absorption.

(2) The useful life of the aircraft is based on the dates of the projected cessation of use of each aircraft, which takes into account, *inter alia*, the exit dates of the aircraft as a result of the Boeing 787 model aircraft procurement plan as stated above.

(3) The average weighted capitalization interest, after tax, of 6.0%, which is equivalent to capitalization interest before tax of 13%.

In an examination conducted by the Company, it was determined that the recoverable amount of the aircraft fleet exceeds the carrying amount in the Company's financial statements. Accordingly, no provision for impairment was recorded.

As of December 31, 2016, it was determined that the estimate of the annual contribution of the aircraft fleet compared to the estimate of the contribution used for the calculation done as of March 31, 2016, is not different in a manner that may show any indication of impairment. In this context, it is noted that although there is a gap between the Company's budget that was used in the calculation of the recoverable amount as of March 31, 2016 and between the actual results, this difference is attributed primarily to the special circumstances prevailing in the Company in the second half of the year, mainly due to the labor relations (see Note 14.l) and therefore there is no reasonable basis to assume that the above will also continue in future terms and impact the recoverable amount.

In addition, there was no substantial change in the market interests compared to the same date, and it was found that the changes in the price list prices that were updated in October 2016 (taking into account aging of the aircraft) are lower than the depreciation expenses recognized by the Company for its aircraft. In connection with Note 9a(2) regarding a decrease in the residual values of the 777 aircraft, in light of the fact that the decrease in the residual values is substantially lower than the difference between the value in use and the book value of the aircraft fleet, it was determined that there is no need to reexamine the value in use beyond the examination done as of March 31, 2016, as stated above. Accordingly, during the year ending December 31, 2016, no provision was recognized for aircraft impairment.

(6) Reduction of other fixed assets and intangible assets:

The balance of the Company's assets is amortized in a straight line over the course of the expected useful life of the various assets, or in the case of leasehold improvements, for its useful life or the remainder of the asset's rental period, whichever is shorter.

(7) Regarding critical accounting discretion and key sources of uncertainty in estimates used in determining the value of the assets in the financial statements, see Note 2c(5) above.

b. Composition:

	As of December 31	
	2016	**2015**
	USD thousands	**USD thousands**
Aircraft and flight equipment - amortized cost	1,095,879	1,107,477
Other fixed assets and intangible assets - amortized cost	73,684	63,977
	1,169,563	1,171,454

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 9 - Aircraft, flight equipment, other fixed assets and intangible assets (cont.)

c. Aircraft and flight equipment:

	Passenger planes	General engine overhauls	Engines to replace	Payments on account of planes and engines	Accessories and spare parts	Total
	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands
Cost:						
As of January 1, 2016	1,641,825	161,274	25,605	100,299	253,770	2,182,773
Classification	96,595	396	-	(96,991)	-	-
Additions	23,737	24,916	-	71,287	35,186	155,126
Disposals	(28,740)	(3,344)	-	(12)	(46,271)	(78,367)
As of December 31, 2016	1,733,417	183,242	25,605	74,583	242,685	2,259,532
Accumulated depreciation:						
As of January 1, 2016	864,236	37,002	15,576	-	158,482	1,075,296
Depreciation of the year	94,796	19,433	950	-	13,724	128,903
Disposals	(22,062)	(3,344)	-	-	(15,140)	(40,546)
As of December 31, 2016	936,970	53,091	16,526	-	157,066	1,163,653
Amortized cost:						
As of December 31, 2016	796,447	130,151	9,079	74,583	85,619	1,095,879

	Passenger planes	General engine overhauls	Engines to replace	Payments on account of planes and engines	Accessories and spare parts	Total
	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands
Cost:						
As of January 1, 2015	1,623,853	155,761	25,605	77,194	249,159	2,131,572
Classification	30,324	-	-	(30,324)	-	-
Additions	16,829	7,642	-	53,429	44,428	122,328
Disposals	(29,181)	(2,129)	-	-	(39,817)	(71,127)
As of December 31, 2015	1,641,825	161,274	25,605	100,299	253,770	2,182,773
Accumulated depreciation:						
As of January 1, 2015	797,396	26,985	14,408	-	158,895	997,684
Depreciation of the year	90,022	12,146	1,168	-	10,557	113,893
Disposals	(23,182)	(2,129)	-	-	(10,970)	(36,281)
As of December 31, 2015	864,236	37,002	15,576	-	158,482	1,075,296
Amortized cost:						
As of December 31, 2015	777,589	124,272	10,029	100,299	95,288	1,107,477

In general, the majority of the Company's aircraft and engines are pledged in favor of the bodies accompanied by fixed and specific first-degree liens, including potential and associated rights such as leasing and insurance. The Company is precluded from transferring or registering an additional lien on the assets without the prior consent of the accompanying bodies. See Note 13(c) below as well.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 9 - Aircraft, flight equipment, other fixed assets and intangible assets (cont.)

d. Procurement plan for the acquisition and lease of 787 wide-body aircraft:

Aircraft acquisition:

On October 29, 2015, the Company signed an agreement with the Boeing Company ("Boeing") according to which the Company undertook to purchase four new 787-9 Dreamliner aircraft and five new 787-8 Dreamliner aircraft from Boeing ("the Purchase Agreement" and "the Aircraft," respectively). In accordance with the Purchase Agreement, the Company was granted terms offering flexibility in the matter of the dates the planes were received in such a manner so as to allow compatibility with the Company's requirements from time to time, regarding its aircraft fleet, including the right to convert them to aircraft of different 787 Boeing models.

In addition, the Company was granted options to purchase seven additional 787-10 aircraft ("the Option Aircraft"), as long as their delivery date is no later than December 31, 2023. The Company paid non-refundable advance payments for the option planes at a non-material sum. In addition, in a situation in which the Company decides to exercise any of the Option Aircraft, on each exercise date the Company shall have the right to purchase an additional option to purchase a 787-10 aircraft, up to a total of six additional planes ("the Additional Option Aircraft"). The Company will pay a non-refundable advance payment near the date the option in question is purchased. The Option Aircraft and the Additional Option Aircraft are expected to be received between 2020 and 2023. Note that according to the Purchase Agreement, the Company has the option of cancelling some of the planes, and the Option Aircraft and the Additional Option Aircraft have conversion rights for planes of other 787 series models.

The estimated cost for the purchase of the nine planes as well as the aircraft engines, the alternate engines and the spare parts (for all 16 aircraft, including the leased aircraft as set forth below) amounts to USD 1,250,000,000. The payment for each aircraft will be made upon its delivery to the Company, other than an advance in the rate of about 30% from the aforesaid estimated cost for each aircraft, which will be paid at an earlier date according to the terms of the Purchase Agreement. Until the publication of the financial statements, the Company paid a total of USD 119.3 million (of which USD 65.8 million was paid by the date of the statement of financial position) as an advance for the aforesaid procurement transaction, while taking a loan in the amount of USD 85 million (of which about USD 30 million was paid by the date of the statement of financial position), as stated in Note 13 below.

In addition, in September 2016, the Company signed agreements with a foreign company based on which two of the 787-8 aircraft from the nine aircraft purchased by the Company from Boeing as stated above would be sold to the foreign company upon its delivery from Boeing and would be leased back by the Company (sale and lease), such that upon the completion of the sale and lease transactions, the estimated purchase cost of the seven remaining aircraft, spare engines and spare parts within the procurement transaction will amount to USD 1,025,000,000. It is noted that the Company has the right to terminate the sale and lease transactions upon the occurrence of certain conditions, as determined in the Agreement and subject to prior notice to the lessor.

Aircraft leasing:

In addition to the Purchase Agreement and the sale and lease agreements as stated above, the Company signed agreements for the lease of five new model 787-9 Dreamliner aircraft, and two 787-8 model aircraft.

All of the leases (including the leases at the subject of the sale and lease transactions) are for a period of 12 years, when regarding some of the aircraft, the Company has an early termination option after ten years, subject to providing prior notice and payment of exit fees based on the terms set forth in each agreement.

In summary of all of the above, the Company will acquire 16 new 787 Boeing wide-body aircraft (with options for additional aircraft), of which nine aircraft are leased (five 787-9 and four 787-8 aircraft, including the aircraft, regarding which the sale and lease was agreed) and seven owned aircraft (four 787-9 and three 787-8 aircraft).

Expected delivery dates of all of the aircraft:

Sample	2017	2018	2019	2020	Total
787-9	2	5	2	-	9
787-8	-	-	3	4	7

Regarding the Company's undertakings for payment of the minimum lease fees at the subject of these leases, see Note 10.d below, and regarding the expected impact of IFRS 16 "Leases," see also Note 2.d(2) above.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 9 - Aircraft, flight equipment, other fixed assets and intangible assets (cont.)

e. Absorption of 737-900 ER model narrow-body aircraft:

During the months of February and March 2016, the Company received three 737-900ER Boeing aircraft: Upon receipt of the same aircraft, the Company completed the purchase and absorption of eight aircraft of this model. To finance the purchase of the aforesaid three aircraft, the Company engaged with three local banks in loan agreements, as stated in Note 13 below.

f. Sale of 737-700 aircraft and their removal from service:

In April 2016, an agreement was signed for the sale of a 737-700 aircraft, the last of the Company's aircrafts of this model, in consideration for USD 7.7 million. The aircraft was delivered to the purchase in June 2016. For the sale and cessation of use as stated, the Company recognized capital gains in the amount of USD 1 million within the other revenue section.

g. Other fixed assets and intangible assets:

	As of December 31, 2016			As of December 31, 2015		
	Cost:	Accumulated depreciation	Balance	Cost	Accumulated depreciation	Balance
	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands
Buildings and facilities at Ben Gurion Airport	89,860	59,644	30,216	86,310	57,096	29,214
Computers and office furniture	22,546	12,650	9,896	167,116	155,131	11,985
Machinery and ground equipment	71,314	59,981	11,333	67,439	57,365	10,074
Renovations of leased offices	25,865	23,082	2,783	25,208	22,016	3,192
Vehicles and garage equipment	7,084	5,472	1,612	6,338	5,255	1,083
Owned offices	3,237	2,628	609	3,150	2,478	672
Intangible assets (1)	34,767	17,532	17,235	22,195	14,438	7,757
	254,673	180,989	73,684	377,756	313,779	63,977

(1) This balance includes rights in use of security equipment and software purchased by the Company, including their development costs.

Note 10 - Leases

a. General background and accounting policy:

Upon engaging in a lease, the Company examines in accordance with the terms of the lease whether the lease constitutes a financing or operating lease. Most of the Company's leases are aircraft leases, which were all recognized as operating leases.

As of December 31, 2016, the Company leases 15 aircraft. The remainder of the lease terms range between one and seven years. For the lease of aircraft, the Company pays the lessors a fixed monthly sum in addition to another amount paid for the maintenance reserves derived mainly from the scope of the aircraft's use, which will be used by the lessor to finance a future renovation of the aircraft. Regarding signing the agreements for the lease of 787 model aircraft, see Note 9.d above.

In addition, the Company's lease agreements also include leases for additional structures and facilities, including engagements with the Airport Authority as set forth in section b below, and vehicles that are leased by the Company and its subsidiaries.

Lease expenses are recognized in a straight line for the duration of the lease. In lease agreements where no leasing fee, or a reduced or increased leasing fee, is paid at the start of the leasing period, the Company recognizes expenses for the minimal leasing fees on a straight line basis for the duration of the lease.

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 10 - Leases (cont.)

a. General background and accounting policy: (cont.)

Leasing expenses contingent on the scope of use of the leased asset, such as sums that need to be deposited to the maintenance reserves of leased aircraft, are recognized as a current expense in the period in which the expense is created.

Regarding IFRS 16 regarding leases, see Note 2d(2) above.

b. Engagements with the Israel Airports Authority (hereinafter: "IAA"):

The Company has a use-right (permit) to 290 hectares of land at Ben Gurion Airport (hereinafter – "BGN") until December 31, 2010 with an option to extend for an additional 25-year period. The Company has notified the IAA of its intent to exercise the above option in accordance with the agreement, and is currently negotiating with the IAA to extend the agreement by an additional term. Furthermore, the Company has the right to use certain facilities and buildings in the area in question, including use of the BGN warehouse (regarding which the current lease agreement expired at the end of 2016 and was extended after the date of statement of financial position to 2019), and holds the right to us the guest lounge in BGN's Terminal 3. As noted, most of the rental and authorization agreements have come to a conclusion as of the report, and the Company is negotiating with the Airport Authority to extend them.

c. Amounts recognized as an expense for a lease in profit and loss:

	For the year ended December 31		
	2016	**2015**	**2014**
	USD thousands	**USD thousands**	**USD thousands**
Payment for the lease of aircraft and engines (1) (2)	54,340	57,290	62,818
Payment for maintenance reserves	19,445	19,343	20,773
Other leases (3)	26,934	24,909	26,503
	100,719	101,542	110,094

(1) It shall be clarified that the expenses presented in this note do not include expenses for "wet leases" (the lease of aircraft with their crew).

(2) The comparative periods have been restated to express the leases of engines leased in the sale and lease transactions.

(3) The comparative periods have been restated to express the additional leases (mainly buildings in Israel and abroad).

d. Commitments for payments of future minimum lease fees for non-revocable operating leases:

The following are details of the payment amounts for the future minimum lease fees for the Company's operating leases, including leases of 787 model aircraft that are expected to begin to be actively used by the Company for 2017-2020, gradually. It is noted that the amounts do not include a payment for maintenance reserves for operating leases of aircraft and engines, which are contingent on the scope of their use. Furthermore, the lease payments include payments that the Company expects following the extension of the option to use the area of the IAA as stated in section b. above, although the extension agreement has not been signed as aforesaid, in a manner consistent with the current expenses recognized for this lease each period.

	As of December 31
	2016
	USD thousands
Year 2017	67,223
Year 2018	99,170
Year 2019	116,317
Year 2020 and after	1,534,023
	1,816,733

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 11 - Accounts payable

a. Current liabilities:

	As of December 31	
	2016	**2015**
	USD thousands	**USD thousands**
Airport taxes payable	31,746	34,752
Payables for foreign companies' unrealized flight segments (1)	11,819	11,736
Interest payable	2,211	1,979
Deposits received in respect of passenger groups	1,524	4,575
Payables for baggage claim	-	2,344
Other payables	12,558	14,800
	59,858	70,186

(1) This balance reflects the sales sums of flight tickets sold by the Company, so that the sum the Company collected from its customers is transferred to these foreign companies that executed the flights.

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 12 - Unearned revenue

Flight ticket sales are included as unearned revenue until the flight date, when they are charged to the profit and loss statement. Air passenger revenues also include revenues where the service is provided by the Company, whereas flight tickets are sold by other airlines. Furthermore, air passenger revenues also include revenues due to collaboration agreements with other airlines. In these cases, when the service is provided by the other airlines while the sale is made by the Company, revenues are stated on net basis, which means that Company collects the receipts deriving from the transportation of passengers, passes on the share of the other airline, and lists revenue for the difference between them only.

Regarding the frequent flyer programs, the Group has applied IFRIC 13, “Customer Loyalty Programs.” Accordingly, sales of flight tickets in which the Company grants its customers flight points that can be converted to flights on a later date are handled as multi-component transactions, while allocating the payment received from the customer for the flight component and the points component, based on the fair value of the flight point estimated by the Company. The proceeds attributed to the frequent flyer points will be recognized as income when the service provided by the Company in consideration for conversion of the points is executed (for instance, the actual flight of the bonus ticket). Until the revenue recognition date, the liability for the frequent flyer point is recognized as unearned revenue.

The proceeds from the sale of the frequent flyer to business partners is recognized as unearned revenue and stated as income upon the execution of the service provided by the Company in consideration for conversion of the points.

Regarding critical accounting considerations and key sources for uncertainty estimates used in determining the value of the liability in the Financial Statements, see Note 2.c.(6).

Regarding the application of IFRS 15 regarding contracts with customers as of 2018, see Note 2d(1) above.

a. Current liabilities:

	As of December 31	
	2016	**2015**
	USD thousands	**USD thousands**
Ticket sales	254,914	242,917
For frequent flyer points	55,342	47,179
	310,256	290,096

b. Non-current liabilities:

	As of December 31	
	2016	**2015**
	USD thousands	**USD thousands**
For frequent flyer points	41,730	42,127

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 13 - Loans from bank corporations and others

The loans taken by the Company for the purchase of aircraft are initially recognized at the amount raised after reducing transaction costs and fees paid mainly for guarantees provided to the Company by third parties, such as the EX-IM guarantee (see below). After the date of initial recognition, the loans are measured at amortized cost through use of the effective interest method.

a. Composition:

	Transactions and balances for the year ended December 31, 2016					
	Fixed-rate loans	**Variable rate loans (LIBOR)**	**Loans to finance advance payments on PDP aircraft**	**Overdrafts**	**Total**	
	USD thousands	**USD thousands**	**USD thousands**	**USD thousands**	**USD thousands**	**Comments**
Annual percentage rate	2.44-4.90	0.74-5.08	2.92-3.69	-		
As of January 1, 2016						
Current maturities	28,572	73,352	72,051	19,252	193,227	
Long-term loans	209,095	230,235	-	-	439,330	
Total loans	237,667	303,587	72,051	19,252	632,557	
Transactions during 2016						
Receipt of long-term loans and repayment of PDP	41,000	82,000	(72,051)	-	50,949	1
Receipt of PDP loans	-	-	30,000	-	30,000	3
Early repayment of loan	-	(15,700)	-	-	(15,700)	2
Current repayments and overdraft transaction	(32,302)	(61,441)	-	(155)	(93,898)	
Other changes	4,815	(1,300)	-	-	3,515	
Total loans at December 31, 2016	251,180	307,146	30,000	19,097	607,423	
Of which: current maturities	28,508	133,294	-	19,097	180,899	
Long-term loans	222,672	173,852	30,000	-	426,524	

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 13 - Loans from bank corporations and others

b. Changes in the number of loans of the Company in the reporting year and thereafter:

(1) To finance the purchase of the three 737-900ER aircraft as stated in Note 9.e above, the Company engaged with three local banks in loan agreements. Each loan is in the amount of USD 41 million and will be repaid over a period of 12 years. One of the aforesaid three loans is a fixed interest loan, while the other two are LIBOR-based variable interest in addition to a margin. These loans were used, *inter alia*, for payment of the loans received to finance the advances for aircraft acquisitions (“PDP”), in a total of about USD 72 million.

(2) In March 2016, the Company repaid a loan early in the amount of USD 15.7 million, instead of the contractual repayment of the loan that was planned for November 2016. For the aforesaid early repayment, the Company recognized, in the year ending December 31, 2016, profit (stated in the financing expenses section) in the amount of USD 1.3 million.

(3) In December 2016, the Company signed an agreement with a foreign bank to finance payment of an advance for a new Boeing 787-9 aircraft purchased from Boeing as part of the procurement transaction (see Note 9.d above), which is expected to be received by the Company in 2018. The loan is in the amount of USD 30 million, and was provided to the Company for a period of up to 18 months from the date on which it was taken or until receipt of the aircraft by the Company, whichever of the two is earlier. The loan is variable interest of LIBOR plus a margin paid each quarter, and will be repaid on the date of receipt of the aircraft through receipt of long-term financing. As a security for payment of the loan, the Company assigned its rights in the aircraft to the foreign bank under the Purchase Agreement with Boeing.

(4) In February 2017, after the date of the statement of financial position, the Company signed an agreement with another foreign bank to finance payments of advances for two new Boeing 787-9 aircraft, which were purchased from Boeing as part of the procurement transaction (see Note 9.d above), which are expected to be received by the Company in 2018. The total loan amount is in the amount of USD 55 million, and was provided to the Company by the date of receipt of each aircraft by the Company (about 16 and 18 months from the date on which it was taken, respectively), with an option to extend by three additional months in the case of the postponement of the date of receipt of the aircraft. The loan is variable interest of LIBOR plus a margin paid each quarter, and will be repaid on two dates upon receipt of each aircraft through receipt of long-term financing. As a security for payment of the loan, the Company assigned its rights in the aircraft to the foreign bank under the Purchase Agreement with Boeing.

(5) On March 14, 2017, the Company engaged with a local bank to refinance a loan taken to finance the purchase of 737-800 aircraft, the expected balance of which on the repayment date is USD 30 million, and a loan taken to finance 777-200 aircraft, the expected balance of which on the repayment date is USD 48 million. The new loans are for periods of four years beyond the payment dates of the existing loans, which are April 2017 and June 2017, respectively. The two loans are fixed interest of LIBOR plus a margin.

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 13 - Loans from bank corporations and others (cont.)

c. Credit characteristics, securities and loan to securities ratio

Some of the credit agreements state that the ratio of the debt balance to the bank compared to the market value of the pledged aircraft shall not exceed a ratio of between 65% and 80% (see Section 1 below). An examination of compliance with this ratio should be performed once a year (in some agreements – twice a year) based on certain stipulated international professional publications determined regarding the aircrafts' market value. It was also decided that should the actual ratio be lower than the above ratio, the Company will provide additional securities, or repay its bank loans earlier in order to satisfy the ratio requirement. As of December 31, 2016, and shortly after the publication of the Report, the Company meets the ratio of loans to securities as required.

Below are details of the Company's financing sources, securities provided against the loans and, where relevant, a requirement for a ratio of unpaid balance to the value of securities:

Source of funding	Outstanding balance NIS thousands As of 12/31/2016	Aircraft as collateral	Requirement for a ratio of unpaid balance to the value of securities
Local bank (1)	134,138	Three 777-200 aircraft Three 737-800 aircraft One 737-900 aircraft Two 747-400 aircraft (2)	80%
Local bank	46,771	One 747-400 aircraft (3)	65%
		One 737-900 aircraft	80%
Domestic and foreign banks	248,912	Two 737-900 aircraft Three 777-200 aircraft Two reserve engines Three 737-800 aircraft	-
Bonds issued by a special purpose company (4)	144,628	Four 737-900 aircraft	-

(1) A cross-default mechanism exists between the various loans of the same banking institution.
(2) With the exception of one 747-400 aircraft, taken as collateral at a ratio of 50%.
(3) An USD 1.425 million deposit serving as additional collateral for the banking institution.
(4) Loans taken to finance aircraft and financed by bonds issued by SPCs that are not owned by the Company, and are guaranteed by Ex-Im collateral, which is a bank owned by the US government, with the source of the liability being principal and interest payments made to the SPC by the Company. In the event that the bonds are not redeemed properly by the Company, and the Ex-Im collateral is realized, Ex-Im shall sell the pledged aircraft and redeem the balance of the bonds. Inasmuch as the aircraft realization funds do not suffice to cover the amount of the collateral, the Company will be required to return the balance of the debt to Ex-Im.

It is noted that most of the loans existing as of December 31, 2016 may be repaid early by the Company as is generally accepted. In addition, some of the loan agreements taken by the Company feature a right on behalf of the bank to demand immediate repayment of the balances of the loans vis-a-vis the relevant bank upon the occurrence of certain events such as mergers or transfers of control without the bank's prior written consent, and upon the occurrence of other and standard occurrences generally accepted in financing transactions.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 13 - Loans from bank corporations and others (cont.)

d. Fair value of long-term loans from bank corporations at fixed interest:

	Book value		Fair value (1)	
	As of December 31		As of December 31	
	2016	2015	2016	2015
	USD thousands	USD thousands	USD thousands	USD thousands
Long-term loans at fixed interest	267,339	258,641	259,140	254,567

(1) The fair value of the loans is based on the calculation of the current value of the cash flow based on an interest rate of 2.8% as of December 31, 2016 (as of December 31, 2015: 2.6%), customary for loans with similar characteristics. (Level 2 - based on observable data)

e. Liquidity risk:

The following tables list the Company's outstanding contractual maturities in respect of financial assets (liabilities) that do not constitute financial derivatives. These tables were prepared based on the uncapitalized cash flows, according to the earliest date on which the Company may receive the assets or be required to repay the liabilities.

	Year 2017	Year 2018	Year 2019	Year 2020	Year 2021 and after	Total
	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands
As of December 31, 2016:						
Principal and interest loan payments	182,602*	103,277	127,126	50,314	206,584	669,904
As of December 31, 2015:						
Principal and interest loan payments	190,450	167,095	58,418	112,667	154,693	683,323

* See also Note 13.b(5) regarding refinancing.

The Company has additional future cash flow liabilities arising from future leasing fees detailed in Note 10.d, as well as from the procurement plan in Note 9.d above.

The Company’s management estimates that repayment of these loans will be based on the Company’s positive cash flow arising from and expected to arise from its current activity in the current business environment in which it operates. Furthermore, the procurement plan of modern and efficient wide-bodied aircraft as per Note 9.d above is expected to bring about significant savings in fuel consumption costs and maintenance expenses, is also expected to bring about a significant contribution to the Company’s ability to meet its obligations, both present and future, arising from the same procurement plan.

Regarding the loan to finance an advance on the Company’s 787-9 Boeing aircraft (PDP), which is expected to be repaid in 2018, it is expected to be repaid by long-term financing that is expected to be received on the date of receipt of the aircraft at the subject of the loan.
Additionally, the Company has cash balances and cash equivalents and short-term available deposits as of December 31, 2016 in the total amount of USD 201.2 million.

Note 14 - Liabilities for employee benefits

a. Accounting policy

(1) Post-employment benefits:
Post-employment benefits include liabilities for severance pay, redemption of unused sick days, adaptation grants for senior employees and certain benefits for retirees from the Company. The benefits also include pension payments for certain local employees who are employed in the United States and England. The Company's post-employment benefits are partly defined contribution plans and partly defined benefit plans.

Expenses the Company's liabilities for the deposit of funds within a defined contribution plan are recognized in the profit and loss statement on the date of receipt of the work services for which the Company is required to make the deposit.

Expenses for the defined benefit plan are recognized in the profit and loss statement in accordance with the projected unit credit method through use of actuarial assessments. The present value of the Company's liabilities for the defined benefit plan is determined through discounting the future expected cash flows for the plan with market yields of high-quality corporate bonds denominated in the currency in which the benefits will be paid for the plan and with redemption periods that are close to the projected settlement date of the plan.

In accordance with the Company's accounting policy, the net interest cost (after offsetting the return on the plans' assets) is included in the profit and loss statement within salary expenses. Actuarial profits and losses are recognized as other comprehensive income on the date of creation and will not be reclassified to profit or loss at a later date.

The assets of the various plans (such as a central severance fund) are measured at fair value. Interest income on assets of the plans are determined on the basis of the discount rate of the suitable liabilities and are recognized as profit and loss as part of the net interest cost. The difference between the interest income on assets of the plans and their actual returns is recognized in other comprehensive income and will not be reclassified to profit or loss on a later date.

(2) Other long-term employee benefits:
Other long-term employee benefits are benefits expected to be utilized in a period over 12 months from the end of the period in which the service qualifying for the benefit was rendered.

Other employee benefits include utilization and redemption of sick and rest days, an educational grant for children of employees, as well as jubilee bonuses. These benefits are recognized and measured in the same manner as post-employment benefits, so long as actuarial gains and losses for them are charged to gain/loss upon creation, in lieu of other comprehensive income.

(3) Short-term employee benefits:
Short-term employee benefits are benefits that are expected to be cleared in full within 12 months from the end of the year in which the crediting service was granted by the employee.

Short-term employee benefits include Company liability in respect of current wages and benefits. These benefits are recognized in the profit and loss statement when generated.

(4) Benefits for early retirement plans:
Early retirement plan benefits are recognized when the Company has a practical obligation towards employees in issuing benefits, while not against these workers' material future service. The sum of the liability is determined in accordance with the current value of the cash flows expected due to the liability. When recognizing a liability in the financial statements, the full expense is also recognized for the plan in the Company's profit and loss statement.

(5) Regarding critical accounting considerations and key sources for uncertainty estimates used in determining the value of the liability in the Financial Statements, see Note 2.c.(3).

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 14 - Liabilities for employee benefits (cont.)

b. Composition:

	Reference	Currency of the plan	As of December 31, 2016 Current liabilities USD thousands	As of December 31, 2016 Non-current liabilities USD thousands	As of December 31, 2016 Non-current assets USD thousands	As of December 31, 2015 Current liabilities USD thousands	As of December 31, 2015 Non-current liabilities USD thousands	As of December 31, 2015 Non-current assets USD thousands
Short-term employee benefits:								
Wages, salaries and social benefits		Mainly in NIS	52,924	-	-	58,421	-	-
Post-employment benefits:								
Benefit in respect of severance pay in Israel	c.	NIS	-	-	58,937	-	17	65,910
Unused sick leave	d.	NIS	-	35,119	-	-	35,305**	-
Pension funds for employees in the Company's overseas offices:	e.							
United States		US USD	-	12,830	-	-	15,382	-
England		GBP	-	7,481	-	-	6,739	-
Benefits for retirees	f.	NIS	-	8,378	-	-	7,769	-
Other post-employment benefits	g.	NIS	-	4,920	716	-	4,872**	435
Other long-term employee benefits:								
Liability for vacation and rest days*	i1	NIS	42,682	-	-	42,225**	-	-
Other long-term benefits	i2	NIS	-	4,116	-	-	4,345**	-
Severance benefits:								
Voluntary retirement programs	j	NIS	-	447	-	-	4,549	-
Total in the statement of financial position			95,606	73,291	59,653	100,646**	78,978**	66,345

* Note that the liability for vacation and rest is presented in the statement of financial position as a current liability, despite the fact that it is expected to be realized after a 12-month period from the report date (and is therefore defined as a long-term benefit), since the Company has no "unconditional right" to defer the clearance of the liability for this period, and therefore according to the accounting rules, the liability is presented on a shot-term basis.

** Reclassified

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 14 - Liabilities for employee benefits (cont.)

b. Benefits in respect of severance pay of employees in Israel:

(1) Company's commitment in respect of severance pay in Israel:

The Company's work agreements, Israeli labor law and the Severance Pay Law, 1963 require that the Company pay severance pay to employees upon retirement or dismissal. Regarding the agreement signed with respect to the status of veteran pilots and severance pay regarding the same, see Note 14.l. below.

Regulation of retirement payments and severance pay of Company employees:
Beginning in September 1992, the social benefits of part of the Company's employees have been regulated within the context of a designated pension agreement. The agreement stipulates that the Company's payments to the pension fund and an approved fund (executive insurance or provident fund) for an employee joining the pension arrangement will come in lieu of its severance pay obligation to that employee, pursuant to Section 14 of the Severance Pay Law, 1963, for that part of the salary and for that period as to which the payments were made. Usually, employees who subsequently received permanent status in the Company were then obligated to join the plan. It is also noted that workers joining the Company starting September 1992 have signed Section 14 as noted above (whether they are regular employees, part-time or senior executives).

Defined deposit plan:
Accordingly, the current deposits in the pension funds and in policies in insurance companies exempt the Company from any additional obligations to employees, and regarding senior employees who joined the pension agreement in 1992 – the exemption in question is for periods for which deposits only were made.

Defined benefit plan:
Regarding the period between the start of the employee's work at the Company and the employee joining the pension plan, the employees are entitled to severance pay in accordance with their salary upon retiring from the Company for the number of years in the relevant period. Employees who had not joined the pension agreement as stated are entitled to severance pay to the level of their salaries upon retirement from the Company for all of their years of seniority at the Company.

(2) Arrangements and plans for securing retirement and severance pay payments (plan's assets):
According to the provisions of the collective agreement, since January 1983, the Company deposits 8.33% of the current salary of employees in provident funds for severance at Israeli banks. The deposit is in the Company's name.

Since the Company did not deposit monies for severance pay in a severance pay provident fund until January 1983, and since January 1983 severance pay was paid to retired employees (for periods prior to the start of the deposits as well) from the money accrued in the provident funds for severance pay, as of the date of the Company's privatization, no balances remained in the severance pay provident funds and balances to secure payment of severance pay to the Company's employees.

Eligible population and settlement with the State of Israel:
In June 2003, as part of the process of privatizing the Company, an agreement was signed between the State, the Company and the employees' association, in which the State and the Company agreed to act to cover the deficit created until that date (NIS 516 million) in addition to interest and linkage as of this date and until the date of the actual deposit in the funds, and which is connected to the eligibility of employees who had been employed by the Company in 1982 and who continued to be employed in June 2003 ("the Eligible Employees"). Under this agreement, the Company opened central compensation funds to which the State and the Company transferred the immediate proceeds that they received from the sale of securities in the pursuant to the 2003 Prospectus, including consideration of the exercise of the options issued by the State and the Company within the prospectus.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 14 - Liabilities for employee benefits (cont.)

c. Benefits in respect of severance pay of employees in Israel: (cont.)

(2) Arrangements and plans for securing retirement and severance pay payments (plan’s assets): (cont.)

After making the aforesaid State and Company deposits, the deficit in the fund for eligible employees, as defined in the agreement between the Company and the State signed on the eve of the Company's privatization, was covered in full.

After making the above deposits and fully covering the deficit in the severance pay fund, as required by the agreement, the Company deposited NIS 32.6 million (as of December 31 2016, including interest accrued as of the reporting date), constituting the surplus between the proceeds of the issuance from the sale of the State’s shares and the consideration from the issuance of the Company’s shares and the deficit created in the central compensation funds for the group of “eligible employees” mentioned above, in a separate account included in short-term deposits. On the other hand, the Company recognizes the provision for the obligation to the State of Israel at the same sum, due to the fact that the Company is studying the existence of limitations regarding its ability to make use of the above balance of the consideration according to the agreement with the State and with the workers' representatives.

In the matter of a NIS 125 million lawsuit filed against the Company by the Ministry of Finance in the matter of the reimbursement of excess money transferred to the compensation fund in surplus, in light of profits the State claims accumulated for them, see Note 15.b.(23).

Special collective agreement for long-term employees for the deposit of severance pay money in the fund in the employee’s name:

In accordance with the agreement signed on December 22, 2011, in light of a legislative arrangement that came into effect on January 1, 2011, and that no longer allows the deposit of severance pay in the main compensation fund, for long-term employees who had severance money deposited for them as of December 31, 2010 in the central fund, money shall be deposited for them as of January 1, 2011 to the severance component in the provident fund in the employee’s name.

(3) Managers and senior officers:

Senior employees, including senior officers, are employed under personal employment agreements, with long-term employees being entitled to a payment for the period of their work, beyond the severance pay required by law, additional severance pay equal to one month per year for the period of their work according to their last total salary. It is hereby made clear that new officers joining the Company shall not be entitled to such additional compensation. This liability is financed by designated personal funds.

(4) The financing policy:

The Company’s severance pay payments are mainly paid from the plan’s assets, i.e. from the central funds and from the employees’ personal funds. The Company’s central funds as well as the employees’ personal funds are managed by leading investment houses.

Composition of plans’ assets:

	Fair value of plan’s assets:	
	As of December 31	
	2016	2015
	USD thousands	USD thousands
Shares	38,659	62,040
Government bonds	24,476	30,725
Corporate bonds	28,184	30,491
Cash, cash equivalents and deposits	18,312	17,794
Other investments	30,796	14,360
Total	140,426	155,410

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 14 - Liabilities for employee benefits (cont.)

d. Redemption of sick leave:

Pursuant to the terms of the collective agreement, employees are entitled to 30 fully paid sick days per year, which may be accrued throughout the employee's employment at the Company.

Upon retirement from the Company with mandatory retirement or retiring after reaching the age of 45 under conditions that entitle them to receive compensation, permanent employees (other than executives, beginning from their transition to personal employment contracts) are entitled to receive a grant for unused sick days at a rate of up to 26.6% of the value of the unused days.

This liability is largely paid from the Company's current resources.

e. Pension funds of some of the Company's local employees in the US and England:

Some of the local employees of the Company in the US and the UK benefit from pension plans ("the Plans"), with the pension cost of the branch employees being paid for by the Company. The cost of the pension is computed as a multiple of the "years of eligibility" for the pension multiplied by the rate of determining salary for pension. Retirement commencing at the age of 65 ordinarily entitles the employee to full benefits. The pension plan assets are managed by a designated body and are invested mainly in marketable securities. The Company is obliged to cover any deficit that would be created in the value of the funds' assets relative to any actuarial obligation, if any.

Regarding the pension fund in the UK, starting from 2005 the fund does not accept new employees and no addition rights are accumulated pursuant to the same. The US pension fund is also closed to new members, however, there is still accumulation of rights for existing workers entering into the arrangement.

The obligation payments are largely financed by the plan assets, however in light of the current deficit in pension plans, the Company is expected to supplement certain funds for the liabilities from its own sources as well.

f. Benefits for pensioners:

Employees of the Company after certain seniority are entitled, after their retirement, to fight tickets in accordance with the Company's policy, as well as to holiday gifts.

g. Other post-employment benefits:

Other benefits include an adjustment grant to which some of the Company's senior employees are entitled. In addition, in some of the Company's branches, the Company's local employees are entitled to severance pay in accordance with the local law and the Company's agreements. Furthermore, the other benefits include liabilities for severance pay of the subsidiaries.

h. Multi-employer program in a subsidiary

The subsidiary "Borenstein Caterers Inc." (USA) participates in a multi-employer pension plan for some of its employees, in which the subsidiary invests amounts approximating USD 300 per year. The subsidiary's share in the non-funded liabilities of the plan is USD 10.8 million, such that if the subsidiary ceases to make ongoing payments as stated or withdraws from the plan, it will be required to carry that amount. The subsidiary intends to continue to deposit funds in the plan, and therefore no liability has been recognized in the financial statements for the same.

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 14 - Liabilities for employee benefits (cont.)

i. Detail of quantitative effects for defined benefit plans to the financial statements:

	For the year ended December 31, 2016					
	Severance pay in Israel	Unused sick leave	Pension funds	Benefits for retirees	Other benefits	Total
	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands
Amounts recognized in profit and loss for defined benefit plans						
Current service cost	1,906	1,972	547	136	408	4,969
Cost of interest	2,651	1,070	2,725	314	286	7,046
Return on the plan’s assets according to the discount rate	(4,587)	-	(1,899)	-	(132)	(6,618)
Real yield transferred from severance to benefits	34	-	-	-	-	34
Exchange rate differences	(1,131)	586	(1,254)	85	42	(1,672)
Other changes during the period	-	-	-	-	114	114
Total	(1,127)	3,628	119	535	718	3,873

	For the year ended December 31, 2015					
	Severance pay in Israel	Unused sick leave	Pension funds	Benefits for retirees	Other benefits	Total
	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands
Amounts recognized in profit and loss for defined benefit plans						
Current service cost	2,176	1,857	607	116	265	5,021
Cost of interest	2,940	1,308	2,702	339	239	7,528
Return on the plan’s assets according to the discount rate	(4,918)	-	(1,791)	-	(93)	(6,802)
Real yield transferred from severance to benefits	295	-	-	-	-	295
Exchange rate differences	552	(29)	(360)	(19)	237	381
Other changes during the period	(1,522)	-	-	-	-	(1,522)
Total	(477)	3,136	1,158	436	648	4,901

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 14 - Liabilities for employee benefits (cont.)

i. Detail of quantitative effects for defined benefit plans to the financial statements: (cont.)

	For the year ended December 31, 2014					
	Severance pay in Israel	Unused sick leave	Pension funds	Benefits for retirees	Other benefits	Total
	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands
Amounts recognized in profit and loss for defined benefit plans						
Current service cost	3,623	2,055	546	117	233	6,574
Cost of interest	3,706	1,460	2,807	338	275	8,586
Return on the plan's assets according to the discount rate	(5,563)	-	(2,010)	-	(123)	(7,696)
Real yield transferred from severance to benefits	435	-	-	-	-	435
Exchange rate differences	6,917	(4,734)	(372)	(625)	(400)	786
Other changes during the period	-	-	-	-	160	160
Total	9,118	(1,219)	971	(170)	145	8,845

<u>Expenses for defined benefit plans included in the following sections in the profit and loss statement:</u>

	For the year ended December 31		
	2016	2015	2014
	USD thousands	USD thousands	USD thousands
Operating expenses	3,110	3,936	7,103
Sale expenses	217	274	495
Management and general expenses	546	691	1,247
Total	3,873	4,901	8,845

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 14 - Liabilities for employee benefits (cont.)

i. Detail of quantitative effects for defined benefit plans to the financial statements: (cont.)

	For the year ended December 31, 2016					
	Severance pay in Israel	**Unused sick leave**	**Pension funds**	**Benefits for retirees**	**Other benefits**	**Total**
	USD thousands	**USD thousands**	**USD thousands**	**USD thousands**	**USD thousands**	**USD thousands**
Transaction in the present value of the commitment						
Opening balance - present value of the commitment	89,517	35,305*	69,184	7,769	7,859*	209,634
Current service cost	1,906	1,972	547	136	408	4,969
Cost of interest	2,651	1,070	2,725	314	286	7,046
Actuary (profit) loss**	7,685	(219)	4,275	564	(429)	11,876
Benefits paid	(17,593)	(3,595)	(3,170)	(490)	(368)	(25,216)
Changes in exchange rates	1,466	586	(3,507)	85	76	(1,294)
Other changes during the period	(4,142)	-	-	-	114	(4,028)
Closing balance - present value of the commitment	81,490	35,119	70,054	8,378	7,946	202,987
Change in fair value of plan's assets						
Opening balance - fair value of plan's assets	155,410		47,063		3,430	205,902
Return on the plan's assets according to the discount rate	4,587		1,899		132	6,618
Re-measurement for difference between actual return on the plan's assets and the return calculated according to the discount rate	(2,181)		1,719		56	(406)
Contributions by the employer ***	2,185		4,484		151	6,820
Benefits paid	(17,996)		(3,170)		(61)	(21,226)
Real return transferred from severance to benefits	(34)		-		-	(34)
Changes in exchange rates	2,597		(2,253)		34	378
Other changes during the period	(4,142)		-		-	(4,142)
Closing balance - fair value of plan's assets	140,426		49,742		3,742	193,910
Average duration of commitment (in years)	7.5	8	13.1	12		
Discount rate in percentages	3.04	3.21	2.7-4.0	4.03-5.25		
Sensitivity analyses of the 1% increase in the discount rate	(3,224)	(2,452)	(8,031)	(1,685)		
Sensitivity analysis for a 1% decrease in the discount rate	3,643	2,839	9,346	(1,685)		

*Immaterial adjustment of comparative numbers

** The principal amount arises from changes in financial assumptions.

*** The Company's estimate of expected deposits in 2017 is USD 6 million.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 14 - Liabilities for employee benefits (cont.)

i. Detail of quantitative effects for defined benefit plans to the financial statements: (cont.)

	For the year ended December 31, 2015					
	Severance pay in Israel	**Unused sick leave**	**Pension funds**	**Benefits for retirees**	**Other benefits**	**Total**
	USD thousands	**USD thousands**	**USD thousands**	**USD thousands**	**USD thousands**	**USD thousands**
Transaction in the present value of the commitment						
Opening balance - present value of the commitment	100,693	35,466*	73,988	8,466	7,850*	231,209
Current service cost	2,176	1,857	607	116	265	5,021
Cost of interest	2,940	1,308	2,702	339	239	7,528
Actuary (profit) loss**	1,780	43	(4,027)	(676)	(429)	(3,309)*
Benefits paid	(13,336)	(3,340)	(3,056)	(457)	(295)	(20,484)
Changes in exchange rates	(21)	(29)	(1,030)	(19)	229	(870)
Other changes during the period	(4,715)	-	-	-	-	(4,715)
Closing balance - present value of the commitment	89,517	35,305	69,184	7,769	7,859	214,380
Change in fair value of plan's assets						
Opening balance - fair value of plan's assets	166,201		48,844		3,197	218,242
Return on the plan's assets according to the discount rate	4,918		1,791		93	6,802
Re-measurement for difference between actual return on the plan's assets and the return calculated according to the capitalization rate	(1,856)		(2,619)		(91)	(4,566)
Contributions by the employer **	3,430		2,773		343	6,546
Benefits paid	(13,222)		(3,056)		(105)	(16,383)
Real return transferred from severance to benefits	(295)		-		-	(295)
Changes in exchange rates	(573)		(670)		(8)	(1,251)
Other changes during the period	(3,193)		-		-	(3,193)
Closing balance - fair value of plan's assets	155,410		47,063		3,429	205,902
Average duration of commitment (in years)	8	8	14	21		
Capitalization rate in percentages	3.04	1.39	3.3-4.21	3.88-5.22		
Sensitivity analyses of the 1% increase in the discount rate	(3,361)	(302)	(6,975)	(1,415)		
Sensitivity analysis for a 1% decrease in the discount rate	3,676	4,478	7,069	1,711		

*Immaterial adjustment of comparative numbers

** The principal amount arises from changes in financial assumptions.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 14 - Liabilities for employee benefits (cont.)

i. Detail of quantitative effects for defined benefit plans to the financial statements: (cont.)

Other actuarial assumptions:

The principal actuarial assumptions used by the Company in order to estimate the commitments and quantitative impacts below as set forth above, are as follows:

- The expected rate of increase in salary is between 2.8% and 3.7%, in addition to the salary increase of an additional percent in 2017-2018, compared to an expected rate of increase in salary at the end of 2015 between 1.2% and 3.4%, in addition to an additional percent for 2016-2018. In the event that the expected rate of increase of the salary is higher by a percent compared to the rate taken into account in calculating the commitment, the liability for post-employment benefits (excluding pension) was USD 6,534,000 higher. The sensitivity analyses above was determined based on reasonably potential changes in the actuarial assumptions as of the end of the reporting period. The sensitivity analysis does not take into account any interdependence between the assumptions. Regarding the update of the pilots' salary according to the addendum to the collective agreement, see Note 14.l below.
- The rate of turnover is estimated at a range between 0.5% to 4.1%, depending on the age of the population (with no significant change from 2015).
- Life expectancy on the basis of which the commitments for pension in the US and the UK are estimated are determined based on the appropriate mortality tables. In 2016, there was a certain decrease in the expected life expectancy arising from the amendment of the mortality tables published by the US authorities, which led to actuarial profit of USD 802 thousand.

j. Other long-term employee benefits:

(1) Paid vacation days:

According to the Annual Vacation Law, 1951 and in accordance with the Company's work agreements, Company employees are entitled to a number of paid vacation days for each work year. Employees who have left the Company prior to making use of the balance of his accrued vacation days are entitled to payment for the balance of these vacation days upon leaving. In addition, certain Company employees are entitled to days of rest they accumulate and that can also be accumulated and redeemed upon retirement. The Company's vacation commitments also include its commitments for these days.

(2) Other long-term benefits:

These benefits primarily include a grant for academic studies of children of employees, as well as jubilee benefits for employees reaching 20, 30 and 40 years of seniority at the Company, who are entitled to a grant awarded at the annual "decades ceremony" held by the Company.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 14 - Liabilities for employee benefits (cont.)

j. Other long-term employee benefits: (cont.)

(3) Detail of quantitative impacts for other long-term employee benefits on the financial statements:

	For the year ending on December 31, 2016		For the year ending on December 31, 2015		For the year ending on December 31, 2014	
	Vacation and rest	Other long-term benefits	Vacation and rest	Other long-term benefits	Vacation and rest	Other long-term benefits
	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands
Opening balance	42,225	4,345	42,658*	4,159*	49,851*	4,248*
Amounts recognized in profit and loss for defined benefit plans						
Current service cost	29,421	171	26,484	57	25,212	60
Cost of interest	1,638	140	1,382	42	2,110	52
Exchange rate differences	724	48	1,500	2	(7,240)	(121)
Actuary (profit) loss	(54)	(260)	(2,533)	200	488	32
Total profit and loss	31,729	99	26,833	301	20,570	23
Benefits paid	(31,272)	(328)	(27,266)	(115)	(27,763)	(112)
Closing balance	42,682	4,116	42,225	4,345	42,658	4,159
Average duration of commitment (in years)	8.4	8.6	8	19		

*Immaterial adjustment of comparative numbers

Expenses for vacation and rest included in the following sections in the profit and loss statement:

	For the year ended December 31		
	2016	2015	2014
	USD thousands	USD thousands	USD thousands
Operating expenses	25,478	21,547	16,518
Sale expenses	1,777	1,503	1,152
Management and general expenses	4,474	3,783	2,900
Total	31,729	26,833	20,570

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 14 - Liabilities for employee benefits (cont.)

k. Early retirement plans:

	As of December 31	
	2016	2015
	USD thousands	USD thousands
Obligations in respect of retirement plans	4,939	6,595
Plan assets to finance commitment	(4,492)	(2,046)
Net commitment	447	4,549

l. Agreements signed with the pilots' sector during 2016 and after the date of the statement of financial position:

During the year, the Company's pilots, led by the representatives of pilots in the workers' union, took actions that the Company claims constituted illegal sanctions, which were expressed, *inter alia*, in the unwillingness to man flights, conditioning consent to man flights on a demand to split the flight (one-way flight), excess sick notes and more. Consequently, the takeoff times of flights were delayed, flights were cancelled or transferred to leased aircraft of other airlines, which led to an increase in the Company's operating expenses.

Subsequently, in December 2016, a streamlining agreement was signed that constitutes an addendum to the collective agreement between the Company and the workers' union and Histadrut regarding understandings with the pilots (the "Agreement"), including a number of agreements regarding the pilots' undertakings from an operational standpoint, as well as the undertaking to maintain industrial quiet, while the Company undertook, on the other hand, to discontinue the operation of wet leases for passenger aircraft (the lease of an aircraft with its crew), which were used at the time, and the Company's undertook to raise the salaries of all of the Company's pilots at a rate of 8.75%, subject to a partial reduction mechanism of 2.4% from this addition in the case of failure to meet the undertakings in the Agreement, at the decision of the chairman of the Histadrut. The salary raise was taken into account within the actuarial assumptions regarding the rate of the salary increase.

Additionally, during February 2017, after the date of the statement of financial position, an agreement was signed between the Company and the Histadrut and workers' union to address the position of senior pilots when reaching the age of 65, when they can no longer continue to serve as active pilots based on Aviation Regulations. Under the agreement, some of the aforesaid pilots will serve as instructors and supervisors, while others will conclude their employment and be entitled to retirement grants in accordance with the determined amounts.
In light of the same, and from this point forward, the Company will recognized in 2017 an additional severance pay liability, which will lead to an increase in the current service cost for 2017 of the Company for this plan, in a scope of NIS 18 million (USD 4.7 million), which will gradually decrease in subsequent years.

m. Additional information:

For information regarding the current liabilities in respect of employee benefits provided to key managerial personnel, see Note 23.f.

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 15 - Provisions and contingent liabilities

In accordance with IAS 37, provisions are included in respect of claims and legal proceedings (including deductions assessments) that are expected to require a negative cash flow (with a probably of over 50%), which the Company's management believes, based *inter alia* on an opinion by its legal counsel, are appropriate in accordance with the circumstances of the case.

Therefore, the financial statements include appropriate provisions regarding legal proceedings and claims, as stated, against the Company, which the management believes are unlikely to be dismissed or rejected, despite the fact that it denies the aforesaid claims.

Regarding critical accounting considerations and key sources for uncertainty estimates used in determining the value of the liability in the Financial Statements, see Note 2.c.(2).

As of the publication of the report, legal claims have been filed against the Company (including tax deductions) in the amount of USD 757 million in addition to legal claims that are not quantifiable in monetary amounts. For these claims, the Company has recorded a provision in the financial statements in a total amount of USD 17.8 million. In the opinion of the Company's management, based on the opinion of its legal counsel, it is not expected that the Company will have exposure to additional loss for the aforesaid claims beyond the amounts of the provisions included in the financial statements.

a. Transfers in provisions:

	State of Israel for dispute on surplus of severance fund for eligible employees*	**Other provisions**	**Total**
	USD thousands	**USD thousands**	**USD thousands**
Balance as of January 1, 2015	8,382	1,717	10,099
Additional provisions recognized (including updating existing provisions)	7	986	993
Amounts that have been used and have been cancelled during the year	-	(573)	(573)
Impact of exchange rate	(28)	(13)	(41)
Balance at December 31, 2015	8,361	2,117	10,478
Additional provisions recognized (including updating existing provisions)	-	7,296	7,296
Amounts that have been used and have been cancelled during the year	-	(79)	(79)
Impact of exchange rate	124	27	151
Balance at December 31, 2016	8,485	9,361	17,846

*See Note 14.c(2) regarding liabilities for employee benefits

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 15 - Provisions and contingent liabilities (cont.)

b. Detail of main legal proceedings:

Class actions:

(1) Regarding the motion to certify a class action and in the matter of an appeal filed following the ruling of the Haifa District Court to dismiss a motion to certify a class action ("the Ruling") filed against the Company in May 2011, claiming that the Company is overcharging cancellation fees for off-site transactions at a rate exceeding the maximum rate permitted by the Consumer Protection Law, on August 17, 2014 the Supreme Court, in its capacity as a civil court of appeals, ruled against the appeal filed against the Ruling, thus accepting the Company's position. The Supreme Court ruled that the Company may collect cancellation fees in accordance with the Consumer Protection Law for each cancelled flight ticket, even when a number of tickets were purchased as part of a single reservation. On August 31, 2014, the plaintiff filed a motion for an additional hearing by the Supreme Court, and the Company filed its response to the motion. The Company believes, based on the opinion of its legal counsel, that it is more likely than not that the complaint will be dismissed.

(2) In February 2013 the Company received at its offices a motion to certify a class action filed with the Central District Court (the "Motion") against the Company and against British Airways, Lufthansa and Swiss Air. The motion was filed by "Hatzlacha the Consumer Movement for Promoting a Fair Economic Society" on behalf of customers shipping cargo to or from Israel (with the exception of to and from the U.S.), after no other plaintiff was found, as noted in the Motion. The Motion alleged that there existed a restrictive arrangement to fix various elements of cargo shipping prices, published by various authorities around the world in February 2006 and the grounds of the claim are in accordance with the Antitrust Law. The total damages listed in the motion amount to NIS 613 million, of which NIS 473 million is attributed to the Company.

In December 2014, after the commencement of evidence hearings in the suit, the Company filed a motion to strike the representation and to disqualify the applicant and its representatives, due to the fact that one of the applicant's representatives (who in light of the above concluded their representation in the proceedings) had formerly represented the Company on matters pertaining to the claims that came up in the motion to certify. Following the rejection of the above motion by the District Court, the Company and the other defendants filed a motion to appeal before the Supreme Court in March 2016, which was rejected. The evidentiary proceedings in the case have concluded and dates were scheduled for the submission of summations. The Company believes, based on the opinion of its legal counsel, that it is more likely than not that the complaint will be dismissed.

(3) In April 2014 the Company's main offices received a motion to certify a class action, which was filed against it before the Jerusalem District Court ("the Motion"). The key points of the Motion are that buyers who performed transactions with the Company and purchased flight tickets had not received the information on conditions for altering and cancelling flight tickets, as required by law, and that the Company had not met the terms of cancellation and change presented to its customers, but rather operated in accordance with different terms that had not been revealed to them, as claimed by the plaintiff in the Motion. The original motion was denominated in a personal amount estimated at NIS 774, and the collective damage was estimated at NIS 226 million. On March 23, 2016, the Jerusalem District Court certified the action as a class action. The Company filed a motion for leave to appeal, which was rejected on July 11, 2016. According to the decision, the class of plaintiffs was defined as purchasers of plane tickets through the Company's website alone (and excludes purchasers on alternative channels) who did not receive the information regarding the change and cancellation of plane tickets as required under the law and regulations, who actually requested to change or cancel the plane ticket purchased, and who was not allowed by the Company to do so or from whom the Company collected a fine to do so, who were not notified of the same in advance, and that is not considered to be reasonable cancellation or service fees. The hearing in the claim in taking place in the Jerusalem District Court, to which an amended statement of claim and amended statement of defense were filed. Within the amended statement of claim, the plaintiff estimated the damage to the class in an amount ranging between NIS 160 million and NIS 523 million. For this claim, the Company recognized a provision based on the estimate of the management and based on the opinion of its legal counsel.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 15 - Provisions and contingent liabilities (cont.)

b. Detail of main legal proceedings: (cont.)

Class actions: (cont.)

(4) In January 2015 the Company's main offices received a motion to certify a class action, which was filed before the Central District Court ("the Motion"). The Motion was filed against Arkia Israeli Airlines Ltd., Israir Aviation and Tourism Ltd., the Company and the Airports Authority ("the Respondents"). According to the Motion, the Respondents are in violation of their obligations in accordance with the Disabled Persons' Equality Law, 1988, to operate a hearing accessory system with an induction coil in each airport passenger terminal to benefit people with hearing disabilities who use hearing aids. The Motion notes a personal sum of NIS 500 and a total sum for the entire class of NIS 83 million. The Company has filed its response and the parties are conducting mediation proceedings. The Company believes, based on the opinion of its legal counsel, that it is more likely than not that the complaint will be dismissed.

(5) In January 2015 the Company's main offices received a motion to certify a class action, which was filed before the Central District Court ("the Motion"). According to the Motion, it pertains to failure to repay fees and/or port taxes collected by the Company from its customers on the charge date for flight tickets in cases in which the passengers failed to take their flights, in light of the fact that the Company does not transfer the fees and/or port taxes collected from these customers to third parties. The Motion notes a personal sum of NIS 183 and a total sum for the entire class of NIS 30 million. The Company has filed its response. The Company believes, based on the opinion of its legal counsel, that it is more likely than not that the complaint will be dismissed.

(6) In April 2015, the Company's main offices received a motion to certify a class action, which was filed against it before the Tel Aviv District Court ("the Motion"). The Motion was filed on behalf of the members of the Company's Matmid frequent flyer club (the "Class" and the "Club"). According to the main claims in the Motion, the Company unilaterally changed the terms of the Club in a number of aspects that all constitute a substantial deterioration of the terms of the Club and caused substantial economic harm to the value of the points accumulated by the Class. The Motion lists a personal amount of NIS 7,300 and a total amount for the entire Class estimated by the applicant in the amount of NIS 1.3 billion. The Company filed its response. The Company believes, based on the opinion of its legal counsel, that it is more likely than not that the complaint will be dismissed.

(7) In February 2016 the Company's main offices received a motion to certify a class action, which was filed against it before the Central District Court ("the Motion"). According to the Motion, the applicant purchased from the Company a plane ticket to the United States, while the flight was actually executed in a "wet lease" arrangement by a Spanish airline. The applicant claims that her personal damage amounts to USD 100, and that the Motion was filed on behalf of all of the purchasers of the Company's plane tickets whose flights were actually carried out by a foreign company in a "wet lease" and who were not notified of the same in advance as required by law (the "Class"), while according to the applicant, the damage amounts to USD 328 per passenger in the Class, based on a computation performed by the applicant between the prices of the Company's plane tickets and the prices of plane tickets for other airlines, as claimed by the applicant. The Company has filed its response to the Motion. The Company believes, based on the opinion of its legal counsel, that it is more likely than not that the complaint will be dismissed.

Note 15 - Provisions and contingent liabilities (cont.)

b. Detail of main legal proceedings: (cont.)

Class actions: (cont.)

(8) In April 2016 the Company's main offices received a motion to certify a class action, which was filed against the Company before the Jerusalem District Court ("the Motion"). The main claims in the Motion are that the Company does not update its customers that contact it by phone for the purchase of plane tickets as to all of the details required under the Consumer Protection Law, 1981 (the "Law"), including the full terms for cancellation and/or change of the plane tickets and the terms of remote sales transactions. The applicant has defined the class of plaintiffs for which the Motion is filed as follows: (a) Any person who purchased a plane ticket through the call center and was not verbally updated or updated in writing of the substantive terms of the transaction, payment terms, cancellation terms and additional terms, during the seven years preceding the filing of the Motion and until the date of the decision therein; (b) any person who purchased a plane ticket through the call center and was not updated of the information set forth above and contacted the Company with a request to cancel or modify the plane ticket or its terms, but was prevented by the Company from doing so or was charged a financial payment of which the purchaser was not informed verbally upon executing the transaction or thereafter in writing, during the seven years preceding the filing of the Motion and until the date of the decision therein. The Motion notes a personal sum of NIS 987 and a total sum for the entire class of NIS 105 million. The Company has filed its response to the Motion. The Company believes, based on the opinion of its legal counsel, that it is more likely than not that the complaint will be dismissed.

(9) In May 2016 the Company's main offices received a motion to certify a class action, which was filed against the Company before the Central District Court ("the Motion"). The Motion was filed by two passengers who purchased duty-free products during their flights, through the Company. According to the claim in the Motion, the prices of duty-free products sold by the Company on its aircraft and website, by pre-order while the payment for the products is executed on the aircraft, are presented in US dollar and not Israeli currency, and therefore the conversion is done at the exchange rate updated once per week and not based on the exchange rate on the trading day in the foreign currency preceding the purchase date. The Company has filed its response to the Motion. The Company believes, based on the opinion of its legal counsel, that it is more likely than not that the complaint will be dismissed.

(10) In August 2016 the Company's main offices received a motion to certify a class action, which was filed against it before the Central District Court ("the Motion"). The main claims in the Motion were that the Company publishes, markets and sells plane tickets based on the flight schedule that it publishes, while at the outset it does not have sufficient pilots and captains to execute the flight schedule as stated, which misleads the public and lures it to purchasing plane tickets for flights while the Company is aware that it will not be able to carry out some of the flights on the planned date or they will be cancelled, or experience significant delays. The Motion further claims that the Company's flight schedule increased and expanded, while the number of pilots and specifically captains employed in its service did not increase in a manner that would be able to support and uphold the flight schedule as sold to the public, and the Company does not notify the public of ticket purchasers in advance, and even refuses to compensate the purchasers of the plane tickets who were harmed. In the aforesaid Motion, the Class was defined as those who purchased plane tickets from the Company in the seven years preceding the date of filing the Motion, for a specific date as published and marketed by the Company, while in reality, the flight took off following a delay exceeding two hours from the scheduled flight time, due to a lack of pilots, and who were not compensated by the Company. The scope of damage estimated in the Motion for the entire class amounts to "tens of millions of shekels." The Company is studying the Motion and will file its response as required. At this early stage, the chances of the claim being accepted cannot be assessed.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 15 - Provisions and contingent liabilities (cont.)

b. Detail of main legal proceedings: (cont.)

Class actions: (cont.)

(11) In November 2016 the Company's main offices received a motion to certify a class action, which was filed against it before the Central District Court in Tel Aviv Jaffa ("the Motion"). The main claims in the Motion are that the Company does not notify its passengers with Israeli citizenship regarding their entitlement to compensation in a case of a delay of three or more hours in their flights departing or landing at airports in the European Union as required under the European Union's Directive regarding passenger compensation (the "European Directive"), does not fulfill the other provisions of the European Directive and discriminates between its Israeli passengers and the foreign passengers. The Motion lists a personal amount of NIS 2,191 and that at this stage, the total amount of the class action cannot be estimated.

In December 2016 the Company's main offices received a motion to certify a class action, which was filed against it and against the subsidiary Sun D'Or International Airlines Ltd. ("Sun D'Or") before the Central District Court in Tel Aviv Jaffa ("the Motion"). The main claims in the Motion are that the Company and Sun D'Or do not publish information and notify [passengers] as required regarding the rights, under the European legislation, to which their customers are entitled under circumstances of a delay in a flight or cancellation of a flight and do not uphold their obligations to compensation as stated, as well as claims regarding failure to disclose and misrepresentation. According to the Motion, the class is defined as the customers of the Company and Sun D'Or who flew through them or purchased from them or on their behalf plane tickets from a destination located within the European Union and are entitled to compensation, a reimbursement or other benefits based on the European Regulation (the "Class"). The Motion lists a total of NIS 2,000 as average compensation estimated per customer as well as an estimated calculation for the entire Class in the amount of NIS 50 million. The Company is examining the Motion and will file its response as required. At this early stage, the chances of the claim being accepted cannot be assessed.

On December 14, 2016, the Court granted the applicant's Motion to dismiss the Motion to Certify filed in November 2016 in light of the similarities between this motion and the motion filed in December.

(12) In November 2016 the Company's main offices received a motion to certify a class action, which was filed against it before the Central District Court in Tel Aviv ("the Motion"). The main claims in the Motion are that the Company and/or its employees are deliberately causing delays of flights since the salary agreements of the Company's pilots encourage them to increase the flight time, while harming the consumers who are forced to spend extraneous time in the air and on the ground while losing time and spending more on flights that are longer than necessary. According to the Motion, the class is defined as all of the Company's customers who flew on a flight of the Company that experienced excessive delays that were caused by the Company and/or its employees compared to the minimum time that the flight could have taken (the "Class"). The Motion lists personal damage in the amount of NIS 3,000, and that it is difficult to estimate the amount of damage for the entire Class without data from the Company, but that the applicants estimate that the amount is tens of millions of shekels. The Company is reviewing the Motion and will file its response as required. At this early stage, the chances of the claim being accepted cannot be assessed.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 15 - Provisions and contingent liabilities (cont.)

a. Detail of main legal proceedings: (cont.)

Class actions: (cont.)

(13) In December 2016 the Company's main offices received a motion to certify a class action, which was filed against it before the Central District Court ("the Motion"). The main claims in the Motion are that the Company collects from customers making changes to the plane tickets an additional payment that is the difference between the price of the original flight and the price of an alternative flight, in cases in which the alternative flight is less expensive. The Motion claims that this collection by the Company constitutes a violation of the transport agreement and a violation of the provisions of the Consumer Protection Law. According to the Motion, the class is defined as the customers of the Company who changed the date or destination to an alternative flight that, on the date of the change, was less expensive than the original flight, in the seven years preceding the filing of the Motion (the "Class"). The Motion lists a personal claim amount estimated at USD 45.6 as well as an estimated calculation for the entire Class, performed by the applicant, in the amount of NIS 92 million. The Company is examining the Motion and will file its response as required. At this early stage, the chances of the claim being accepted cannot be assessed.

(14) In December 2016 the Company's main offices received a motion to certify a class action, which was filed against it before the Central District Court in Tel Aviv ("the Motion"), in which a claim was made of improper discrimination in the collection of payment of membership fees for the Matmid frequent flyers club. The Class includes any person who paid the Company for joining the Matmid frequent flyers club. The applicant estimated the scope of the Motion for the entire class in the amount of NIS 60 million. The Company is studying the Motion and will file its response as required. At this early stage, the chances of the Motion being accepted cannot be assessed.

(15) In February 2017, after the date of the statement of financial position, the Company's main offices received a motion to certify a class action, which was filed against it before the Central District Court ("the Motion"). The main claims in the Motion are that upon cancellation or delay of a flight, the Company operates in violation of the Aviation Services Law (Compensation and Assistance for Cancellation of a Flight or Change in Terms), 5772-2012, breach of contractual obligations and obligations under the Consumer Protection Law and more. The class defined in the motion is, *inter alia*, customers of the Company whose flights were cancelled and did not receive a reimbursement of the ticket fees or an alternative flight of their choice, customers of the Company who did not receive assistance and information about their rights to benefits, and customers of the Company that allegedly received a misleading response.
The plaintiffs demand, *inter alia*, declarative remedies for the fulfillment of the provisions of the law, as claimed by them, and financial compensation, and estimated the scope of the Motion for the entire class in the amount of NIS 50 million. The Company is examining the Motion and will file its response as required. At this preliminary stage, the changes of the Motion being granted cannot be assessed.

Class action cases that have been concluded:

(16) In June 2015 the Company's main offices received a motion to certify a class action, which was filed against it before the Central District Court in Tel Aviv ("the Motion"). According to the Motion, it was filed on behalf of any person who examined the possibility of purchasing reduced-cost flights on the Company's website in accordance with the Company's publications, but there were no such flights present ("the Class"). The Motion lists a personal sum of NIS 400 and a total sum for the entire Class, estimated by the applicant, of NIS 40 million. In January 2016, the Court approved the parties' joint request to dismiss.

Note 15 - Provisions and contingent liabilities (cont.)

a. Detail of main legal proceedings: (cont.)

Class action cases that have been concluded: (cont.)

(17) In June 2015 the Company's main offices received a motion to approve a claim as a class action, which was filed before the Tel Aviv District Court against the Company and against Israir Aviation and Tourism Ltd., Israir Charter (1994) Ltd. and Arkia Israeli Airlines Ltd. (the "Motion"). As alleged, the Motion was filed on behalf of all of the airlines' passengers starting August 16, 2012 for whom the flight takeoff time had been delayed for over two hours and/or whose flight had been cancelled and the takeoff date of their alternate flight had been delayed for over two hours from the original takeoff time and who were not provided with assistance in accordance with the Aviation Services Law, 5772-2012 (the "Class"). The Motion notes a personal sum of NIS 50, with the sum for the entire Group estimated by the applicants at NIS 47 million, of which NIS 32.5 million is attributed to the Company. On May 1, 2016, the Court approved the joint motion to dismiss regarding the Company without ordering costs for any of the parties.

(18) In August 2015, the Company's main offices received a motion to certify a class action, which was filed in the Central District Court ("the Motion"). The Motion was filed on behalf of all passengers belonging to the Company's "frequent flyer" club ("the Club") who has purchased vouchers from the Company for the purchase of duty-free products in return for the Club points they have accumulated, in the seven years prior to the approval of the Motion, if certified. According to the Motion, the vouchers' purchasing condition according to which there are "No refunds for partial voucher redemptions" constitute a harmful condition in a standard contract. The remedies requested in the motion are, among other things, to compel the Company, from now on, to provide change in cash or credit vouchers or credit in Club points for partial use of the voucher as well as suitable monetary reimbursement to all customers who did not receive change for such partial usage. It is noted that the direct monetary damage is estimated by the applicant in the amount of NIS 4 million. On November 30, 2016, the Court certified the joint motion to dismiss filed by the parties.

(19) In January 2016 the Company's main offices received a motion to certify a class action, which was filed against it before the Central District Court in Tel Aviv Jaffa ("the Motion"). According to the Motion, the applicant purchased return flight tickets at full price to Budapest, with her seat on these flights being in seats characterized by smaller space than usual for passenger legs with no option of reclining the seats. The applicant claims that full price should not be charged for these seats and the applicant clams that her personal damage amounts to NIS 500, and that the Motion was filed on behalf of all customers flying over the past seven years on Company flights featuring a row of seats that do not recline and who paid regular price, as well as those who flew until the cessation of the fault covered by the Motion ("the Class"), and the applicant claims that the total damages of the Class amount to NIS 15 million. The Company has filed its response to the motion for appeal. On February 14, 2017, after the date of the statement of financial position, the Court certified the joint motion to dismiss filed by the parties.

(20) In May 2016 the Company's main offices received a motion to certify a class action, which was filed against the Company before the Jerusalem District Court ("the Motion"). The Motion was filed by a passenger who purchased a food product from the Company's Fly&Buy duty-free. According to the Motion, the Company's catalog included products exempt from tax that it sold, and indicated that the food products were kosher, despite the fact that the products do not bear any kosher certification. The Motion further claims that the products do not contain the writing as required under the Public Health Regulations (Food) (Nutritional Markings), 5753-1993 and the Consumer Protection Order (Marking Goods), 5743-1983.

The Motion lists a personal amount of NIS 73 and a total amount for the entire class in the amount of NIS 3.1 million. On February 19, 2017, after the date of the statement of financial position, the Court granted the motion to dismiss filed by the Motion without ordering expenses.

Note 15 - Provisions and contingent liabilities (cont.)

a. Detail of main legal proceedings: (cont.)

Class action cases that have been concluded: (cont.)

(21) In February 2015 the Company's main offices received a motion to certify a class action, which was filed against it before the Central District Court ("the Motion"). The Motion was filed on behalf of the holders of the branded credit card of the Company's Matmid frequent flyers club - the Fly Card. According to the Motion, contrary to the Company's publications and representations, within the UP flights operated by the Company, holders of the aforesaid credit card are not given various benefits, as promised by the Company. The Motion lists a personal amount of NIS 192, and a total amount for the class estimated by the applicant at NIS 10 million. On January 8, 2017, and after the date of the statement of financial position, a judgment was given that certifies the settlement arrangement reached by the parties in an amount immaterial to the Company.

Details of other main legal proceedings:

(22) In February 2013 the Company received a statement of claim in the amount of NIS 56 million filed against it in the Tel Aviv District Labor Court by 130 security workers who, as alleged in the statement of claim, were/are employed by the Company as assistant security officers sent to various destinations as needed, for flight security duties. The plaintiffs are demanding that the Court issue a declaratory remedy according to which it will be decided that the collective work agreement regulating the rights of workers at the Company applies to the plaintiffs and to order monetary remedies for the various salary components. The Company filed a statement of defense. On April 11, 2016, the Company received an amended statement of claim based on which, *inter alia*, the amount of the claim was quantified as NIS 86 million, the claim components were updated and the number of plaintiffs was now 126. For this claim, the Company recognized a provision based on the estimate of the management and based on the opinion of its legal counsel.

(23) In August 2014 the Company's offices received a suit filed against it by the State of Israel – Ministry of Finance in the Central District Court, in the amount of NIS 58 million. The suit deals with the State's demand for the restitution of funds transferred as consideration from the Company's securities to cover a deficit in the severance fund of the Company's employees as part of the privatization of the Company in 2003. It is noted that the deficit, as defined in the Agreement, was covered in full in 2007 and there remained a surplus between the issuance consideration of the Company and the State and between the amount deposited in the central severance fund for "entitled employees," as described in the Company's financial statements (see Note 14c.(2)). It was further claimed that the Company received additional consideration under the issuance of options to employees of the Company, which was supposed to be transferred to the aforesaid severance fund. Furthermore, the suit includes remedy for accounting regarding the severance fund and the claimed deficit. The Company filed a statement of defense on November 30, 2014, and the State filed a statement of response on December 28, 2014. Regarding a provision made regarding the surplus in the issuance consideration, see Note 14c(2) above. The Company's management estimates, based on the opinion of the Company's legal counsel, and in light of the fact that the surplus created in the severance fund (NIS 32.6 million) was deposited in a separate account, that no additional provision was included in the financial statements.

In March 2015, the Ministry of Finance filed an additional claim against the Company before the Central District Court in Lod in the amount of NIS 77 million, regarding profit as a result of the investment of money in the severance fund, plus surpluses deriving from accounting regulation (at a non-quantified sum).

In its suit, the Ministry of Finance claimed that some of the surplus in the severance fund was created subsequent to the date on which the State was supposed to supplement the balance of the deficit in the severance fund, and as a result the supplementation sum required from the Sate to cover the deficit was supposed to be significantly lower than the sum paid in reality in light of reasons related to profit as a result of investments in the fund and a change in the IFRS accounting standard, and therefore a claim was filed for the reimbursement of these sums. In March 2016, the Ministry of

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 15 - Provisions and contingent liabilities (cont.)

b. Detail of main legal proceedings: (cont.)

Details of other main legal proceedings: (cont.)

Finance filed an amended statement of claim against the Company to the Central District Court in Lod in the amount of NIS 125 million. The amended statement of claim pertains that over deposits as a result of profits from investments in the severance fund and not (as claimed in the second original claim from March 2015) over deposits as a result of changes in the accounting standards.

Furthermore, regarding the request of an entity known as the “El Al Workers’ Action Committee” to join the claim of the Ministry of Finance as a defendant and the request of the workers’ union and General Labor Federation in July 2016, the Court decided, with the consent of the parties, to reject the motion to join by the Action Committee and to grant the motion to join the workers’ union and the General Labor Federation as formal defendants. The Court ruled within the decision that the workers’ union and the General Labor Federation could not make claims regarding their alleged entitlement to the funds with the Company within the claim. The parties are required to file revised statements of claim.

(24) In November 2015 the Company’s main offices received a suit filed against it at the Center District Court to the sum of USD 20 million (“the Suit”). According to the Suit, most of the claims deal with the breach of contract, damages and unlawful gain within the framework of a joint venture in the field of credit cards in the United States between the Company’s frequent flyer club and Heritage Affinity Services Ltd., a company registered in the State of New York, with a fully-owned subsidiary incorporated in Israel. The Company has submitted a statement of defense to the statement of claim in the amount of USD 1.9 million in addition to temporary motions to deposit collateral and forfeiture. The Company believes, based on the opinion of its legal counsel, that it is more likely than not that the complaint will be dismissed.

(25) In December 2016, the Company’s offices received assessment notices on behalf of the Securities Authority, Ramla Tax Assessor (the “Tax Assessor”), further to the withholdings audit conducted for the Company regarding the calculation of withholding salary tax and employee expenses for the years 2011 and 2012, based on which the Company was required to pay a total of NIS 33 and NIS 28 million, respectively (about USD 9 and USD 7 million, respectively, excluding linkage differentials and interest). The Company rejects the claims of the Tax Assessor and filed an objection to the assessments. Assessments have not yet been received for 2013 and thereafter (in which no material change occurred in the Company’s pattern of activity, in the matters discussed in the assessments).

Following the above, the Company recognized a provision for the exposure (for the entire period until the date of the statement of financial position) in the amount determined based on the management’s estimate and based on the opinion of the Company’s legal advisors.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 16 - Income tax

Deferred taxes are recognized in respect of temporary differences between the value of assets and liabilities for tax purposes and their carrying amount in the financial statements. The deferred tax balances (assets or liabilities) are calculated using the tax rate expected upon their realization, in accordance with tax laws effectively enacted as of December 31, 2016, as set forth below.

In calculating the deferred taxes, taxes that would apply in case of realization of the investments in investees are not accounted for, as these temporary differences are under the Company's control and are not expected to reverse in the foreseeable future.

a. Deferred tax balances:

Composition (Liabilities) of deferred tax assets set forth below:

	Balance as of January 1, 2016	Recognized in profit or loss	Recognized in other comprehensive income	Balance at December 31, 2016
	USD thousands	USD thousands	USD thousands	USD thousands
Timing differences:				
Fixed assets	(205,849)	25,238	-	(180,611)
Derivative financial instruments	10,784	233	(16,499)	(5,482)
Provisions, doubtful debts and liabilities in respect of employee benefits	15,618**	(5,844)	2,926	12,700
Total	(179,447)	19,627	(13,573)	(173,393)
Unutilized tax losses and benefits:				
Losses for tax purposes*	118,880	(31,705)	-	87,175
Total	(60,567)	(12,078)***	(13,573)	(86,218)

* The balance of the Company's transferred losses for tax purposes as of the end of 2016 is USD 379 million. On this amount in full, the Company recognized a tax asset in its financial statements (as of the end of 2015: USD 448 million).

** Immaterial adjustment of comparative numbers.

*** In addition, during the year, the subsidiaries recognized an expense in the amount of USD 688 thousand for current taxes.

	Balance as of January 1, 2015	Recognized in profit or loss	Recognized in other comprehensive income	Balance at December 31, 2015
	USD thousands	USD thousands	USD thousands	USD thousands
Timing differences:				
Fixed assets	(212,888)	7,039	-	(205,849)
Derivative financial instruments	19,433	(7,718)	(931)	10,784
Provisions, doubtful debts and liabilities in respect of employee benefits	15,816**	(520)	322	15,618
Total	(177,639)	(1,199)	(609)	(179,447)
Unutilized tax losses and benefits:				
Losses for tax purposes*	155,402	(36,522)	-	118,880
Total	(22,237)	(37,721)	(609)	(60,567)

* The balance of the Company's transferred losses for tax purposes as of the end of 2015 is USD 448 million. On this amount in full, the Company recognized a tax asset in its financial statements (as of the end of 2014: USD 586 million).

** Immaterial adjustment of comparative numbers.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 16 - Income tax (cont.)

b. Effective tax:

	For the year ended December 31		
	2016	**2015**	**2014**
	USD thousands	**USD thousands**	**USD thousands**
Profit (loss) before taxes on income and before the distribution of profit Associated companies - without revaluation of Maman options	91,815	143,768	(39,343)
Statutory tax rate	25.0%	26.5%	26.5%
Tax expenses (income) based on statutory tax rate	22,954	38,099	(10,426)
Additional tax in respect of:			
Non-deductible expenses	353	149	199
Adjustments for changes in tax rates	(11,140)	-	-
Other provisions	599	(191)	-
Total income tax (tax benefits) presented in the profit and loss statement	12,766	38,057	(10,227)

c. Tax laws applicable to the Company:

(1) According to the Income Tax Regulations (Rules Concerning the Maintenance of Accounting Records of Airlines with Foreign Investments and of Certain Partnerships and the Determination of their Taxable Income), 5746-1986, the results of the Company and some of its subsidiaries are measured for tax purposes on a dollar basis. Some of the subsidiaries are assessed jointly with the Company.

(2) The Company is deemed an industrial company under the Law for the Encouragement of Industry (Taxes), 5729-1969 and, accordingly, is entitled to accelerated depreciation rates on aircraft and equipment. Pursuant to the Income Tax Regulations - Depreciation, 1941, the Company is entitled to depreciate the cost of these asset items, at an early rate of 30% and for engines, to depreciate at an annual rate of 40%.

(3) Changes in the tax rates during the year:

On January 4, 2016, the Knesset plenum approved the Amendment to the Income Tax Ordinance (No. 216), 5776-2016, which determined, *inter alia*, the reduction of the corporate tax rate as of January 1, 2016 and thereafter at a rate of 1.5%, such that it amounts to 25%. This event is reflected in the Company’s financial statements in the reports of the first quarter for 2016. Additionally, on December 22, 2016, the Knesset plenum approved the Economic Efficiency Law (Legislative Amendments to Reach Budgetary Objectives for the 2017 and 2018 Budget Years), 5777-2016, which prescribed, *inter alia*, the reduction of the corporate tax rate from 25% to 23% in two increments. The first increment to a rate of 24% as of January 2017 and the second increment to 23% as of January 2018 and thereafter. As a result, the following are the Company’s relevant tax rates as of December 31, 2016:

	For 2015	**For 2016**	**For 2017**	**For 2018 and thereafter**
Statutory tax rate	26.5%	25%	24%	23%

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 16 - Income tax (cont.)

The impact of the changes described above on the financial statements as of December 31, 2016, is expressed in the decrease in the balances of deferred tax liabilities in the amount of USD 27,357,000 and a decrease in the balances of deferred tax assets in the amount of USD 16,815,000 (of this amount, a total of USD 3,180,000 was recognized in the first quarter of 2016). The update of the deferred tax balances was recognized against deferred tax income of USD 11,140,000 (of this amount, a total of USD 3,815,000 in the first quarter), against other comprehensive profit (capital reserve) in the amount of USD 598,000 (of this amount, a total of about USD (635,000) in the first quarter).

d. Final assessments:

The Company has received tax assessments considered final up to and including the 2002 tax year and in addition, the Company has tax assessments considered final up to and including the 2012 tax year.

Regarding assessments for deductions received at the Company’s offices, see Note 15.b.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 17 - Capital and surplus

a. The Company's share capital:

	Registered		Issued and paid up	
	Special share	Ordinary shares	Special share	Ordinary shares
	NIS 1 par value	NIS 1 par value	NIS 1 par value	NIS 1 par value
	NIS	NIS	NIS	NIS
Balance:				
As of December 31, 2016	1	1,000,000,000	1	495,719,135
As of December 31, 2015	1	1,000,000,000	1	495,719,135

b. The State's special share and the associated rights:

On May 18, 2003, the Company allocated a special share to the Government of Israel that cannot be sold or transferred. This share was designed to protect the State's vital interests, in accordance with the following Government resolutions:

- Maintaining the Company's existence as an Israeli company, subject to Israeli law;
- Keeping the operating capability and the flight capability of carrying passengers, and cargo, above a minimum established level;
- Preventing any hostile interests or entities from harming the vital interests of the State, from being an interested party in the Company or having any impact in any other way on its management;
- Maintaining security and safety arrangements as determined by State bodies on behalf of the State.

In addition, the Government Companies Order (Declaration of a Vital Interest to the State in El Al Israel Airlines Ltd.), 5765-2004, provides that the State has an essential interest in connection with the Company to allow effective use of essential assets (aircraft with a minimum flight capacity, as defined in the Company's articles of association), in emergency times or for safety purposes to secure the continued existence of activity that is essential to the security of the State and the Company will employ, at all times, Israeli air personnel, and in Israel, Israeli land personnel, that are trained and licensed as required for the operation of the essential assets - all in the number that is at least the number required for the continuous and simultaneous operation of all of the essential assets during an emergency or for a security need. As of the signing date of these consolidated financial statements, the provisions of the Order do not require the Company to make any change in the manner of operation or any change in the composition of its employees.

c. Dividend:

Pursuant to the Company's dividend distribution policy, the Company will distribute a dividend from time to time, at the discretion of the Board of Directors and subject to the Company's needs.

Implementation of this policy is subject to any relevant law provisions as well as the assessment of the Company's board of directors of the Company's ability to meet its present as well as projected liabilities and taking into account its liquidity, and present as well as future business plans and activities. The adoption of this policy does not diminish the authority of the board of directors of the Company to decide upon a change, amendment and/or abolition of the currently established dividend policy and/or to approve any additional distributions that comply with the law and/or to decide on a reduction of actual distributions or to preclude them altogether should it be warranted by changes from time to time in the Company's liquidity, operations and conditions.

The following are details about the dividend distribution that occurred during the year:

(1) On March 23, 2016, the Company declared a distribution of dividend in the amount of NIS 0.117 per share (USD 0.03) for each ordinary share par value NIS 1. The total dividend amount amounts to NIS 57.8 million (USD 15 million). The effective date for the dividend distribution was set for March 31, 2016, and was actually paid on April 13, 2016.

(2) On August 17, 2016, the Company declared a dividend distribution in the amount of NIS 0.14 per share (USD 0.37) for each ordinary share par value NIS 1. The total dividend amount was NIS 69.4 million (USD 18.3 million). The effective date for the dividend distribution was set for August 25, 2016, and was actually paid on September 7, 2016.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 18 - Derivative financial instruments and hedging

a. Management of financial risks and their origins:

The Company uses a range of derivative financial instruments to manage exposure to changes in price of jet fuel, which has a direct impact on the Company's operating expenses, as well as exposure to exchange rates, largely arising from the Company's mostly NIS salary expenses. The Company also has certain exposure, limited in scope, to other currencies, mainly due to the surplus of receipts over payments in these currencies. In addition, the Company also bears interest risk deriving from loans taken at variable interest.

The Company's board of directors is responsible for approving a market risk management policy and supervises the implementation of the policy through the Market Risk Management Committee. The Committee is responsible for defining and updating the policy, supervising the policy's implementation and issuing instructions/approvals for Company management to deviate from implementing the policy in accordance with various development (this Committee reports to management at least once per month). The Company's CEO is responsible for making decisions regarding implementing hedging agreements in practice in accordance with the Committee's policy and guidelines.

The Company's financial sector provides services to its business activity, provides access to local and international financial markets, supervises and manages the financial risks involved in the Company's activities by way of internal reports that analyze levels of exposure to risk according to degree and strength.

As of December 31, 2016, most of the Company's derivative instruments are designated as hedging instruments in cash flow hedge accounting. The hedging ratios are documented by the Company on the date of the engagement in the hedging transaction. Within the documentation, the hedging instrument identifies the hedged item, the hedged risk, the hedge strategy applied, and examines the extent of suitability of the strategy to the Company's hedging policy.

b. Accounting policy:

As of 2015, the Company is implementing IFRS 9 (2013) early, which enables the implementation of various provisions in certain cases from those required in accordance with IAS 39. Accordingly, changes in the value of derivative financial instruments intended to hedge cash flows are first recognized in the statement of other comprehensive profit (and in the Company's equity) and are then charged to the profit and loss statement, with the projected hedged transaction listed in the profit and loss statement (for instance, the purchase of jet fuel). In particular, on the date on which the results of the hedging transaction are charged to the profit and loss statement, the results of the jet fuel hedging transactions are charged to operating expenses, while forward contracts for the protection of the NIS/USD exchange rate are charged to salary expenses, constituting the projected hedged transaction for this matter.

When the hedging by the options is done using their internal value only, the component of time for the same options will also be recorded in other comprehensive income (and presented in the statement of changes in equity in a separate capital reserve) and will be classified to profit and loss upon the occurrence of the hedged transaction or under certain terms prior.

In light of the application of the new hedging provisions, the Company must first hedge the changes in the prices of jet fuel only for a specific risk of changes in the raw material price (crude oil), for example, instead of hedging the entire change in the price of jet fuel (including changes in the margins of the marketing factors or the cost of transportation), as performed under the provisions of IAS 39. Furthermore, the examination of the effectiveness of the hedging is currently performed by a principle test based on "economic ratios," when the assessment of the effectiveness of the hedging is not required in advance.

Over the course of the reported year and in the comparison periods, the Company also held derivative financial instruments (for these exposures) that were not recognized as hedging instruments for accounting purposes. These derivatives were recognized in the financial statements at fair value, in such a manner that the differences in fair value in each reporting period were recognized immediately to the profit and loss statement, in the same profit/loss items as the profits and losses of the derivative instruments designated as hedging instruments were recognized (operation and salary).

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 18 - Derivative financial instruments and hedging (cont.)

c. Composition of derivative financial instruments in the statement of financial position:

	As of December 31, 2016				
	Contractual payment (receipt) date	Nominal amount	Current assets	Non-current assets	Total
		USD thousands	USD thousands	USD thousands	USD thousands
Derivative financial instruments designated as hedged items:					
Jet fuel hedging transactions	1/17-12/18	56,061	17,754	3,980	21,734
Hedging transactions in the NIS / USD exchange rate	2/17-6/17	75,061	205	-	205
Interest hedging transactions	4/17-7/19	105,720*	-	980	980
Total assets (liabilities) for derivative financial instruments			17,959	4,960	22,919

*Reflects the fund amount

	As of December 31, 2015					
	Contractual payment (receipt) date	Nominal amount	Current assets	Current liabilities	Non-current liabilities	Total
		USD thousands	USD thousands	USD thousands	USD thousands	USD thousands
Derivative financial instruments designated as hedged items:						
Jet fuel hedging transactions	1/16-6/17	91,606	-	(39,474)	(2,712)	(42,186)
Hedging transactions in the NIS / USD exchange rate	2/16-3/16	21,008	616	-	-	616
			616	(39,474)	(2,712)	(41,570)
Derivative financial instruments measured at fair value by way of profit and loss:						
Hedging transactions in the EUR / USD exchange rate	1/16-12/16	72,000	851	-	-	851
Total assets (liabilities) for derivative financial instruments			1,467	(39,474)	(2,712)	(40,719)

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 18 - Derivative financial instruments and hedging (cont.)

d. Jet fuel derivatives:

As stated above, the Market Risks Management Committee supervises the scope and manner of hedging of future consumption of jet fuel, subject to the policy approved by the Company board of directors, as detailed below. The significance of the financial hedging of jet fuel prices is to guarantee the range of jet fuel purchase prices, in order to protect the Company's exposure to changes in global jet fuel prices.

According to Company policy in this regard, jet fuel hedging will be carried out for a period of 12-24 months forward, on a monthly basis and at decreasing rates, as follows:

- For the coming month the Company shall hedge at least 60% and at most 75% of its jet fuel consumption.
- These percentages will decrease by 5% each month until the 12th month.
- For the 13-18th months, the Company’s management will be given the option of hedging up to 20% of the Company’s expected jet fuel consumption (with no minimum hedging obligation).
- For the 19-24th months, the Company’s management will be given the option of hedging up to 10% of the Company’s expected jet fuel consumption (with no minimum hedging obligation).

Hedging is carried out using various financial instruments as decided by management (price fixing, options and various option structures), using appropriate base assets such as jet fuel, crude oil or refined oil, with at least 20% of the hedging being carried out using options, and the balance via options and/or price fixing, at Company management’s full discretion.

Jet fuel prices paid by the Company in practice (before influence of hedging) are determined according to its market price, and as a result, the hedging agreements for purchasing jet fuel and setting the prices as noted above, naturally hedge the Company’s exposure to the risk of changes in jet fuel prices. It is noted that when hedging jet fuel prices, the Company hedges the refining component only from the Company’s engagements in jet fuel purchases, which also include other components such as refining and transportation margins. As the refining component constitutes the most significant and primary component of these engagements (85%-90%), the hedging agreements are expected to be effective. On occasion, the Company chooses to hedge these transactions by hedging the crude oil component only (by engaging in derivatives in which the base asset is crude oil). The crude oil price constitutes the primary component in setting the market price of the jet fuel (80%-85%), with the coefficient between the price of the crude oil and the price of jet fuel examined by the Company from time to time, in order to ensure that hedging the oil component in question constitutes and is expected to constitute effective hedging.

The Risk Management Committee is authorized to exceed the policy detailed above, including in the scope of hedging. As of December 31, 2016, the Company was hedged with the approval of the committee in scopes that exceed the maximum amounts defined in the policy set forth above regarding the periods of September - December 2017, and June - December 2018. As of the reporting date, the Company has commitments for the hedging of jet fuel prices in a scope estimated at 44% of the consumption expected in 2017 and 30% of the consumption expected for 2018.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 18 - Derivative financial instruments and hedging (cont.)

d. Jet fuel derivatives: (cont.)

Below is the impact of the jet fuel derivatives on the profit and loss statement, other comprehensive profit, capital and cash flows of the Company.

In addition, the table below also includes a sensitivity analysis that explains the change in the Company’s results and capital as a result of changes in the value of jet fuel derivatives. The fair value of jet fuel hedging transactions as of the date of the statement of financial position is determined through use of standard forward pricing curves (level 2).

For the year ended December 31, 2016:

	Impact on income for the year	Impact on other comprehensive income for the year	The total effect on the Company's capital	Cash flow for derivatives	Increase in asset / decrease in liability (decrease in asset / increase in liability)
	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands
Jet fuel derivatives					
Balance of jet fuel derivatives as of January 1, 2016					(42,186)
Revaluation of transactions that are designated as hedging instruments for accounting purposes	-	31,936	31,936	-	31,936
Payment of transactions that are designated as hedging instruments for accounting purposes	(31,984)	31,984	-	(31,984)	31,984
Total movement in jet fuel derivatives	(31,984)	63,920	31,936	(31,984)	63,920
Balance of jet fuel derivatives as of December 31, 2016					21,734
Potential impact of 15% increase / (decrease) in the price of jet fuel on the fair value of derivatives at the end of the period (in USD millions)	-	27.1 / (23.4)	27.1 / (23.4)	-	(27.1) / 23.4

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 18 - Derivative financial instruments and hedging (cont.)

d. Jet fuel derivatives: (cont.)

For the year ended December 31, 2015:

	Impact on income for the year	Impact on other comprehensive income for the year	The total effect on the Company's capital	Cash flow for derivatives	Increase in asset / decrease in liability (decrease in asset / increase in liability)
	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands
Jet fuel derivatives					
Balance of jet fuel derivatives as of January 1, 2015					(62,074)
Revaluation of transactions that are designated as hedging instruments for accounting purposes	-	(65,623)	(65,623)	-	(65,623)
Payment of transactions that are designated as hedging instruments for accounting purposes	(65,514)	65,514	-	(65,514)	65,514
Revaluation of transactions that are not designated as hedging instruments for accounting purposes	(5,789)	-	(5,789)	-	(5,789)
Payment of transactions that are not designated as hedging instruments for accounting purposes	-	-	-	(25,786)	25,786
Total movement in jet fuel derivatives	(71,303)	(109)	(71,412)	(91,300)	19,888
Balance of jet fuel derivatives as of December 31, 2015					(42,186)
Potential impact of 15% increase / (decrease) in the price of jet fuel on the fair value of derivatives at the end of the period (in USD millions)	-	11.9 / (13.0)	11.9 / (13.0)	-	0.31 / (11.9)

f. Currency risk:

Most of the Company’s revenues and expenses are in dollars, which is its functional currency. The Company is exposed to changes in the rate of the USD compared to other currencies in which it has revenues and expenses, primarily for most salary expenses paid in Israel in NIS. Accordingly, a change in the shekel/dollar exchange rate influences the Company's shekel expenses in dollar terms.

The Company also has balance sheet exposure to the weakening of the USD compared to the NIS and other currencies, due to the excess of financial liabilities over financial assets (mainly due to employee benefit obligations, see Note 14), denominated in currencies other than the dollar (primarily the NIS).

From time to time, the Company examines the need to invest in derivative financial instruments to reduce its exposure to currency risks.

In accordance with its policy, the Company hedges its expected cash flow exposure at a rate of 75% for the coming 12 months. The extant of the hedging shall be determined by management.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 18 - Derivative financial instruments and hedging (cont.)

e. Currency risk: (cont.)

Below is the impact of the shekel-dollar derivatives on the profit and loss statement, other comprehensive profit, capital and cash flows of the Company. The fair value of the foreign exchange forward contracts as of the date of the statement of financial position is determined through use of future exchange rates published and the yield curves derived from the interest rates published that correspond to the maturity dates of the contracts denominated in foreign currency (level 2).

For the year ended December 31, 2016:

	Impact on income for the year	Impact on other comprehensive income for the year	The total effect on the Company's capital	Cash flow for derivatives	Increase in asset / decrease in liability (decrease in asset / increase in liability)
	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands
Exchange rate derivatives					
The balance of NIS-dollar derivatives as of January 1, 2016					616
Revaluation of transactions that are designated as hedging instruments for accounting purposes	-	1,986	1,986	-	1,986
Payment of transactions that are designated as hedging instruments for accounting purposes	2,397	(2,397)	-	2,397	(2,397)
Total movement in exchange rate derivatives	2,397	(411)	1,986	2,397	(411)
Balance of NIS-dollar derivatives as of December 31, 2016					205
Potential impact of 10% increase / (decrease) in the exchange rate on the fair value of derivatives at the end of the period (in USD millions)	-	8.3 / (6.8)	8.3 / (6.8)	-	(8.3) / 6.8

In addition, the table below also includes a sensitivity analysis that explains the change in the Company's results and capital as a result of changes in the value of the derivatives arising from fluctuations in the exchange rate (meaning, this analysis required in accordance with the accounting rule does not take into account the impact of the change in exchange rate on the Company's salary expenses). Nevertheless, it is noted that beyond the potential impact set forth below regarding the exchange rate derivatives, a potential change in the shekel/dollar exchange rate also has an impact on the Company's balance sheet balances due to the surplus of liabilities over shekel assets as set forth above. A decrease of 10% in the exchange rate would lead to an expense of USD 4.8 million, due to revaluation of the balances in the statement of financial position as stated.

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 18 - Derivative financial instruments and hedging (cont.)

e. Currency risk: (cont.)

For the year ended December 31, 2015:

	Impact on income for the year	Impact on other comprehensive income for the year	The total effect on the Company's capital	Cash flow for derivatives	Increase in asset / decrease in liability (decrease in asset / increase in liability)
	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands
Exchange rate derivatives					
The balance of NIS-dollar derivatives as of January 1, 2015					(11,043)
Revaluation of transactions that are designated as hedging instruments for accounting purposes	-	2,207	2,207	-	2,207
Payment of transactions that are designated as hedging instruments for accounting purposes	(1,321)	1,321	-	(1,321)	1,321
Revaluation of transactions that are not designated as hedging instruments for accounting purposes	108	-	108	-	108
Payment of transactions that are not designated as hedging instruments for accounting purposes	-	-	-	(8,023)	8,023
Total movement in exchange rate derivatives	(1,213)	3,528	2,315	(9,344)	11,659
Balance of NIS-dollar derivatives as of December 31, 2015					616
Potential impact of 10% increase / (decrease) in the exchange rate on the fair value of derivatives at the end of the period (in USD millions)	-	1.9 / (2.3)	1.9 / (2.3)	-	(1.9) / 2.3

In addition, the table below also includes a sensitivity analysis that explains the change in the Company’s results and capital as a result of changes in the value of the derivatives arising from fluctuations in the exchange rate (meaning, this analysis required in accordance with the accounting rule does not take into account the impact of the change in exchange rate on the Company’s salary expenses). Nevertheless, it is noted that beyond the potential impact set forth below regarding the exchange rate derivatives, a potential change in the shekel/dollar exchange rate also has an impact on the Company’s balance sheet balances due to the surplus of liabilities over shekel assets as set forth above. A decrease of 10% in the exchange rate would lead to an expense of USD 4.3 million, due to revaluation of the balances in the statement of financial position as stated.

f. Interest risk:

The Group is exposed to interest risk deriving from loans at variable interest rates. The risk is managed by the Company by maintaining an appropriate ratio between variable interest and fixed interest loans, and by use of interest derivatives. The hedging actions are evaluated regularly in order to adapt them to projections regarding the desired interest rate and hedged risk. An optimal hedging strategy is ensured by adapting the Company's loan mixture and conducting back to back hedging against the repayment schedules of existing loans.

In accordance with the Company's interest hedging policy, the Company hedges its cash flow exposure to the LIBOR interest rate (exposure arising from Company loans), at a scope of up to 50% of its total exposure for a horizon of up to five years.

The hedging policy is applied by the creation of an appropriate mix of fixed interest loans and variable interest loans as stated above. Additionally, mainly during the fourth quarter of 2016, the Company engaged in interest replacement hedging transactions for a principal of USD 106 million, the value of which as of the date of the statement of financial position is positive amount of USD 1 million. This amount is recognized as an increase in other comprehensive profit of the Company in 2016.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 19 - Items for sections of the profit and loss statement

a. Operating income:

See Note 12 regarding the Company's accounting policy for the recognition of income from passenger flights and advance income.

	For the year ended December 31		
	2016	2015	2014
	USD thousands	USD thousands	USD thousands
Passenger flights	1,827,805	1,825,369*	1,846,798*
Less - discounts	(4,722)	(4,291)	(5,119)
	1,823,083	1,821,078	1,841,679
Cargo and mail transport (in the body of passenger planes and in the cargo plane)	150,441	169,796	179,409
Other	64,904	63,167*	60,215*
Total	2,038,428	2,054,041	2,081,303

* Reclassified

b. Operating expenses:

	For the year ended December 31		
	2016	2015	2014
	USD thousands	USD thousands	USD thousands
Fuel	386,048	480,715	703,060
Salary and benefits	378,989	351,397	348,220
Fees and services at airports	198,983	192,534	195,261
Aircraft maintenance, flight equipment and ground equipment	110,014	101,663*	110,737*
Air passage and aerial communications	88,686	87,957	100,207
Depreciation	143,081	127,739	110,664
Lease of planes and engines (1)	158,604	96,057*	83,895*
Food and provisions	52,296	47,888	46,182
Air crew expenses	62,933	57,148	53,737
Security expenses less State participation (2)	3,465	3,208	3,486
Other operating expenses	59,318	46,538	47,212
Total	1,642,417	1,592,844	1,802,661

* Reclassified

(1) The increase of the lease expenses in 2016 arises mainly as a result of use of wet leases of aircraft (the lease of an aircraft with its crew), which is mainly required in light of disruptions in manning flights, arising from the actions of pilots that were taken during the year (see Note 14.l above), and the need to locate alternative solutions in connection with the same, and as a result of an increase in the Company's operations.

(2) Participation in security expenses - the participation rate by the State in the Company's security expenses amounted in 2016, 2015 and 2014 to 97.5%.

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 19 - Items for sections of the profit and loss statement (cont.)

c. Sale expenses:

	For the year ended December 31		
	2016	2015	2014
	USD thousands	USD thousands	USD thousands
Commissions to agents and credit card companies	102,864	107,668	112,963
Salary and benefits	44,881	44,796	47,856
Advertising and public relations	12,835	13,658	11,278
Other sale expenses	31,985	28,789	30,043
Total	192,565	194,911	202,140

d. Management and general expenses:

	For the year ended December 31		
	2016	2015	2014
	USD thousands	USD thousands	USD thousands
Salary and benefits	58,209	61,210	66,389
Professional services	7,174	6,320	6,654
Communication	2,352	1,419	2,420
Rentals and office maintenance	10,111	9,759	9,269
Insurance	1,740	1,622	1,995
Other	15,213	12,907	14,084
Total	94,799	93,237	100,811

e. Other expenses (income), net:

	For the year ended December 31		
	2016	2015	2014
	USD thousands	USD thousands	USD thousands
Expenses (income) in respect of employee retirement plans, net (See Note 14.k)	763	5,509	(177)
Capital gain on sale of fixed assets (see Note 9.f)	(1,680)	(2,043)	(5,457)
Cancellation of provision for legal action	-	-	(6,037)
Capital gain from the sale of holdings in Holiday Lines (see Note 8.b.)	(1,164)	-	-
Other	122	(184)	146
Total	(1,959)	3,282	(11,525)

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 19 - Items for sections of the profit and loss statement (cont.)

f. Financing expenses:

	For the year ended December 31		
	2016	**2015**	**2014**
	USD thousands	**USD thousands**	**USD thousands**
Interest on loans	16,248	15,617	15,061
Expenses for interest hedging transactions	-	216	864
Commissions for raising loans and other banking expenses	5,348	7,067	6,451
Exchange rate differentials in respect of non-dollar balances	2,614	3,920	5,095
Total	24,210	26,820	27,471

g. Financing income:

	For the year ended December 31		
	2016	**2015**	**2014**
	USD thousands	**USD thousands**	**USD thousands**
Interest for short-term bank deposits	1,077	236	111
Exchange rate differentials in respect of non-dollar balances and other	6	51	114
Total	1,083	287	225

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 20 - Sector reporting

a. General:

Operational segments are identified based on internal reports, which are reviewed on a regular basis by the chief operational decision maker for the purpose of allocating resources and assessing the performance of the operational sectors, as follows (the Company's chief operational decision maker does not receive reports regarding measurement of sectors assets and therefore this information is not included in the sector-based reporting):

Sector A – passenger aircraft activity including revenues (without deducting discounts) from the transport of passengers including baggage, transporting freight in the body of passenger aircraft, mail transport and the contribution from the sale of duty-free products.

Sector B – cargo aircraft activity includes revenues from airborne cargo shipping fees. In this area of activity, the Company offers cargo transportation services using a cargo plane (and occasionally through the use of leased aircraft and their crew – “wet leases”) from Israel to destinations abroad and from destinations abroad to Israel.

The Company’s other activities include activities from subsidiary Sun D’Or, providing maintenance service provided to outside elements as well as a broad variety of other services and revenues such as equipment leasing, frequent flyer membership fees, loading and unloading services and more.

b. Analysis of revenues and results according to operating segments:

Sector income represents the contribution produced by the sector, as follows: revenues created from operating segments less expenses involved in the operation of passenger aircraft and the cargo airplane, which include, *inter alia*, fuel expenses (including the impact of hedging, in general), depreciation expenses, fees, variable maintenance costs, air navigation and communication, passenger food and supplies, aircraft leasing fees, discounts given to passengers and commissions paid to travel agents, air crew expenses including salaries and variable security costs.

Non-attributed expenses include mainly salary expenses that are not attributed to the Company’s operational activities and other fixed expenses.

	For the year ended December 31, 2016				
	Passenger planes	**Cargo plane**	**Other**	**Adjustments**	**Total**
	USD thousands	**USD thousands**	**USD thousands**	**USD thousands**	**USD thousands**
Income:					
Revenue from external customers	1,847,135*	64,171	39,088	88,034	2,038,428
Intersegment revenues	-	-	69,171	(69,171)	-
Total segment revenues	1,847,135	64,171	108,259	18,863	2,038,428
Sector’s results	336,461	(6,378)	38,888	-	368,971
Unallocated expenses					(258,365)
Operating profit					110,606
Financing expenses					(24,210)
Financing income					1,083
The Company’s share of the profits of associated companies and revaluation of options for them					5,981
Profit before income tax					93,460

* Including revenues from cargo and mail in the body of the passenger planes in the amount of USD 81,964,000.

In 2016, the Company attributed depreciation expenses in the amount of USD 128,092,000 to the passenger aircraft segment. The cargo aircraft is leased and therefore the Company does not recognize depreciation expenses for it.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 20 - Sector reporting (cont.)

b. Analysis of revenues and results according to operating segments: (cont.)

	For the year ended December 31, 2015				
	Passenger planes	**Cargo plane**	**Other**	**Adjustments**	**Total**
	USD thousands	**USD thousands**	**USD thousands**	**USD thousands**	**USD thousands**
Income:					
Revenue from external customers (1)	1,874,234*/**	71,386	36,305**	72,116	2,054,041
Intersegment revenues	-	-	50,291	(50,291)	-
Total segment revenues	1,874,234	71,386	86,596	21,825	2,054,041
Sector's results	356,927	(1,832)	38,563	-	393,658
Unallocated expenses					(223,891)
Operating profit					169,767
Financing expenses					(26,820)
Financing income					287
The Company's share of the profits of associated companies and revaluation of options for them					1,357
Profit before income tax					144,591

(1) During 2015, the Company and the State reached an agreement that arranges payment for seats on the Company's flights. As a result of the said agreement, the Company recognized revenue in 2015 in the amount of USD 11.8 million in respect of previous years.

* Including revenues from cargo and mail in the body of the passenger planes in the amount of USD 94,097,000.

** Reclassified in respect of certain income in the amount of USD 8,963,000, which was previously classified in the "others" sector, as a result of a change in the manner of presentation of the data to the chief operating decision maker.

In 2015, the Company attributed depreciation expenses in the amount of USD 112,813,000 to the passenger aircraft segment. The cargo aircraft is leased and therefore the Company does not recognize depreciation expenses for it.

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 20 - Sector reporting (cont.)

b. Analysis of revenues and results according to operating segments: (cont.)

	For the year ended December 31, 2014				
	Passenger planes	**Cargo plane**	**Other**	**Adjustments**	**Total**
	USD thousands	**USD thousands**	**USD thousands**	**USD thousands**	**USD thousands**
Income:					
Revenue from external customers	1,924,079*/**	69,932	34,176**	53,116	2,081,303
Intersegment revenues	-	-	34,529	(34,529)	-
Total segment revenues	1,924,079	69,932	68,705	18,587	2,081,303
Sector's results	206,720	(742)	27,405	-	233,383
Unallocated expenses					(246,167)
Operating loss					(12,784)
Financing expenses					(27,471)
Financing income					225
The Company's share of the profits of associated companies and revaluation of options for them					1,743
Profit before income tax					(38,287)

* Including revenues from cargo and mail in the body of the passenger planes in the amount of USD 105,280,000.

** Reclassified in respect of certain income in the amount of USD 13,459,000, which was previously classified in the "others" sector, as a result of a change in the manner of presentation of the data to the chief operating decision maker.

In 2014, the Company attributed depreciation expenses in the amount of USD 98,795,000 to the passenger aircraft segment. The cargo aircraft is leased and therefore the Company does not recognize depreciation expenses for it.

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 20 - Sector reporting (cont.)

b. Analysis of revenues and results according to operating segments: (cont.)

Presentation by geographic targets:

	North America	Europe	Far East and Central Asia	Rest of the world	Total
	USD thousands	USD thousands	USD thousands	USD thousands	USD thousands
Year 2016:					
Income:					
Revenue attributed to regions	677,066	986,713	298,748	32,535	1,995,062
Revenue not attributed to regions					43,366
Total income in the consolidated report					2,038,428
Year 2015:					
Income:					
Revenue attributed to regions	693,542	942,390	337,368	31,474	2,004,774
Revenue not attributed to regions					49,267
Total income in the consolidated report					2,054,041
Year 2014:					
Income:					
Revenue attributed to regions	680,399	973,994	342,539	33,536	2,030,468
Revenue not attributed to regions					50,835
Total income in the consolidated report					2,081,303

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 21 - Subsidiaries

a. Detail of the companies held by the Company:

(1) Sun D'Or International Airlines Ltd. ("Sun D'Or"):

The Group's charter flights are executed by Sun D'Or (a company fully held by El Al). Sun D'Or operates as a tour operator for wholesalers and individuals and markets charter flights and regular flights, both by chartering an entire aircraft capacity to a third party or by capacity of parts of aircraft to a number of partners at pre-agreed prices, or direct sales.

Starting 2011, Sun D'Or has to serve as a tourism organizer, while preserving the "Sun D'Or" label for charter flights it markets and which are carried out by the Company (on weekdays) and by other airlines (on weekend and holiday flights).

(2) Tamam Aircraft Food Industries (BGA) Ltd. (hereinafter: "Tamam")

Tamam (a fully-owned El Al subsidiary) is primarily engaged in the production and supply of prepared kosher airline meals. The company has recently expanded its non-aviation activity and it supplies, *inter alia*, institutional catering services. Tamam is located in Israel and its factory and offices are located in Ben Gurion Airport. The Company is the principal customer of Tamam.

In January 2016, the IAA published a repeat tender to receive up to three permits to manufacture, transport, disassemble and load food and associated products into planes, after its former tender from May 2014 was cancelled. Pursuant to this tender, the concessionaires were required to build and operate a structure for providing food to aircraft for a period of 25 years (including the construction period) with the parameters the concessionaires were competing for being the permit fees the concessionaire will pay the IAA. Following this tender, the Company estimates that Tamam will be forced to move its plant from its current location over the course of 2020. In August 2016, Tamam won the tender. The investment in the construction of the aforesaid building, its maintenance and the annual authorization fees that Tamam will be required to pay the IAA are immaterial to the Company.
The construction of a new and advanced building for Tamam will allow Tamam to expand its activities substantially in the field of airplane and off-airplane food and to be a leading company in Israel in the food industry.

(3) Borenstein Caterers Inc. (USA) - ("Borenstein"):

Borenstein (a fully-owned subsidiary of the Company), incorporated in the United States and operating out of New York's JFK airport, deals mostly in the production and delivery of prepared meals for airlines and other institutions. The Company is Borenstein's primary customer.

(4) Superstar Holidays Limited (England) - ("Superstar"):

Superstar (a fully-owned subsidiary of the Company), is a tourism wholesaler marketing tour packages to travel agents and individual travelers, and selling airline tickets on Company routes at reduced prices. Superstar has operations in several other countries besides the UK.

(5) Katit Ltd. ("Katit"):

Katit (a fully-owned subsidiary of the Company) operates several restaurants for Company employees at Ben Gurion Airport, commissaries in the Company's office buildings and the King David Lounge at BGA.

(5) Cockpit Innovation Ltd. ("Cockpit"):

Cockpit (fully held by the Company) was established in 2016 by the Company and constitutes the operating arm of the Company as an incubator for investment projects related to the aviation field, both in terms of financial support and in terms of collaboration with the Company for the promotion of the ventures.

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 21 - Subsidiaries (cont.)

b. Translation of the financial statements of investees whose functional currency is different than the dollar:

In order to present the consolidated financial statements, the assets and liabilities of these companies are presented in USD according to the exchange rates in effect as of the end of the reported period, and income and expense items are translated according to the average exchange rates in the reported period. The translation differences are recognized in other comprehensive earnings under “exchange rate differences from the translation of foreign activity,” and will be recognized as profit or loss upon realization of the foreign activity for which the translation differences were created.

c. Material transactions and engagements with the subsidiaries:

As stated in Note 2a, the Company did not include separate financial information in its 2016 and 2015 financial statements in accordance with Regulation 9c. of the Securities Regulations (Periodic and Immediate Reports), 5730-1970, due to the negligibility of the added information.

The Company has engagements with its investee companies as follows:

		Scope of activity For the year ended December 31	
		2016	**2015**
Company	**Type of activity**	**USD thousands**	
Sun D'Or	Leasing planes and providing related services	69,171	50,291
Tamam	Purchase of food for the Company's flights from Ben Gurion Airport	27,067	24,493
Borenstein	Purchase of food for the Company's flights from New York	7,013	6,953
Superstar	Sale of airline tickets and land arrangements	7,361	7,669
Katit	Purchase of food for employees and food services at the King David Terminal in Terminal 3	4,408	3,700

Note 22 - Reclassification

In these Financial Statements, the Company has reclassified, in the statement of financial position as of December 31, 2015, a total of USD 2.7 million for amounts deposited in deposits as part of the lease agreements of its aircraft to the “short-term deposits” item from the “expenses in advance” item (within the current assets), due to the funds in these deposits being returned to the Company at the end of the lease period.

In addition, a total of USD 10.8 million was reclassified to the “long-term deposits” item from the “expenses in advance” item (within non-current asset). The Company also classified a total of USD 0.7 million to the same item from the “long-term investments” item.

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 23 - Transactions with interested parties and affiliates

a. General:

The Company's parent company is K'nafaim Holdings Ltd. (hereinafter "K'nafaim"), which is under the control of the Borovitz family.

b. The Company's controlling shareholder:

In June 2004, K'nafaim became an interested party in the Company. Starting January 2005, K'nafaim became the Company's controlling shareholder. As of December 31, 2016, K'nafaim holds 35.3% of the Company's shares.

The following is a general description of the transactions, their characteristics and their scope:

Within the operating income in 2016, income was included in the amount of USD 619 thousand from a company under K'nafaim's control. In 2015, income was included in the amount of USD 480 thousand. In 2014, income was included in the amount of USD 220 thousand.

Within the framework of operating expenses, transactions with K'nafaim and companies in which its controlling parties have a personal interest to the amount of USD 754,000 were included in 2016. Expenses totaling USD 711,000 were included in 2015 and USD 968,000 were included in 2014.

Within the framework of sales expenses, transactions via a third party with Company in which the controlling parties at K'nafaim have a personal interest, in the field of advertising, to the amount of USD 832,000 were included in 2016. Expenses totaling USD 386,000 were included in 2015 and USD 546,000 were included in 2014.

Within the framework of management and general expenses, expenses for directors' insurance in the amount of USD 146,000 were included in 2016. Expenses in the amount of USD 153,000 were included in 2015 and USD 161,000 were included in 2014.

Regarding the group insurance agreement, see section F below.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 23 - Transactions with interested parties and affiliates (cont.)

c. Transactions with additional affiliates and interested parties:

(1) Controlling shareholder transactions:

(a) From time to time the Company enters into aviation insurance agreements with insurance companies which include, among other things, "aircraft body all risks" insurance and "liability" insurance. On September 30, 2014 and on October 1, 2014 the Company's audit and remuneration committee and board of directors (respectively) ratified the extension of the Company’s engagement in an agreement with K’nafaim for an additional three year period, ending November 25, 2017, according to which additional air insurance coverage was added to K’nafaim within the framework of the Company’s insurance policies (hereinafter, respectively: “the Joint Transaction” and “the Air Insurance Agreement”), under terms similar to those in the original agreement signed between the parties in July 2006 and extended from time to time.

The audit and remuneration committee’s and board of director’s approval of the engagement in the Joint Transaction was given for a period of up to three years, with the Company reserving the right to cancel the agreement in the event of certain incidents set in the Air Insurance Agreement. In addition, each party shall reserve the right to terminate the agreement for any reason and at its sole discretion, after providing the other party with notice at least 60 days in advance. The audit and remuneration committee and the board of directors approved the extension of the Company’s engagement with K'nafaim in the Air Insurance Agreement, *inter alia*, for the following reasons: in light of K’nafaim’s undertakings whereby K’nafaim will compensate the Company for damage that may be caused as a result of the added insurance, the transaction involves no economic exposure to the Company; K’nafaim’s added insurance is immaterial in scope relative to the scope of Company’s insurance policies to which it will be attached; the added premium for the K'nafaim air insurance, paid be K'nafaim, was priced separately by the insurers and is consistent with the relative value of this added insurance compared to the total value of the insurance to which it is attached; nothing in the added K’nafaim insurance shall cause the Company to be liable for higher premiums, which are not covered in full by K’nafaim.

In light of the above reasons, the audit and remuneration committee and the Company's board of directors approved the engagement in the Joint Transaction and determined that there is no material difference between its terms regarding the Company and those regarding K'nafaim, taking into account their relative portions of the Joint Transaction. Therefore, and in accordance with Article 1(4) of the Companies Regulations (Relief in Transactions with Interested Parties), 5760-2000, the Company's engagement in the agreement does not require the approval of the general meeting with a special majority as per Section 275(a)(3) of the Companies Law, 5759-1999.

(b) The rights of the retiring chairman of the board of directors Prof. Israel (Izzy) Borovitz to Company flight tickets for himself and his family – Prof. Israel (Izzy) Borovitz is one of the controlling shareholders of K’nafaim, the Company’s controlling shareholder. The transaction was approved by the audit committee, the Company’s board of directors and by the general meeting from December 30, 2008.

(c) Approval of monetary remuneration for Company directors (including directors considered Company controlling shareholders) – on January 8, 2014 the general meeting, pursuant to its approval of the Company’s executive remuneration policy, approved the compensation (including the right to flight tickets at reduced prices) to which the members of the Company’s board of directors are entitled, including directors constituting Company controlling shareholders and excluding external directors and directors the terms of the remuneration of which was arranged specifically. On December 1, 2016, the general meeting, within the approval of the remuneration policy for the Company’s officers, approved the remuneration to which members of the Company’s board of directors will be entitled as stated, by three additional years (2017-2019).

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 23 - Transactions with interested parties and affiliates (cont.)

c. Transactions with additional affiliates and interested parties: (cont.)

(1) Controlling shareholder transactions: (cont.)

(d) Approval of the revision to the terms of service of Mr. Nimrod Borovitz upon his appointment as Head of Business Development, Long-Term Planning and Procurement at the Company - Mr. Nimrod Borovitz is the son of Mr. David Borovitz (a controlling shareholder of K'nafaim, the Company's controlling shareholder, and husband of Tamar Mozes Borovitz, the Deputy Chairman of the board of directors and a controlling shareholder of K'nafaim), and has been employed at the Company since March 2009 as the strategic partnerships project manager and responsible for business development and examining the Company's business collaborations. On September 10, 2014, Mr. Borovitz was appointed as Head of Business Development, Long-Term Planning and Procurement, and his monthly salary was updated to NIS 35,000 with accompanying terms based on eligibility as manager of his rank in the Company. On April 28, 2016, the general meeting approved payment of a one-time bonus in the amount of NIS 160,000 to Mr. Nimrod Borovitz. As of January 1, 2017, Mr. Nimrod Borovitz serves as Strategy, Procurement of Aircraft and Business Development Manager of the Company.

(e) The Company's audit and remuneration committee and board of directors approved, on March 4, 2014 and March 6, 2014, respectively, the appointment of CPA Dganit Palti (hereinafter: "Dganit") as CFO of the Company as of March 20, 2014 and approved her terms of employment. It is noted that Dganit is the wife of Mr. Nadav Palti, a director of K'nafaim, the controlling shareholder of the Company, and there are also business relations between a company owned by the Paltis and a company / companies owned by Mrs. Tamar Mozes Borovitz. Therefore, the engagement is an engagement in which a controlling shareholder of the Company has a personal interest.

(f) Approval of the terms of employment of Mrs. Dalit Mozes, wife of Ms. Arnon (Noni) Mozes, brother of Ms. Tamar Mozes Borovitz, serving as Deputy Chairman of the Company board of directors and a Company controlling shareholder, market research and projects manager at the Company's frequent flyer club. The terms of Mrs. Dalit Mozes' employment were approved by the audit and remuneration committee, the Company's board of directors and by the general meeting, which convened on May 20, 2015.

(g) Group directors and executives are insured via director and executive insurance in the framework of insurance coverage prepared by K'nafaim and in accordance with the agreement with K'nafaim. The insurance is within a collective insurance policy held by K'nafaim for its officers, in subsidiaries and affiliates, in accordance with the framework transaction that was approved by an annual and special general meeting of the Company's shareholders on November 12, 2014, and in accordance with the remuneration policy of the Company's officers that was approved by a meeting of the Company's shareholders on January 8, 2014 (hereinafter: the "Framework Transaction") for the joint purchase of an insurance policy for directors and officers of the Company and its subsidiaries (including with respect to controlling shareholders of the Company who serve as directors and officers), as serving in the Company from time to time, for a period of three additional years as of December 28, 2014 and until December 27, 2017. During the aforesaid period, the Company may, from time to time, subject to the approval of the audit and remuneration committee and board of directors of the Company and without being required to obtain additional approval of the general meeting, join K'nafaim in the acquisition of an insurance policy for subsidiaries and affiliates (hereinafter: the "Collective Insurance"), with respect to all of the directors and officers that serve in the Company and its subsidiaries at the time (including the controlling shareholders).

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 23 - Transactions with interested parties and affiliates (cont.)

c. Transactions with additional affiliates and interested parties: (cont.)

(1) Controlling shareholder transactions: (cont.)

(g) (Continued)

On September 18, 2016, the audit and remuneration committee approved, and later on September 20, 2016, the board of directors of the Company approved the continued engagement, vis-a-vis K'nafaim, with Menorah Mivtachim Insurance Ltd., for the renewal of the policy for the insurance of director and officer liability, including directors who are considered to be officers of the Company, for an additional period as of October 1, 2016 and until January 31, 2018, under the Framework Transaction. The limitation of liability within the insurance policy purchased was adjusted to the terms of the aforesaid Framework Transaction, and amounted to a total of USD 100 million. In addition to the aforesaid limitation of liability, policyholders are entitled to reasonable legal defense expenses beyond the limitation of liability set forth above, under the Insurance Contract Law, 5741-1981.

In accordance with the terms of the policy and the Framework Transaction, the Company's share of the insurance fees is the amount of USD 102 thousand per year (and relative to a period of 16 months, about USD 137 thousand), constituting 72% of the total insurance fees for the collective policy in light of the recommendations of the insurance consultants, considering various parameters examined thereby - equity, balance sheet and experience in claims (K'nafaim bears the additional 28% of the insurance payments), the deductible is between USD 10 and 75 thousand (based on the type and nature of the claim).

The audit and remuneration committee and board of directors of the Company has approved the engagement in accordance with the provisions of Article 1(3) and 1b(5) of the Companies Regulations (Relief in Interested Party Transactions), 5760-2000 (hereinafter: the "Relief Regulations") and determined that the engagement is consistent with the terms set forth in the Framework Transaction.

It is noted that the Company's position is that a policy purchased in the period and in accordance with the terms of the Framework Transaction and also approved under the relevant relief in the Relief Regulations with respect to approval of officer liability insurance, will also remain in force in the event that the term of the policy (January 31, 2018) is concluded after the end of the current Framework Transaction (December 27, 2017). In any event and without derogating from the above, the Company intends to act to extend the Framework Transaction for an additional three year period. Additionally, in the event that a new framework transaction is not approved, the Company may announce termination of the existing policy and purchase a new policy on its own before the end of the existing policy.

Summary of the reasons for the approval of the engagement by the audit and remuneration committee and board of directors of the Company:

a) Entering into the insurance policy benefits the Company as it allows its directors and executives to fulfill their duties properly, taking the risks involved in their duties and the legal responsibilities borne by the directors and executives into account; b) the very act of purchasing the insurance policy reduces the Company's indemnification obligation towards the directors and executives in accordance with the letters of indemnification granted the directors and executives by the Company; c) the terms of the engagement are as set in the Company's remuneration policy and also match the terms set in the framework agreement in the matter of engagement in director and officer insurance policies approved by the general meeting of the Company' shareholders on November 12, 2014. The cost of the policy premium, as described above, is lower than the policy cost ceiling as set in the terms of the framework agreement; d) engagements in executive liability insurance agreements are generally accepted engagements with Israeli public companies; e) the terms of the engagement are identical for all of the Company's executives, including executives who are also controlling shareholders, as they were in the past and as they will be from time to time; f) furthermore, engagement in the insurance policy is carried out under improved terms compared to the policy ending in light of the discount the Company earned, and in any event are in accordance with market conditions and will have no material impact on the Company's profitability, property or liabilities.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 23 - Transactions with interested parties and affiliates (cont.)

c. Transactions with additional affiliates and interested parties: (cont.)

(1) Controlling shareholder transactions: (cont.)

(h) On November 12, 2014, a special yearly general meeting of Company shareholders approved the re-issue of letters of indemnification to Company directors included among the Company’s controlling shareholders, Ms. Tamar Mozes Borovitz, Sofia Kimerling and Yehuda (Yudi) Levy for a period of three years starting December 29, 2014. It is noted that as of the date of the Report, Mr. Yehuda (Yudi) Levy is not considered to be part of the Company’s controlling shareholders.

(2) Negligible transactions or non-exceptional transactions with a controlling shareholder:

The Company’s board of directors approved the Company’s engagements with the Yediot Acharonot Group, as detailed below: (1) an engagement for the purchase of advertising spaces in the various media owned by the Yediot Acharonot Group; (2) an engagement to purchase newspapers and magazines in Israel belonging to the Yediot Acharonot Group intended for distribution to passengers on Company flights. (3) Engagement for the purchase of subscriptions to newspapers from the Yediot Group for managers of the Company. The engagements with the Yediot Acharonot Group were classified as transactions in which the Company controlling shareholder has a personal interest, as the Yediot Acharonot Group is owned by the brother of Ms. Tamar Mozes Borovitz, who serves as Deputy Chairman of the Company’s board of directors and is a controlling shareholder of K’nafaim, the Company’s controlling shareholder.

The Company’s board of directors examined the engagements in question and came to the conclusion that the engagements benefit the Company. The audit and remuneration committee has determined that the aforesaid engagements do not constitute extraordinary transactions.

It is noted that in addition to the aforesaid engagements, the Company has additional engagements with the Yediot Acharonot Group, as detailed blow: an engagement for the transportation of cargo (newspapers) from Ben Gurion Airport to JFK Airport in New York and providing flight ticket benefits to Yediot Acharonot according to a business customer agreement. The aforesaid engagements were approved by the board of directors as “negligible transactions,” after their classification by the audit and remuneration committee as non-extraordinary transactions.

On March 18, 2014 the Company’s board of directors established the rules and guidelines for the classification of a transaction made by the Company or one of its subsidiaries with an interested party as a negligible transaction as set in Article 41(a)(6) of the Securities Regulations (Annual Financial Statements), 2010 (“the Financial Statements Regulations”). These rules and guidelines serve the Company in determining the extant of disclosure in the periodic report and in the prospectus (including in shelf proposal reports) as regards transactions by the Company, a corporation under its control or an investee, with a controlling shareholder or in which the controlling shareholder has a personal interest in its approval as defined in Article 22 of the Securities Regulations (Periodic and Immediate Reports), 5730-1970 (“Periodic and Immediate Report Regulations”) and Article 54 of the Securities Regulations (Prospectus Details and Prospectus Draft – Structure and Form), 5729-1969 (“Prospectus Details Regulations”) (the types of transactions set in the Financial Statements Regulations, the Periodic Report Regulations and the Prospectus Details Regulations denoted above, shall be called “Transactions with Interested Parties”).

Accordingly, the Company's board of directors has determined that in the absence of special qualitative considerations deriving from the circumstances of the matter, a Controlling Shareholder Transaction carried out over the normal course of the Company’s business, under market conditions and that has no material impact on the Company, shall be considered a "negligible transaction" if all of the following conditions are met:

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 23 - Transactions with interested parties and affiliates (cont.)

b. Transactions with additional affiliates and interested parties: (cont.)

(2) Negligible transactions or non-exceptional transactions with a controlling shareholder: (cont.)

a. The scope of the annual engagement (on a calendar year basis) denoted therein does not exceed NIS 1 million. In the event the Company does not have full rights in the transaction covered by a specific engagement, the engagement shall be determined based on the Company's relative portion of the transaction.

b. The Company is not required to issue an immediate report on the transaction in accordance with the Periodic and Immediate Reports Regulations or any other law.

c. The transaction does not deal with terms of service and employment (as defined in the Companies Law, 5759-1999, hereinafter: “the Companies Law”) of an interested party or their relative.

As a rule, any interested party transaction shall be examined separately in order to examine its classification as a “negligent transaction” on the basis of the relevant criteria in the Company’s latest consolidated and annual audited financial statements. Relevant criteria for examining a transactions are, for instance: (1) total sales the subject of the Interested Party Transaction; (2) the total cost of the sales the subject of the Interested Party Transaction; (3) the extent of assets the subject of the Interested Party Transaction; (4) the extent of liabilities the subject of the Interested Party Transaction; or – (5) the extent of the expense or yield the subject of the Interested Party Transaction.

In cases in which, at the Company’s discretion, all of the aforementioned criteria are irrelevant for the determination of the negligibility of the Interested Party Transaction, the transaction shall be considered negligible, in accordance with a different relevant criterion, determined by the Company, so long as the relevant criterion used for this transaction shall not exceed NIS 1 million per calendar year.
Despite the above, separate transactions constituting part of the same engagement or ongoing transactions or very similar transactions carried out frequently and repeatedly, shall be examined as a single transaction on an annual calendar basis for the purpose of examining their classification as a negligible transaction and such cases, the cumulative scope of the engagement during a calendar year shall not exceed NIS 1 million.

Over its regular course of business, the Company carried out, during the reported year or as of the date the report was filed or which are still in effect as of the report date, transactions with controlling shareholders defined as “negligible transactions” of the following types and with the following characteristics:
Receipt of billboard advertising services; providing ground services; cooperation in hosting members of the El Al club in the Dan Lounge; granting discounts for flight tickets according to a business customer agreement; the purchase of screens and their installation in the Company’s offices and providing ongoing content, production and maintenance service for the Company; catering services for passengers whose flights have been delayed; undercover inspections on Company flights and during security screening for Company flights; controls for the Company’s website; transportation services for passenger boarding and disembarkation, providing and receiving maintenance services, advertising cooperation within which benefits are given to Matmid club members, advertising flights and packages of the Company on search engines, business collaboration in which operations are performed in some of the Company’s aircraft by television stars produced by an affiliate of the controlling shareholder, in consideration for providing exposure and promoting the show, and providing various food-related services via subsidiary Tamam.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 23 - Transactions with interested parties and affiliates (cont.)

c. Transactions with additional affiliates and interested parties: (cont.)

(3) Transactions with interested parties:

a. Transactions between the Company and member of the Company's board of directors, Mr. Pinchas Ginsburg (hereinafter: "Ginsburg") or a party on his behalf (including corporations under his control):

Pinchas Ginsburg (serving on the Company's board of directors) and I. Hillel & Co. Ltd. ("I. Hillel"), fully held by him, received the approval of the holder of the Special State Share on September 3, 2006 according to which the holder agrees that individual members of Pinchas Ginsburg's family and I. Hillel may hold the Company's shares together at a rate lower than 15% of the Company's issued stock value.

It is noted that Pinchas Ginsburg has a personal interest, direct or indirect, in various transactions carried out by the Company and/or related companies, as detailed below: (a) I. Hillel conducts, from time to time, transactions with the Company and with Sun D'Or for the purchase of flight tickets for Company flights and flights marketed by D'Or as well as leasing charter flights marketed by Sun D'Or. Furthermore, the Company purchased ground services from I. Hillel for workers taking part in trips to Poland initiated by the Company in 2016; (b) the Company and Sun D'Or enter, from time to time, into transactions with Airtour Israel Ltd. ("Airtour"), half of the shares of which are held by the Company and the other half are held, to the best of the Company's knowledge, by travel agents, including I. Ginsburg, who also serves as a director at Airtour. These transactions are essentially for the purchase of flight tickets, providing outsourcing services by Airtour in ticketing areas, making reservations and providing ground services; (c) Mr. Ginsburg acts as the general sales agent for Thai Airways ("Thai") in Israel. Mr. Ginsburg's remuneration is based on commissions resulting from the sale of Thai's plane tickets in Israel. Agreements are in place between the Company and Thai regarding the transport of passengers and cargo, including code sharing and interline agreements. In addition, the Company purchases, from time to time, flight tickets from Thai for workers for business travel to destinations the Company does not reach. Furthermore, by virtue of Mr. Ginsburg being the general sales agent for Thai in Israel, Mr. Ginsburg was given free flight tickets from the Company in 2016 free of charge, in accordance with a Company procedure.

In light of Mr. Ginsburg's personal interest in all of the transactions in question, the Company's board of directors approved, as non-extraordinary transactions, the transaction procedure between the Company and Airtour and between Sun D'Or and Airtour as well as framework agreements between I. Hillel and/or Mr. Ginsburg and the Company and Sun D'Or (all of the transactions in question shall hereby be referred to as "the Engagements"). The basic principles of the transaction procedures and framework agreements are, *inter alia*, that all of the engagements be carried out at market prices and under market conditions (a supervising party has been appointed); engagements not under market conditions shall require the advance approval of the audit and remuneration committee and Company board of directors; at the end of each calendar half, a written report regarding the engagements carried out in the previous half and their conditions is submitted and inasmuch as the audit and remuneration committee determines that a deviation had occurred from market prices and conditions in any of the engagements, is passed on to the Company's board of directors for its decision on the steps required for their approval. As of the date of the report, no extraordinary transactions were identified.

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 23 - Transactions with interested parties and affiliates (cont.)

c. Transactions with additional affiliates and interested parties: (cont.)

(3) Transactions with interested parties:

b. Extraordinary transactions with interested parties:

(1) In March 2016, the audit and remuneration committee and board of directors of the Company approved the extension of the Company's engagement with Mor Medical Information Institute Ltd. ("Mor Institute") for 2016-2017 in an agreement for qualification tests for the Company's pilots. The engagement with Mor Institute was classified as an engagement in which an interested party in the Company has a personal interest since Mr. Eli Defes, who serves as a director of the Company, is chairman of the board of directors of the Mor Institute.

For the sake of caution and since no suitable alternatives are located (although the engagements are long-standing that began before Mr. Defes was appointed as director of the Company's board of directors), the audit and remuneration committee determined that the engagement is an extraordinary transaction. The audit and remuneration committee and board of directors of the Company have examined the aforesaid engagement and concluded that the engagement is for the benefit of the Company.

(2) In May 2016, the audit and remuneration committee and board of directors of the Company approved the exercise of the Company's option for the extension of the engagement with Maman - Cargo Handling and Terminals Ltd. ("Maman") in a framework agreement (the "Framework Agreement") signed on February 3, 2010 for an additional period that began retroactively as of April 1, 2015 and until December 31, 2019, under improved commercial terms (the "Extension Period"). The Framework Agreement set forth the engagement terms regarding the terminal services provided to the Company by Maman that include, *inter alia*, cargo handling, transport of cargo and storage. In accordance with the letter of extension to the Framework Agreement and approval of the general meeting of shareholders of Maman in August 2016, the exercise period of the options allocated by Maman to the Company, that are exercisable to ordinary shares of Maman at a rate of 10% of the issued share capital of Maman on a fully diluted basis, was extended until December 31, 2018. The impact of the update of the terms of the option on the Company's financial statements is immaterial. The engagement with Maman was classified as a transaction in which an interested party of the Company has a personal interest, since on the date of the transaction's approval, Mr. Amikam Cohen, chairman of the Company's board of directors, and Mr. Yehuda (Yudi) Levy, Deputy Chairman of the Company's board of directors, served as directors of Maman. It is noted that in January 2017, Mr. Amikam Cohen completed his tenure as a director of Maman.

c. Other interested party transactions:

It is noted that in addition to the Company's engagements described in this Note above, the Company has additional engagements in which the Company interested parties have a personal interest and which are non-extraordinary. The scopes of these engagements are included in the financial data below.

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 23 - Transactions with interested parties and affiliates (cont.)

c. Transactions with additional affiliates and interested parties: (cont.)

(3) Transactions with interested parties:

d. Services agreement with chairman of the Company's board of directors:

On January 8, 2014, the general meeting approved the revision to the service agreement between the Company and the Chairman of the board of directors, starting January 1, 2014. According to this revision, the services provided by the Chairman of the board of directors shall be at no less than 40% employment. In return for the services, the Chairman of the board of directors shall be entitled to a management fees of NIS 53,000 plus VAT as required by law linked to the CPI. In addition, the Chairman of the board of directors shall be entitled to a yearly bonus, in accordance with the yearly bonus mechanism set in the Company's executive remuneration policy, at a rate that will not exceed 90% of the level of the bonus the CEO is entitled to according to the job percentage (according to the policy the CEO is entitled to a bonus of 2% of the Company's yearly pre-tax profit and no more than NIS 3 million). The other provisions that are not explicitly changed in the update continue to apply in accordance with the services agreement.

e. Engagement with the Company's CEO:

On January 29, 2014 the Company's board of directors approved the appointment of Mr. David Maimon as Company CEO, and he began serving in his position on March 20, 2014. Mr. Maimon has served in various positions at the Company since 2005 and his most recent position was as VP of Commerce and Aviation Relations.
On April 8, 2014 the general meeting of the Company's shareholders approved the terms of service and employment of Mr. David Maimon and the Company CEO. The employment agreement between the CEO and the Company is for an unlimited period of time in which he will serve as Company CEO as full-time employment. Each party (the CEO or the Company) may terminate the agreement with six months' advance notice.

The CEO was entitled to a gross monthly salary in the amount of NIS 97,500 (the "Total Salary"). The comprehensive salary is linked to the Consumer Price Index or any other index that replaces it and shall be updated on a yearly basis, in January, according to the increase in CPI in the past year, less price of living increases paid since the last update date of the comprehensive salary. For the avoidance of doubt, if the index decreases, the total salary is not reduced. The CEO shall be entitled to a yearly bonus equal to 2% of the Company's yearly earnings (before tax) and no more than NIS 3 million, in accordance with the terms, restrictions and instructions as per the Company's executive remuneration policy, as it may be from time to time, including provisions regarding the threshold conditions for the receipt of a bonus, deferred long-term remuneration as well as in the matter of the right to reduce the sum of the bonus by the Company board of directors. Regarding the rate of the deferred bonus, it is noted that in the past, the rate of the deferred bonus for the CEO was 45% and not 30%.

The CEO is entitled to social terms such as provisions for managers' insurance or a pension fund, loss of employment ability and a continuing education fund, as customary regarding senior officers of the Company. The CEO is also entitled to a reimbursement of per diem expenses in Israel and abroad based on the Company's policy and in accordance with the rates and amounts applicable in the Company from time to time. The Company provides the CEO with a mobile phone and the CEO is also entitled to a reimbursement of expenses for maintenance of the phone at his home. The Company makes a licensing group 6 vehicle available to the CEO. The expenses involved in the maintenance of the vehicle and use thereof are borne by the Company and paid for thereby. The Company will collect the tax value applicable for use of the vehicle. The CEO is entitled to plane tickets for himself and his relatives as currently accepted by the Company regarding the person in the position of CEO, based on the existing procedures of the Company, as updated from time to time.

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 23 - Transactions with interested parties and affiliates (cont.)

c. Transactions with additional affiliates and interested parties: (cont.)

(3) Transactions with interested parties:

e. Engagement with the Company's CEO: (cont.)

Upon the termination of the CEO's employment in the Company, following the termination of his employment agreement for any reason (but excluding termination under special circumstances) and his total resignation from the Company, the CEO will be entitled to plane tickets and also to the pension arrangement, severance pay at a rate of one month per year for the term of his employment in the Company based on his last salary as CFO as of the signing date of the employment agreement as CEO of the Company for years of service as CFO, and the last salary as CEO for years of service as CEO.
On April 28, 2016, the special general meeting of the shareholders updated the terms of employment of the Company's CEO, as follows: an increase of the monthly gross salary of the CEO to a total of NIS 130,000, retroactively as of January 1, 2016, and an amendment of the deferred remuneration rate long term with respect to the CEO such that it is reduced from 45% and amounts to 30%, similar to the other senior officers of the Company.

f. Remuneration of key managerial personnel:

	For the year ended December 31		
	2016	2015	2014
	USD thousands	USD thousands	USD thousands
Short-term benefits	4,261	5,480*	4,913
Post-employment benefits	67	277	806
Total	4,328	5,757	5,719

Restated *

El Al Israel Airlines Ltd.

Notes to the Consolidated Financial Statements

Note 23 - Transactions with interested parties and affiliates (cont.)

g. Benefits given to interested parties:

	For the year ended December 31		
	2016	2015	2014
	USD thousands	USD thousands	USD thousands
Services of the chairman and management fees (including a benefit for options) for interested parties employed by the Company	391	441	178
The number of people to whom the benefit relates	1	1	1
Compensation of directors who are not employed by the Company	383	304	423
The number of people to whom the benefit relates	9	9	10

h. Balances with interested parties and affiliates:

	As of December 31	
	2016	2015
	USD thousands	USD thousands
Other interested parties / affiliates:		
Within current assets:		
Customers:		
Related party - affiliated company	2,290	4,420
Related party and interested parties	49	26
	2,339	4,446
Highest total debit balances in the accounting year	7,877	7,577

	As of December 31	
	2016	2015
	USD thousands	USD thousands
Within current liabilities:		
Interested party	507	655
Current liabilities for employee benefits:		
Interested party	840	919*
Within non-current liabilities:		
Interested party	231	150

* Retroactively adjusted.

	As of December 31	
	2016	2015
	USD thousands	USD thousands
Affiliated companies:		
Within the non-current financial assets:		
Investment in shares and options	22,371	17,821

El Al Israel Airlines Ltd.
Notes to the Consolidated Financial Statements

Note 23 - Transactions with interested parties and affiliates (cont.)

i. Transactions with interested parties and affiliates:

	For the year ended December 31		
	2016	2015	2014
	USD thousands	USD thousands	USD thousands
Interested parties / affiliates:			
Income from interested parties / affiliates:			
Airline tickets (1)	41,144	44,895	51,738
Transportation of cargo (1)	10,522	16,142	18,603
Other income	927	830	871
Operating expenses:	1,580	2,674*	2,155*
Sale expenses:			
Mainly commissions and marketing fees to interested parties	4,346	4,068	4,822
Advertising services from interested parties (through third parties)	832	386	546
Management and general expenses:	2,499	2,680**	1,990**

(1) It should be clarified that the amount presented in the table also includes, for the sake of caution, the volume of total turnover in respect of the transactions from which commissions are derived at various rates paid to the related parties or to the Company, as the case may be.

* Reclassified

** Retroactively adjusted.

Additional Details about the Company

Company Name: El Al Israel Airlines Ltd.

Company No. at Registrar: Public Company 520017146

Address: Ben Gurion Airport 7015001

Balance Sheet Date: December 31, 2016

Reporting Date: March 21, 2017

Reporting Period: 2016

Article 10a: Summary of Consolidated Quarterly Income Statements of the Company

The following is a summary of the quarterly income statements for 2016 in thousands of dollars:

	Q4 10-12/2016	Q3 7-9/2016	Q2 4-6/2016	Q1 1-3/2016
Operating Revenue	460,774	643,690	537,479	396,485
Operating expenses	(396,270)	(470,396)	(413,653)	(362,098)
Gross profit	64,504	173,294	123,826	34,387
Sale expenses	(46,300)	(53,523)	(50,898)	(41,844)
Management and general expenses	(26,884)	(22,990)	(22,828)	(22,097)
Other net revenue (expenses)	1,123	(517)	1,036	317
Profit (loss) from ordinary activities	(7,557)	96,264	51,136	(29,237)
Financing expenses	(6,409)	(6,586)	(6,066)	(5,149)
Financing Revenue	323	202	1,592	476
The Company's share of the profits of included companies	967	2,817	314	373
Profit (loss) before income tax	(12,676)	92,697	46,976	(33,537)
Tax benefit (income tax)	10,246	(23,180)	(11,965)	12,133
Profit (loss) for period	**(2,430)**	**69,517**	**35,011**	**(21,404)**
Profit (loss) for re-measurement of defined benefit, net of tax	(4,158)	(729)	(2,601)	(2,115)
Exchange rate differences on translating foreign operations	(385)	424	(237)	606
Gain (loss) on hedging cash flows, net of tax	8,564	2,590	12,637	16,627
Loss on hedging cash flows - time value, net of tax	205	1,428	6,837	(870)
Total comprehensive income (loss) for the period	1,796	73,230	51,647	(7,156)

Article 10c: Using the proceeds of securities

Since May, 2003 (the date of the Company's issuance prospectus), the Company has not raised money under a prospectus. For details concerning surplus in consideration for the exercise of options that were not deposited in the compensation account, see Note 14c.(2) of the financial statements as of December 31, 2016.

Article 11: List of investments in subsidiary and affiliated companies

Below is a list of the Company's investments, on the date of the statement of the financial situation, in each of its active subsidiaries and affiliated companies (in thousands of dollars):

Company name	Class of shares / convertible securities	Number of shares / convertible securities held	Total par value of issued shares	Par value of shares held	Share in %		Their value in the Company's Separate Financial Statements, as defined in Article 9c	Share of the balance sheet equity as of Dec 31, 2016	Loans to Investee Companies as of Dec 31, 2016
					In capital	In voting	USD thousands	USD thousands	USD thousands
Sun d'Or International Airlines Ltd. ("Sun d'Or")	Ordinary shares par value NIS 0.001 each	5,000	NIS 5	NIS 5	100	100	3	3	
Katit Ltd. ("Katit")	Ordinary shares par value NIS 0.0001	1,000	NIS 0.1	NIS 0.1	100	100	-	-	-
	Deferred shares par value NIS 0.0001	5,000	NIS 0.5	NIS 0.5	-	-	-	-	-
Superstar Holidays Limited ("Superstar")	Ordinary shares par value GBP 1	50,000	GBP 50,000	GBP 50,000	100	100	(343)	1,037	694
	Ordinary A	-	NIS 25.2						
Tour Air Israel Ltd. ("Airtour")	Ordinary B[1]	50	NIS 10	NIS 5		50	13	13	-
	Ordinary C	-	NIS 64.8						
Tamam Aircraft Food Industries (Ben Gurion Airport) Ltd. ("Tamam")	Ordinary shares par value NIS 1	1,068	NIS 1,068	NIS 1,068	100	100	1,005	1,005	-
Borenstein Caterers Inc. ("Borenstein")	Ordinary shares at no par value	80,000	USD 80,000	USD 80,000	100	100	6,056	6,056	-
Cockpit Innovation Ltd. ("Cockpit")	Ordinary shares par value NIS 0.01	10,000	NIS 100	NIS 100	100	100	-	-	-
	Founders' shares par value NIS 0.01	-	NIS 1.1	-					
Air Consolidators Israel Ltd. ("ACI")[2]	Ordinary shares par value NIS 0.1	-	NIS 11	-	50	50	4	4	-
	Ordinary B shares par value NIS 0.1	55	NIS 11	NIS 5.5					

1 The shares held by the Company grant it the right to participate and vote in the general meetings of Airtour at a rate of 50%, and to appoint half of the members of its board of directors, without having a right to receive revenues.

2 The shares held by the Company grant it the right to participate and vote in the general meetings of ACI and to appoint half of the members of its board of directors, without having a right to receive revenues.

	Ordinary C shares par value NIS 1	-	NIS 10	-					
Maman - Cargo Terminals and Handling Ltd.[3] ("Maman")	Ordinary shares par value NIS 1	6,176,472	NIS 41,176,472	NIS 6,176,472	15	15	22,354	22,354	-
Visitors and Legacy Center of EL AL Ltd.(CC) . (the "Visitors' Center Company")[4]	Ordinary shares par value NIS 1	1	NIS 7	NIS 1	0	14.2	-	-	-

Article 12: Changes in investments in subsidiaries and affiliated companies in the Reporting Year

- ✓ In March, 2016, "Cockpit Innovation Ltd." ("**Cockpit**"), a wholly-owned subsidiary of the Company, was founded, which is active in the development of entrepreneurship and coordinates the "Cockpit" operation - an innovative program of the Company to accelerate and support start-ups in the fields of aviation and tourism, in Israel and around the world. For additional information about the activities of "Cockpit," see Section 9.15 (Business Strategy and Objectives), Chapter A (Description of Company Operations) of the periodic report.
- ✓ In March, 2016, a public benefit company - the Visitors and Heritage Center of El Al Ltd. was founded, as detailed in the table above. As of the reporting date, the Visitors Center Company is inactive.
- ✓ In October, 2016, the Company sold all of its holdings (20%) in Holiday Lines Ltd. For further details, see Note 8b. of the financial statements.

Article 13: Comprehensive income (loss) of subsidiaries and affiliates and the revenues from them as of the date of the statement of financial position

Company name	Profit (loss) for the year	Other comprehensive income (loss) for the year	Total comprehensive income	Dividend received	Dividend received after the date of the statement of financial position	Interest received	Management fees received	Managed fees received after the date of the statement of financial position
	USD thousands	USD thousands	USD thousands	USD thousands		USD thousands	USD thousands	
Sun d'Or	-	-	-	-	-	-	-	-
Superstar	(81)	-	(81)	-	-	-	-	-
Borenstein	700	179	879	40	-	-	229	-
Tamam	121	126	247	-	-	-	-	-
Katit	-	-	-	-	-	-	-	-
Cockpit	-	-	-	-	-	-	-	-
Airtour	283	-	283	-	-	-	-	-
Air Consolidators Israel	3	-	3	-	-	-	-	-
Maman	14,463	(326)	14,137	682	-	-	-	-
Visitors Center[5]	-	-	-	-	-	-	-	-

The translation of local currency data was performed using average exchange rates for the year 2016.

[3] Starting January 1, 2012, the Company holds 15% of the share capital of Maman, in addition to options.

[4] In March, 2016, a public benefit company - the Visitors and Legacy Center of EL AL Ltd.(CC) (the "Visitors Center") was founded, which is held by the Company and the Company's employees and retirees, and which was incorporated and registered as a public benefit company. As of the reporting date, operations within the framework of the Visitors Center had yet to commence. The shares held by the Company grant it the right to participate and vote in the general meetings of the Visitors Center and to appoint a director on its behalf.

[5] See FN 4, above.

Article 20: Trading on the Stock Exchange

During the reporting period and until the publication date, securities issued by the Company were not listed for trade, and no interruptions of trade occurred.

Article 21: Remuneration for senior executives and interested parties, as recognized in the financial statements for the Reporting Year

Below are details of the remuneration of the earners of the five highest compensations among senior executives in the Company or a subsidiary, whether granted by the Company or by another, as recognized in the financial statements for 2016:

Details of the recipient of the compensation				Compensation for services (in terms of cost to the Company in NIS)							Total (NIS)
Name	Position	Scope of position	Rate of holdings in capital of the company	Salary*	Bonus**	Share-based payment	Management fees	Consulting fees	Commission	Other	
David Maimon	CEO		-	2,334,071							2,334,071
Tal Becker	Deputy CEO		-	1,467,566							1,467,566
Yaakov Li-Or	CEO of Borenstein		-	1,312,043	75,979						1,388,022
Shalom Zahavi	Deputy CEO			1,228,635							1,228,635
Dganit Palti	Deputy CEO		-	1,214,219							1,214,219

* Compensation for "Salary" in the table above is in terms of cost to the Company, and includes benefits associated with salary, such as car allowance, social benefits, actuarial allocations for employee severance benefits and all income that was imputed to the salary due to the component granted to the employee. It does not include reimbursement for food and lodging expenses for work trips abroad.

The salaries of executives are linked to the CPI and updated annually. The Company provides executives with a vehicle, and bears all expenses associated with the use and upkeep of the vehicle (including overheads). Furthermore, executives are entitled to receive phones, mobile phones, annual vacations, sick and recuperation pay, clothing allowances, managerial insurance/pension and training funds, as is common practice.

In 2016, the remuneration policy for the Company's senior executives that was approved by the meeting of the Company's shareholders on January 8, 2014 was in effect (reference no. 2014-01-008755) (the "**Remuneration Policy**"); on December 1, 2016, the meeting of the Company's shareholders approved a new Remuneration Policy for the years 2017-2019 (reference no. 2016-01-068523).

The Company's Board of Directors deliberated and determined that the terms of service for Company executives, as detailed in Article 21, were consistent with the Remuneration Policy.

** Until the approval date of the financial statements, the Board did not discuss the approval of the distribution of bonuses to the senior executives.

According to accounting standards, the Company did not allocate for disbursing bonuses to executives in its books, other than for bonuses for the Company's CEO and the Chairman of the Company's Board of Directors, who will be entitled to bonuses if and to the extent that the Company's authorized organs do not exercise their authorities to reduce the sum of the bonuses, in accordance with the Remuneration Policy.

The Remuneration Policy establishes that the sum to be paid to executives for 2016 shall stand at only 70% of the maximum amount, with a part of the bonus - 30% - comprising a deferred bonus, to be paid to the executives if, upon the conclusion of a period of three years (2016-2018 - the "Determining Period"), the Company achieves aggregate consolidated EBT (after allocation for the bonuses) that exceeds or is equal to USD 60 million. According to accounting standards, allocations were made in the books for the CEO and the Chairman, as stated, for: (a) 70% of the maximum amount to which the CEO and Chairman of the Board of Directors are entitled (as detailed below), to the extent that the Company's authorized organs do not make use of their authorities to reduce the amount of the bonuses, in accordance with the Remuneration Policy; in addition, (b) an amount equal to 10% of the deferred bonus (comprising a third of the deferred bonus), upon the conclusion of the first year of the Determining Period, given the fiscal results for 2016.

(1) <u>David Maimon</u>

Mr. Maimon has served as President and Chief Executive Officer of the Company since March 20, 2014.

On April 28, 2016, the meeting of the Company's shareholders approved an update to Company CEO's terms of employment, as follows: (a) raising the Company CEO's (gross) salary to a total of NIS 130,000 (one hundred and thirty thousand), retroactively as of January 1, 2016; and (b) reducing the rate of the Deferred Bonus (as defined in the Company's Remuneration Policy) in respect of the Company CEO from 45% (forty-five percent) to 30% (thirty percent), similar to those of the Company's other senior executives.

Upon the cessation of the CEO's work at the Company, following the conclusion of his employment agreement for any reason (with the exception of dismissal under special circumstances), and his complete departure from the Company, the CEO shall be entitled, beyond the pension arrangement, to severance pay at a rate of one month per year of his employment at the Company, in accordance with: his final salary as the Company's Deputy CEO, as of the signing date of his employment agreement as the Company's CEO, for the years he served as Deputy CEO; and his final salary as CEO, for the years he served as CEO. Beyond what is set out in this section, above, the CEO shall be entitled to no severance bonus. Furthermore, he shall be entitled, upon his departure, to rights in flight tickets.

The CEO's employment agreement stipulates that the annual bonus will be 2% of the Company's annual profit (before tax), and not more than a sum of NIS 3 million (the "Maximum Bonus"), subject to the Remuneration Policy.

For additional details concerning the terms of Mr. David Maimon's employment as the Company President and Chief Executive Officer, see Note 23 to the financial statements of December 31, 2016.

(2) <u>Tal Becker</u>

Captain Tal Becker served as Company`s VP Operations from June 1, 2015, and completed his service in December, 2016. Mr. Becker was employed by the Company starting in October, 1994, as part of the collective agreement for air crew members. It should be noted that during Mr. Becker's tenure as VP Operations, Mr. Becker continued to serve in the Company's air crew as a captain in the 747 fleet, in accordance with the minimal requirements, in order to maintain his qualifications. Upon completion of his tenure, Mr. Becker returned to his role as a captain in the Company.

(3) <u>Jacob Li-Or</u>

Mr. Jacob Li-Or served as CEO of the US subsidiary, Borenstein Caterers, starting in September, 2002. Mr. Li-Or left office in December, 2016 when he retired. The salary shown in the table above is the value in shekels, according to the determined average exchange rate, and does not include rent expenses borne by the Company, nor the value of flight tickets.

(4) **Shalom Zahavi**

Mr. Shalom Zahavi served as VP of Commerce and Industry Affairs in the Company from July 28, 2014 until December, 2016, when he retired.

Mr. Zahavi was employed by the Company from March, 2009, and, until his appointment as VP of Commerce and Industry Affairs, served as head of the cargo section and as the VP of Cargo at the Company.

(5) Dganit Palti

Ms. Dganit Palti serves as Company`s VP Finance as of March 20, 2014. Ms. Palti's employment agreement stipulates that it can be terminated by either party by prior written notice of three months, in the event of resignation or dismissal.

Below are details of the compensation provided by the Company to all interested parties in the Company, which was paid to same by the Company or by a subsidiary, and is not listed in one of the above tables:

Details of the recipient of the compensation				Compensation for services (in terms of cost to the Company in NIS)							Total
Name	Position	Scope of position	Rate of holdings in capital of the company	Salary	Bonus	Share-based payment	Management fees	Consulting fees	Commission	Other	
Amikam Cohen	Chairman of the Board of Directors	Part-time*	-				636,000			26,428	662,428

* On January 8, 2014, the general meeting of shareholders of the Company approved that the scope of the office of the Chairman of the Board of Directors is a 40% capacity position.

Mr. Amikam Cohen was appointed as a director in the Company in December, 2008, and, since February, 2009, serves as Chairman of the Board of Directors in the Company.

The management services provided by Mr. Cohen are on the scope of a position that shall not be less than 40%. Mr. Cohen is entitled to benefits in obtaining flight tickets from the Company. The engagement with Mr. Cohen in the service agreement is until the day he ceases to serve as Chairman of the Board of Directors of the Company, for any reason. Furthermore, the service agreement may be terminated at any time by either party, for any reason, by prior written notice of 90 days.

The annual bonus for the Chairman of the Board shall not exceed 90% of the bonus the CEO is entitled to, as stated above (in accordance with the scope of the position of 40% capacity), subject to the Remuneration Policy.

For details regarding the terms of the engagement with the Chairman of the Board of Directors, see Note 23 to the financial statements of December 31, 2016.

Total remuneration granted to directors and related expenses, that do not deviate from the norm, that was paid on account of 2016 to directors of the Company (not including management fees paid to the Chairman of the Board), including the value of the Company's flight tickets exercised by all eligible directors in the Reporting Year, amounts to NIS 1,721 thousand. For details regarding the approval of the general meeting for the granting of flight tickets to directors, see Note 23 to the financial statements.

Article 21a: Control of the Company

The Company's controlling shareholders as of the reporting date, as defined in Section 1 of the Securities Law, 5728-1968 (the "**Securities Law**") are:

(A) Knafaim Holdings Ltd., by virtue of its holdings of 35.3% of the issued share capital of the Company.

(B) David Borovitz and Tamar Mozes-Borovitz, who hold shares in Knafaim, as detailed in the chart below, and who are permitted to appoint a majority of the members of the board of directors of Knafaim, in accordance with shareholder agreements with Knafaim.

The following are also considered to be controlling shareholders in Knafaim: Israel Borovitz[6] (David Borovitz, Tamar Mozes-Borovitz and Israel Borovitz will collectively be termed hereinafter: the "**Individuals of the Borovitz Group**"), Sofia Kimerling, Carmel Ilan and Dafna Arnon, by power of being parties to the shareholder agreements in Knafaim, as detailed below.

Changes in control during the reporting period: from September 13, 2016, A.L. Aviation Assets Ltd. does not hold 4% or more of the issued and voting share capital in Knafaim. Accordingly, the undertakings of A.L. Aviation Assets Ltd., on the one hand, and Individuals of the Borovitz Group, on the other hand, in connection with voting in the general meetings of Knafaim in respect of the appointment of directors on behalf of each party, do not apply; therefore, A.L. Aviation Assets Ltd. ceased to be thought of as a controlling shareholder in Knafaim as of that date.

<u>Description of the ownership of Knafaim - the Company's controlling shareholder</u>

To the best of the Company's knowledge and according to Knafaim's reporting as of March 14, 2017, the holdings in Knafaim's shares are as follows:

6 On January 4, 2015, an agreement was signed for the sale of shares between Israel Borovitz (both personally and through a company wholly owned by him, Israel Borovitz Holdings Ltd.) and Tamar Mozes Investments Ltd. (a company wholly owned by Tamar Mozes-Borovitz), in the framework of which, *inter alia*, Israel Borovitz granted Tamar Mozes Investments Ltd. an option for the purchase of 792,291 shares in Knafaim that he owned, subject to certain terms set out in the agreement. In the framework of this agreement, Israel Borovitz granted Tamar Mozes Investments Ltd. and Tamar Mozes-Borovitz an irrevocable power of attorney to vote on behalf of said option shares, until the date of the option's expiration (no later than December 31, 2017). Subsequently, Knafaim was informed that a consequence of the agreement for the sale of Knafaim's shares, and their sale in practice, was the expiration of the earlier agreement between the relevant shareholders (David Borovitz and Tamar Mozes-Borovitz, on the one hand, and Israel Borovitz, on the other).

Holder name	Number of ordinary shares in Knafaim at par value of NIS 1.00 each, Security 543017	Share of holdings (Undiluted)[7]		Share of holdings (Fully diluted)[8]	
		% capital	% voting	% capital	% voting
Borovitz Tamar[9]	3,654,008.30	22.65	22.83	22.09	22.26
Borovitz David[10]	1,579,836	9.76	9.84	9.56	9.63
Borovitz Israel[11]	472,285	2.92	2.94	2.86	2.88
Ilan Carmel[12]	1,120,223.05	6.92	6.98	6.78	6.83
Arnon Dafna[13]	858,342.70	5.30	5.35	5.19	5.23
Kimerling Sofia	946,544	5.85	5.89	5.72	5.77
Levy Yehuda[14]	276,811.90	1.71	1.72	1.67	1.69
The Zabludowicz Trust[15]	2,284,019	14.11	14.22	13.81	13.92

7 It should be noted that the difference between the share of capital and the voting share stems from the existence of 128,353 treasury shares, held by Knafaim.

8 Shares of holdings in capital and voting rights (fully diluted) in the tables above are under the theoretical assumption of a single ordinary share being allocated for each option granted to executives in Knafaim; in practice, to the extent that the options are exercised, the share allocation will be in an amount that reflects the benefit represented in the options (exercise on a "cash only" basis), in accordance with the terms of the allocation plan under which they were allocated.

9 The holder serves as the Vice Chairwoman of the Company's Board of Directors. The holder conveyed that she holds the securities through Tamar Mozes Investments Ltd., a subsidiary wholly owned by her. The holder is the wife of David Borovitz, and the sister-in-law of Israel Borovitz. In addition, Tamar Mozes Investments Ltd. and Tamar Mozes-Borovitz received an irrevocable power of attorney from Israel Borovitz to vote on behalf of 792,291 shares, in respect of which he provided Tamar Mozes Investments Ltd. with an option for their purchase, until the date of the option's expiration (no later than December 31, 2017) - for additional details, see FN 8, above. The remaining option shares amounted, as of the reporting date, to 472,283 shares, which are not included in the holder's shares as presented above.

10 The holder conveyed that that he holds the securities through BMG (Borovitz Mozes Group) Ltd., a company he wholly owns, apart from a single share that he holds directly. The holder is the brother of Israel Borovitz and husband of Tamar Borovitz.

11 The holder conveyed that he holds the securities both directly and through Israel Borovitz Holdings Ltd., a company he wholly owns. The holder is the brother of David Borovitz and brother-in-law of Tamar Borovitz. The holder granted Tamar Mozes Investments Ltd. (a company wholly owned by Tamar Mozes-Borovitz) and Tamar Mozes-Borovitz an irrevocable power of attorney to vote on behalf of the shares, in respect of which he provided Tamar Mozes Investments Ltd. with an option for their purchase, until the date of the option's expiration (no later than December 31, 2017) - for additional details, see FN 8, above.

12 The holder is the wife of Eran Ilan, a director in Knafaim, and the sister of Arnon Dafna. The holder conveyed that that she holds the securities both directly and through Carmel Ilan Holdings in Knafaim Ltd., a company she wholly owns.

13 The holder is the sister of Carmel Ilan and the sister-in-law of Eran Ilan, a director in Knafaim. The holder conveyed that that she holds the securities both directly and through Dafna Arnon Holdings in Knafaim Ltd., a company she wholly owns.

14 The holder conveyed that he holds the securities through A.L. Aviation Assets Ltd., a private company whose entire issued capital is fully held, as of November 28, 2016, by Levyim Assets, Ltd., a company controlled and wholly owned by Adv. Yehuda (Yudi) Levy, who serves as a director in Knafaim, and his wife (previously, A.L. Aviation Assets Ltd. was held in equal parts by Levyim Assets Ltd. and by Miella Venture Partners, Inc., a wholly owned subsidiary of a foreign trust, whose beneficiaries are members of the Efi Arazi family). Accordingly, the name of the above holder was changed, on that date, to Yehuda Levy, in place of A.L. Aviation Assets Ltd.

15 The holder related that the Zabludowicz Trust is a trust registered in Liechtenstein (trust no. FL-0001.506.639-4), in which Pujo Zabludowicz is the main beneficiary; the Zabludowicz Trust holds shares in Knafaim through Tamares Knafayim Holdings Ltd., a company wholly owned by the company Tamares Israel Investments Ltd., which is wholly owned (indirectly) by the Zabludowicz Trust. In August, 2013, a unilateral undertaking provided by the Individuals of the Borovitz Group, and private companies controlled thereby (in this section: the "**Borovitz Group**"), and given to Tamares entered into force, according to which, in each general meeting of Knafaim whose agenda concerns the appointment of directors, they would vote in respect of all Knafaim shares that they own on the determining date for the vote, as set out in each such meeting, in favor of the appointment of one director recommended by Tamares, provided that (a) they meet all eligibility requirements under the law; and (b) Borovitz Group does not object to their identity. Borovitz Group may object to the identity of a candidate for the Board, as described in subsection (b), with regards to no more than two candidates annually, and has notified Tamares in advance of candidates to which it would not object. The effect of said undertaking by the Borovitz Group will expire on the earliest of the following dates: (1) the earliest date on which Tamares' holdings in the issued share capital of Knafaim are less than 13%; (2) the earliest date on which Borovitz Group ceases to be a controlling

Holder name	Number of ordinary shares in Knafaim at par value of NIS 1.00 each, Security 543017	Share of holdings (Undiluted)[7]		Share of holdings (Fully diluted)[8]	
		% capital	% voting	% capital	% voting
Fox Yossi[16]	2,396	0.01	0.01	0.01	0.01
Knafaim Holdings Ltd.	128,353	0.79	--	0.78	--
Phoenix Holdings Ltd.[17]	762,677	4.71	4.75	4.61	4.65
Excellence Investments Ltd.[18]	41,038	0.25	0.26	0.25	0.25

The following are the existing agreements, to the best of the Company's knowledge, between the shareholders of Knafaim in relation to the exercise of their rights by virtue of their holdings in Knafaim, as of the reporting date:

Knafaim shareholder agreements

Under a shareholders agreement dated November 22, 1993 (as amended on May 27, 2004), the parties to which, as of the reporting date, are the individuals of the Borovitz Group, Sofia Kimerling (in this section: "**Kimerling**"), the children of David Borovitz (Amir Borovitz, Nimrod Borovitz and Maya Borovitz)[19] and the daughters of Yigal Arnon (Carmel Ilan and Dafna Arnon) (collectively referred to hereinafter as the "**Arnon Individuals**"), it was agreed that the parties would use their voting power in Knafaim such that, at all times, eight directors recommended by the parties would be appointed to the board of directors of Knafaim, according to a list determined by them, as detailed below.[20] The agreement also includes provisions concerning a right of first refusal and the appointment of the chairman and CEO, as described below. (Hereinafter in this section: the "**Shareholders Agreement**").

Appointment of directors

This list will be compiled by the parties to the Shareholders Agreement, as follows:

(1) The Individuals of the Borovitz Group will be entitled to include six (6) directors on the list;

(2) The Arnon and Kimerling Individuals, shall each be entitled to include one director on the list;

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shareholder in Knafaim (as "control" is defined in the Securities Law); and (3) the earliest date on which Pujo Zabludowicz, or one of his heirs, cease to be the main beneficiaries of Tamares. Furthermore, Borovitz Group will work to convene a general meeting in the event that the appointment or replacement of a director recommended by Tamares is required, and vote in such meeting, as stated above. As of the date of this report, Mr. Ami Arel serves as a director in Knafaim on behalf of Tamares.

16 The holder is a director in Knafaim. The holder related that he also holds 27,472 ordinary shares of the Company, representing some 0.006% of the issued share capital of the Company (with and without dilution). The Securities in Knafaim and in the Company are held by Director Yossi Fox's sons, who, in accordance with the Securities Law, are considered to be "another person" in this regard.

17 The holder is a member of an institutional reporting group, which includes companies from Delek Group Ltd. and Phoenix Group, as well as Excellence group companies. The above holdings include holdings in a Nostro account and in profit-participating life insurance policies. The holder also holds 2,112,000 Bonds (Series G) in Knafaim (representing some 1.52% of this series) through profit-participating life insurance policies; in 9,675,907 shares of the Company (representing some 1.95% of the issued share capital of the Company).

18 The holder is a member of an institutional reporting group, which includes companies from Delek Group Ltd. and Phoenix Group, as well as Excellence Group companies. The above holdings include holdings in mutual fund management companies and index product issuers. The holder also holds 4,931,610 Bonds (Series G) in Knafaim (representing some 3.55% of this series) through mutual fund management companies; in 1,124,638 Bonds (Series E) in Knafaim (representing some 1.69% of this series); in 5,299,649 ordinary shares of the Company (representing some 1.07% of the issued share capital of the Company).

19 As of the reporting date, and to the best of the Company's knowledge, David Borovitz's children are not shareholders in Knafaim.

20 It should be noted that according to Knafaim's articles of association, Knafaim's board of directors will include no fewer than three and no more than fourteen directors. As of the date of publication of the report, eleven directors serve on Knafaim's board of directors, including two outside directors.

(3) In this context, it was agreed that if Kimerling's holdings dropped to below 5% of the issued and paid up share capital of Knafaim, the Individuals of the Borovitz Group would have the right to demand, by written notice to Kimerling, the termination of her right to serve as a director or to appoint a director. In such a case, wherein notice has been given by the Individuals of the Borovitz Group, Kimerling (or the director she appointed) shall resign, and the right to appoint a director in place of that which was dismissed, as stated, shall transfer to the Individuals of the Borovitz Group. Should Kimerling resign from Knafaim's board of directors as the result of a demand from Borovitz, Kimerling will not be required to exercise her voting right in respect of the appointment of directors in Knafaim on behalf of the other parties to the Shareholders Agreement, as stated above. Furthermore, should Kimerling resign from Knafaim's board of directors as the result of a demand from the Individuals of the Borovitz Group, as stated above, the right of first refusal towards the Individuals of the Borovitz Group, as described below, shall not apply to her.

(4) Should the holdings of the Arnon Individuals (collectively) drop below a rate of 5% of Knafaim's shares, their right to appoint a director to Knafaim's board of directors shall be cancelled, and their right to appoint said director shall be transferred to Borovitz Group.

(5) The parties will vote together against the dismissal of any director appointed under the agreement, unless the party that included them on the list is the party seeking their dismissal. Should a party that appointed a director that was dismissed seek to appoint another director in their place, the parties will exercise their voting powers to effect such appointment.

Appointment of chairman and CEO

Subject to the law, the parties to the agreement will endeavor to have a person appointed to the position of chairman of Knafaim's board of directors and Knafaim's CEO that was recommended for such by the Individuals of the Borovitz Group.

Right of first refusal

The Arnon and/or Kimerling Individuals granted Borovitz Group a right of first refusal to acquire their shares in Knafaim, if and when the rate of each of their holdings fell below 5% of the issued and paid up share capital of Knafaim. Said right of first refusal shall not apply to the transfer or sale of shares by the Arnon and/or Kimerling Individuals to an "Authorized Transferee," i.e., the spouse married to a party to the agreement and/or their adult children (an "Authorized Transferee"), provided such Authorized Transferee provides its approval of the transferor's undertakings under the agreement.

Agreement between BMG and Tamar Mozes-Borovitz

To the best knowledge of the Company, under an agreement signed between BMG and David Borovitz, on the one hand, and Tamar Mozes-Borovitz, on the other, the appointment of directors in Knafaim that Borovitz-Mozes are entitled to appoint, from time to time (in accordance with the aforesaid Shareholders Agreement), is effected in accordance with an arrangement between them, which also includes provisions concerning a right of first refusal and a tag along right.

Article 22: Transactions with controlling shareholders

For details, to the best knowledge of the Company, regarding transactions with controlling shareholders or in whose approval the controlling shareholder has a personal interest, in which the Company engaged in the Reporting Year or until the date of submission of the report or that such transactions remain in effect as of the report date, see Note 23 to the financial statements as of December 31, 2016.

Article 24: Holdings of interested parties and senior executives

Holdings of interested parties in the shares and other securities of the Company and of the Company’s investee companies whose activities are material to the Company’s operations, as of March 14, 2017:

Name of the interested party	Security	Amount	Share of holdings (%)	
			Capital	Vote
Knafaim Holdings Ltd.[21]	Ordinary Share	175,000,000	35.3	35.3
Pinchas Ginsburg[22]	Ordinary Share	49,854,611	10.06	10.06

Furthermore, the State of Israel holds a special state share, in accordance with the Company's prospectus dated May, 2003. To the best of the Company's knowledge, and according to information it was provided, the State of Israel also holds some 1.1% of the Company’s share capital.

Holdings of senior executives in the share and other securities of the Company, its subsidiaries or affiliates, as of March 14, 2017: N/A.

Article 24a: Registered capital, issued capital and convertible securities of the Company, as of March 14, 2017

Share class: Ordinary Share

The registered capital: 1,000,000,001 (including the special state share)

The issued capital: 495,719,135

Security No.: 1087824

Share class: Special State Share

The registered capital: 1

The issued capital: 1

Convertible Securities:

As of March 14, 2017, the Company has no convertible securities.

21 On December 22, 2004, EL Al received approval from the special state shareholder according to which,the holder agrees that Knafaim will hold more than 40% of the issued share capital of the Company, at a rate affording it control of the Company.

22 Pinchas Ginsburg (who serves as a director in the Company) and Y. Hillel & Co. Ltd. (“Y. Hillel”), which he fully owns, received approval from the special state shareholder, on September 3, 2006, for individuals of the Pinchas Ginsburg family and Y. Hillel to collectively hold shares in the Company at an aggregate rate that is lower than 15% of the issued share capital of the Company.
It should be noted that Pinchas Ginsburg has a personal stake, directly and indirectly, in various transactions performed by the Company and/or its affiliates, as detailed in Note 23c.(4)(a) to the financial statements of December 31, 2016.

Article 24b: Shareholder registry

Register of Shareholders Ordinary Shares - Security No. 1087824						
Holder	**I.D. No.**	**Address**	**Par value quantity**	**Issuance date**	**From serial no.**	**To serial no.**
State of Israel	---------	Ministry of Finance, Jerusalem	**1**		Special State Share	
Bank Hapoalim Nominee Company Ltd.	513056603	62 Yehuda Halevy St., Tel Aviv	**495,706,357**	Starting January, 2005	Held through many split share certificates	
Eden Sharabani	324978832	2 Meir Shfeya, Petah Tikva	**980**	November 26, 2003	31,999,021	32,000,000
David Noyman	008332884	14 David Shimoni, Jerusalem	**100**	August 1, 2003	31,998,921	31,999,020
Nathan Panzer	008037392	PO Box 4241, Haifa 31042	**250**	July 1, 2004	395,717,678	395,717,927
Avraham Berkowitz	7675838	123 Barsimantov, Yehud	**77**	July 11, 2004	395,717,601	395,717,677
Barlev Yehuda	064837123	6a Yehuda Leib Halevi Barsky, Tel Aviv	**100**	July 5, 2006	399,458,971	399,459,020
				May 14, 2007	399,459,021	399,459,070
Savyon Tal	35506499	44 Hageulim, Zichron Yaakov	**9,070**	November 4, 2004	395,708,531	395,717,600
Itzak Pachter	003730165	555 Lake View Drive, Miami Beach Florida 33140 USA.	**1,100**	March 1, 2005	31,997,821	31,998,920
Batia Sepin	003730173	6917 Collins Ave. #1503 Miami Beach Florida 33141	**1,100**	March 1, 2005	31,996,721	31,997,820

Article 25a: Registered address

Registered address: PO Box 41, Ben Gurion Airport 7015001

E-mail: corporate@elal.co.il

Tel.: 03-9716720

Fax: 03-9717334

Article 26: The Company's directors

Name I.D. No. Date of Birth Citizenship	Address for service of legal process	Independent director/external director Membership in Board of Directors committees	Employee of the Company, a subsidiary or affiliate of the Company, or of an interested party?	Starting date of their tenure as director	Education and employment in the last five years: Details of companies in which they serve as a director	Relative of another interested party in the Company?	Do they have accounting and financial expertise or professional qualifications?
Amikam Cohen 005265855 June 8, 1948 Israeli	El Al Headquarters, Ben Gurion Airport 7015001	Security Committee - Chair, Human Resources Committee - Chair, Government Relations and Regulation Committee - Chair, Corporate Governance Committee - Chair, Executive Committee - Chair.	No	December 30, 2008	Academic education: BA in Industrial Engineering and Management from Ben Gurion University. Business experience in the last five years: CEO of Hutchison Water. Director in: Amiad Gardens Ltd.	No	Professional qualifications
Tamar Mozes-Borovitz 056400997 March 11, 1960 Israeli	2 Raul Wallenberg, Ramat Hachayal, Tel Aviv	Government Relations and Regulation Committee, Human Resources Committee, Market Risk Management Committee and Executive Committee.	CEO of Tamar Mozes Investments Ltd. - a company wholly owned by the director, which holds shares in Knafaim, the Company's controlling shareholder.	January 6, 2005	Academic education: Graduated MBA studies at Tel Aviv University; Bachelor of Political Science at Bar-Ilan University. Business experience in the last five years: CEO of Tamar Mozes Investments Ltd., CEO of Mapal Communications Ltd. Director in: Knafaim Holdings Ltd., Sun d'Or International Airlines Ltd., Global Knafaim Leasing Ltd., Chairwoman of the Board of Dori Media Group Ltd., Mapal Communications Ltd., Tamar Mozes Investments Ltd., Noa MB Communications Ltd., Communica TV	Yes. Wife of Mr. David Borovitz, a controlling shareholder in Knafaim.	Professional qualifications

					Ltd, Dori Media Durst Ltd., Travelist Ltd., Dori Media Paran Ltd., Dori New Media Ltd., Mapal L.D.Y. Ltd., Mapal-Eden Telenovelas Ltd., Mapal Brands - B.M.I. Ltd., Noa & Yariv Holdings Ltd., S.T.V. Media Israel Ltd., B.M.I. - Brand Management International Ltd., Novebox A.G. MeMeMe Studios Ltd., Apollo Y.A.K. Ltd.		
Yehuda (Yudi) Levy 046201323 June 10, 1945 Israeli	98 Yigal Alon St., Tel Aviv, c/o Goldfarb Seligman & Co.	Market Risk Management Committee, Government Relations and Regulation Committee, Security Committee, Human Resources Committee, Corporate Governance Committee and Executive Committee.	No	January 28, 2008	Academic education: Bachelor of the Faculty of Law at the Hebrew University. Member of the Israel Bar Association and the Bar Association in New York. Business experience in the last five years: Managing partner of Goldfarb Seligman & Co. Law Offices. Director in: Knafaim Holdings Ltd., Dori Media Group Ltd., Maman Cargo Terminals and Handling Ltd., A.L. Aviation Assets Ltd., Global Knafaim Leasing Ltd., Levyim Assets Ltd., The Shalem Foundation, Shalem Academic Center Ltd., the Adv. Yudi Levy company.	No	Professional qualifications
Prof. Joshua (Shuki) Shemer 005360029 December 7, 1947 Israeli	Assuta Medical Centers Ltd., 20 Habarzel, Tel Aviv	**External director** Balance Sheet Committee - Chair, Audit and Remuneration Committee - Chair, Market Risk Management Committee, Security Committee, Budget and Finance Committee.	No	November 19, 2008	Academic education: Holds a degree as an internal medicine specialist from Hebrew University; holds a degree as a medical administration specialist from the Ministry of Health, University of Haifa. Business experience in the last five years: Chairman of the Board of Directors of Assuta Medical Centers Ltd. and its subsidiaries. Director in: Maccabi-Dent Ltd., Bayit Balev Ltd., Compugen Ltd., Maccabi	No	Accounting and financial expertise

					Healthcare Services, S.Y.A. On Ltd.		
Pinchas Ginsburg 054189451 January 2, 1957 Israeli, German	El Al Headquarters, Ben Gurion Airport 7015001	Market Risk Management Committee - Chair, Budget and Finance Committee, Balance Sheet Committee and Executive Committee.	CEO of Y. Hillel & Co., Ltd., which is part of Pinchas Ginsburg Group, which is an interested party in the Company by virtue of its holdings.	June 24, 2009	Academic education: BA in Economics and Accounting from Tel Aviv University. Business experience in the last five years: CEO of Y. Hillel & Co., Ltd. - Travel agency and representatives of foreign airlines in Israel; CEO of West East Airline Representatives Ltd. Director in: Y. Hilel & Co., Ltd., West East Airline Representatives Ltd., Privilege Tourism Ltd., Matador Jerusalem (1994) Ltd., Airtour (Israel) Ltd., Talpiyot Airline Representatives Ltd.	No	Accounting and financial expertise
Shlomo Hanael 064516271 January 10, 1950 Israeli	Ayalon Insurance House, 12 Abba Hillel Silver, Ramat Gan, c/o Knafaim	Government Relations and Regulation Committee, Market Risk Management Committee, Budget and Finance Committee and Security Committee.	Chairman of the Board of Directors of Knafaim Holdings Ltd., the Company's controlling shareholder.	June 24, 2009	Academic education: Bachelor of Aeronautical Engineering, the Technion; MBA from Tel Aviv University. Business experience in the last five years: Chairman of Knafaim Holdings Ltd., CEO of Knafaim Holdings Ltd. (until October, 2012). Director in: Knafaim Holdings Ltd. - Chairman of the board, Global Knafaim Leasing Ltd. - Chairman of the board, Maintenance Wings (2005) Ltd. - Chairman of the board, QAS Israel LTD.	No	Professional qualifications
Sofia Kimerling 71511174 May 1, 1951 Israeli	El Al Headquarters, Ben Gurion Airport 7015001	Corporate Governance Committee	No	January 19, 2011	Academic education: Degree in Business Administration, Derby University Israel. Business experience in the last five years: Entrepreneurship. Director in: Knafaim Holdings Ltd.,	No	Professional qualifications

					Sun d'Or International Airlines Ltd., T.M.M. Aircraft Food Industries (Ben Gurion Airport) Ltd.		
Ruth Dahan (Portnoy) 024807927 February 1, 1970 Israeli	El Al Headquarters, Ben Gurion Airport 7015001	**Independent Director** Audit and Remuneration Committee, Balance Sheet Committee, Budget and Finance Committee - Chair, and Market Risk Management Committee	No	December 31, 2013	Academic education: MBA graduate specializing in Finance and Accounting from the Hebrew University of Jerusalem; BA in Economics, Hebrew University of Jerusalem. Business experience in the last five years: Founder and manager of TMF - Tailor Made Finance, Vice President of Standard & Poor's Maalot (from 2003 until April, 2013). Director in: Luzon Group Ltd., Assuta Medical Centers Ltd.	No	Accounting and financial expertise
Eyal Haimovsky 027425800 May 29, 1974 Israeli	Jerusalem Development Authority, 2 Safra Square, Jerusalem	**External director** Audit and Remuneration Committee, Balance Sheet Committee, Budget and Finance Committee, Corporate Governance Committee and the Government Relations and Regulation Committee.	No	February 18, 2015	Academic degrees: Master of Business Administration (MBA), University of Derby; Graduate in Business Administration (B.Ac) from Champlain College; Structural Engineering, the College of Management. Business experience in the last five years: CEO of the Jerusalem Development Authority (2015-present); PMO bureau chief (2012-2014); Vice President of Development and Construction of the Country Builders Association (2011-2012).	No	Accounting and financial expertise
Eli Defes 052016631 July 31, 1953	Clalit Health Services, 101 Arlozorov, Tel Aviv	Budget and Finance Committee, Government Relations and Regulation Committee and	No	November 29, 2015	Academic education: BA in Political Science - Bar-Ilan University; Graduate of Political Science and Sociology - University of Haifa; Graduate of the National Security College.	No	Professional qualifications

Israeli		Security Committee.			Business experience in the last five years: CEO of Clalit Health Services Group; Chairman of the managerial board of the Moore Institute; Chairman of the board of Shila - Medical Services Ltd; Chairman of the board of Clalit Medical Engineering Ltd. Director in: The Moore Institute - Chair; Shila - Medical Services Ltd. - Chair; Clalit Medical Engineering Ltd. - Chair.		

Article 26a: Senior executives in the Company

Name I.D. No. Date of Birth	Position	Starting date of tenure	Serving in a position in a subsidiary or affiliate of the Company or of an interested party?	Interested party in the Company or relative of another senior executive or interested party in the Company?	Education and employment in the last five years
David Maimon 056491616 July 8, 1960	**President and Chief Executive Officer**	March 20, 2014	Chairman of the Board of Directors of Sun d'Or International Airlines Ltd.	No	Academic education: Graduated MBA studies at Derby University in the UK; Bachelor of Political Science at Bar-Ilan University. Business experience in the last five years: VP of Commerce and Industry Affairs (until January, 2014).
Ofer Tsabary 055336168 July 3, 1958	**VP Organization & Information Technologies**	June 30, 2005	No	No	Education: Graduate of Computer Sciences - Tel Aviv University; Bachelor of Mathematics and Computer Sciences - Tel Aviv University. Business experience in the last five years: VP of Computer Affairs.
Yehudit Grisaro 057895385 September 28, 1962	**VP of Customer Service**	January 1, 2011	No	No	Education: Graduate of Computer Sciences (EMBA) - Tel Aviv University; Bachelor of Social Sciences - Tel Aviv University. Business experience in the last five years: VP of Customer Service at the Company.
Gil Ber 028913051 January 10, 1972	**Chief Audit Officer**	June 1, 2009	Auditor of the Company's subsidiaries.	No	Education: BA in Business Administration and Accounting from the College of Administration, magna cum laude in Auditing and Public Administration at Bar-Ilan University; Accountant, Certified Internal Auditor, USA (CIA) and Certified in Risk and Information Systems Control, USA (CRISC). Business experience in the last five years: Auditor of the Company and its subsidiaries. Lecturer at Ben Gurion University, Haifa University, Tel Aviv University and at the Ono Academic College in the field of risk

					management and internal auditing. In addition, he serves as a director in the Internal Auditor's Association (IIA) and as a member of the Ilan Audit Committee.
Dganit Palti 057696551 June 11, 1962	**VP Finance**	March 20, 2014	No	No	Education: Accountant. Graduate in Economics and Accounting from Tel Aviv University; MBA from Tel Aviv University. Business experience in the last five years: CFO at Granit Hacarmel Investments Ltd.
Hanan Matasaro 058493867 January 1, 1964	**VP of Human Resources and Administration**	May 1, 2014	Chairman of the board of directors of Katit Ltd. (a wholly owned subsidiary of the Company).	No	Education: BA in Political Science - Bar-Ilan University; Graduate of Political Science, Haifa University. Business experience in the last five years: Section head at the Company's Israel station (2009-2014).
Yosef Barzani 057938367 January 6, 1963	**VP Maintenance and Engineering**	September 1, 2014	No	No	Education: B.A - Social Sciences, the Hebrew University; MBA - the Peres Academic Center. Business experience in the last five years: VP at Wings Maintenance Limited Partnership (2010-2014).
Harel Chalamish 050845858 September 15, 1951	**VP Operations**	December 16, 2016	No	No	Education: B.A - Modern Art, Auburn University; Graduate - Geography, Graduate - International Relations, University of Haifa. Business experience in the last five years: Captain in the 747 fleet. * It should be noted that in 2016, until December 15, 2016, Captain Tal Becker served as VP of Operations at the Company.
Gonen Usishkin	**VP of Commercial and Industry Affairs***	January 1, 2017	No	No	Education: Graduate in Business Administration and Economics, from Tel Aviv University; MBA from Tel Aviv University.

011031820 August 19, 1967					<u>Business experience in the last five years</u>: Director of Strategy and Business Development at the Company (October 2014-December 2016); head of the Company's revenue management section (2011-2014). * It should be noted that in 2016, until December 31, 2016, Mr. Shalom Zahavi served as VP of Commerce and Industry Affairs at the Company.
Senior executives whose service was discontinued in the Reporting Year					
Captain Tal Becker - VP Operations			Starting date of his tenure - Jun 1, 2015; date his tenure ended - December 15, 2016.		
Shalom Zahavi - VP of Commercial and Industry Affairs			Starting date of his tenure - Jul 28, 2014; date his tenure ended - December 31, 2016.		

Article 26b: Authorized signatory of the Company

There are no independent authorized signatories in the Company.

Article 27: The Company's accountant

Brightman Almagor Zohar & Co., Accountants.

Address: 1 Azrieli Center, Tel Aviv.

Article 28: Change in the Memorandum or Articles of Association

In the Reporting Year, there was no change in the Company's Memorandum or Articles of Association.

Article 29 (a) and (b): Recommendations and resolutions of the directors

For details concerning dividend payment that were disbursed in the Reporting Year, see Note 17 to the financial statements.

Article 29(c): Special general meeting resolutions

- ✓ In a special general meeting of the Company's shareholders that took place on April 28, 2016, it was resolved as follows: (1) To approve the update of the terms of employment of the Company's CEO, Mr. David Maimon; (2) To approve the amendment to the long-term deferred remuneration rate in respect of the Company's CEO, Mr. David Maimon; (3) To approve the payment of a special bonus to CPA Nimrod Borovitz (son of David Borovitz (spouse of Ms. Tamar Mozes-Borovitz, Vice Chairwoman of the Company's Board of Directors and a controlling shareholder in Knafaim, and nephew of Prof. Israel (Izzy) Borovitz, a controlling shareholder in Knafaim)), who served as the head of the Company's business development, long-term planning and equipment section.[23] For further details, see the Company's immediate report dated March 23, 2016 (reference no.: 2016-01-012522).
- ✓ In a special and annual general meeting of the Company's shareholders that took place on December 1, 2016, it was resolved to approve the Company's executive remuneration policy for the years 2017-2019. For further details, see the Company's immediate report dated October 27, 2016 (reference no.: 2016-01-068523).

Regulation 29a: Company resolutions

(1) Executive liability insurance

On September 18, 2016, the Audit and Remuneration Committee - and on September 20, 2016, the Board of Directors of the Company - approved the continued engagement, through Knafaim, the controlling shareholder of the Company, with Menora Mivtachim Insurance Ltd., for the renewal of the director and executive liability insurance policy, including for directors considered to be controlling shareholders of the Company, for an additional term starting on October 1, 2016, and ending January 31, 2018.

The main terms of the policy are as follows:

[23] Mr. Nimrod Borovitz serves, on the reporting date, as director of strategy, aircraft equipment business development at the Company.

(A) The insurance coverage extends to all directors and executives serving in Knafaim and in the subsidiaries, including in the Company and/or the subsidiaries, as well as executives serving the Company and/or the Company's subsidiaries and affiliates. The policy, which is based on the filing of a claim, covers a liability limit of USD 100 million per incident and for the insurance period.

In addition to the above limit of liability, the policyholders are entitled to reasonable legal defense costs beyond the limit of liability specified above, in accordance with the Insurance Contracts Law, 5741-1981. The insurance policy covers the liability of the policyholder for claims filed in Israel and outside of the borders of the State of Israel, around the world, including in the United States and Canada.

(B) The Company's deductible in claims against the Company relating to violations of securities laws was set at USD 75,000 per incident. The Company's deductible for claims against executives and directors is USD 10,000 per incident for claims all around the world, except for in the US and Canada, and USD 75,000 per incident for claims in the US and Canada (there is no deductible charged to the executives and directors themselves).

(C) The policy is expanded to cover claims against the public companies held by Knafaim (as opposed to claims filed against executives therein) concerning violations of securities laws with respect to the companies' securities that are traded on the Tel Aviv Stock Exchange (Entity Coverage). For this expansion, payment of insurance proceeds, should any occur, are prioritized such that the rights of the executives to indemnification from the insurers take precedence over the right of the Company.

(D) Furthermore, the policy is expanded to include legal defense costs in the course of an authorized authority's investigation into the Company's business dealings.

(E) The insurance policy does not cover claims against directors or executives relating, *inter alia*, to the following matters: instances of profiteering; damage to body or property, pollution (apart from defense costs up to USD 500,000); improper, malicious, fraudulent or criminal acts; claims under US or Canadian securities law (SEC); future issuances of shares to the public on a foreign stock exchange, and future issuances of shares to the public on the Tel Aviv Stock Exchange, to raise capital in excess of NIS 150 million; war; disbursement of profits or benefits to employees, including pension arrangements; breaches of professional liability; breaches of duties of care that are performed out of intent or apathy in respect of the circumstances of the breach or its results, and in the event that a claim is filed by the Company in the US or in Canada (apart from several exceptions).

It is clarified that the insurance coverage is in accordance with the policy terms, including the various exceptions stipulated therein.

For further details, see Note 23 to the financial statements.

(2) Indemnification of executives

For details regarding the indemnification of executives, see Note 23c.(1)(g) to the financial statements.

Date: March 21, 2017

David Maimon	Amikam Cohen
President and Chief Executive Officer	Chairman of the Board of Directors

Corporate Governance Questionnaire

INDEPENDENCE OF THE BOARD OF DIRECTORS				
			Correct	**Incorrect**
1.		Two or more External Directors have served in the Company during theReporting Year. In this question, "correct" can be marked if the time period in which two External Directors did not serve does not exceed 90 days, as stated in Section 363A.(b)(10) of the Companies Law. However, for each answer (correct/incorrect), please note the period of time (in days) in which two or more External Directors did not serve in the Company during the Reporting Year (including a term of office approved retroactively, while distinguishing between the various External Directors): Director A: **Prof. Joshua (Shuki) Shemer.** Director B: **Eyal Haimovsky.** The number of External Directors serving in the Company as of the publication date of this Questionnaire: **2.**	√	
2.		The number [24]of Independent Directors [25] serving in the Company as of the publication date of this Questionnaire: **3/10.** The number of Independent Directors determined in the Company's[26] Articles of Association[27]: **No instruction was given in the Articles of Association.**	———	———
3.		In the Reporting Year, an examination was conducted with the External Directors (and the Independent Directors), and it was determined that they have upheld, during the Reporting Year, the provisions of Section 240(b) and (f) of the Companies Law regarding the lack of a Connection of the External (and Independent) Directors serving in the Company and that they fulfill the terms required for office as	√	

[24]In this Questionnaire, "**number**" - a certain number out of the total. For example, 3/8.
[25] Including "External Directors" as defined in the Companies Law.
[26]For the purpose of this question - "articles of association" including under a specific legal provision applicable to the Corporation (for example, in a banking corporation - instructions of the Supervisor of Banks).
[27]A bonds company is not required to respond to this section.

		External (or Independent) Directors.		
4.		None of the directors who served in the Company during the Reporting Year are subordinate[28] to the CEO, directly or indirectly (excluding a director who is a workers' representative, if the Company has a workers' representative). If your answer is "incorrect" (meaning, the director is subordinate to the CEO as stated) – please list the number of directors who do not meet said limitation: _____.	√	
5.		All directors who have notified that a Personal Interest exists in the approval of a transaction that is on the agenda of the meeting, were not present during the discussion, and didn't participate in the voting as stated (excluding a discussion and/or vote in circumstances as stated in Section 278(b) of the Companies Law, or a transaction under Section 271): If your answer is "Incorrect" - Was it for presentation of a certain issue by him in accordance to the second part of Section 278(a): ☐Yes ☐No The rate of meetings in which directors attended and/or participated in the voting, apart from the circumstances provided in subsection A above: __________.	√	
6.		The Controlling Shareholder (including a relative and/or representative thereof), who is not a director or other Senior Executive of the Company, was not present in meetings of the Board of Directors occurring during the Reporting Year. If your answer is "incorrect" (meaning, a Controlling Shareholder and/or Relative and/or representative thereof which is not a member of the Board of Directors and/or a Senior Executive in the Company was present in the meetings of the Board of Directors as stated) – please provide the following details regarding the presence of any additional person in the meetings of the Board of Directors as stated: Identity: **Nimrod Borovitz** Position: **Company's VP of Business Development, Long-term Planning and Equipment.**		√

[28] For the purpose of this question - Serving as a director in an investee corporation controlled by the Company, shall not be considered to be "subordinate," yet, a Director in the Company serving as an executive (other than a director) and/or employee in an investee corporation controlled by the Company shall be considered "subordinate" for the purpose of this question.

		Description of the Connection to the Controlling Shareholder (if the person present was not the Controlling Shareholder itself): **Mr. Nimrod Borovitz is the son of Mr. David Borovitz (one of the controlling shareholders in Knafaim, the Company's controlling shareholder, and the husband of Tamar Mozes-Borovitz, the Vice Chairwoman of the Board of Directors and one of the controlling shareholders in Knafaim).** Was it for presentation of a certain issue: x Yes □ No The extent of their presence[29] in the meetings of the Board of Directors occurring during the Reporting Year in order to present a specific matter: **29%.** □N/A (there is no controlling shareholder of the Company). **Regarding this question, see note at the end of the questionnaire.**		

QUALIFICATIONS AND SKILLS OF DIRECTORS					
				Correct	**Incorrect**
7.		In the Articles of Association of the Company, there are no provisions limiting the possibility of immediately terminating the office of all of the directors in the Company[30] which are not External Directors (in this regard – a determination with an ordinary majority is not considered to be a limitation). If your answer is "Incorrect" (meaning, there is such a limitation), please state -		√	
		a.	The period of time stipulated in the Articles of Association for the appointment of directors: ______.		
		b.	The majority required in the Articles of Association for the termination of the appointment of the directors: ___________.		
		c.	The legal quorum determined in the Articles of Association for the general meeting to terminate		

[29]Distinguishing between the controlling shareholder, relative and/or representative thereof.
A bonds company is not required to respond to this section.

			the appointment of the directors: _________.		
		d.	The majority required to change these provisions of the Articles of Association: _____.		
8.			The Company has a training program for new directors, in the field of the Company's business and the field of the law applicable to the Company and the directors, as well as a continuous training program for serving directors, adapted, *inter alia*, for the function that the director fulfills in the Company. If you answer is "correct" – please state whether the program was utilized during the Reporting Year: x Yes ☐No	√	
9.		a.	A minimal number of directors on the Board of Directors with Accounting and Financial Expertise was determined. If your answer is "correct" – please state the minimum determined: **1/3 of the directors serving at any time**.	√	
		b.	Number of directors serving in the Company during the Reporting Year: Number of directors serving in the Company during the Reporting Year: With Accounting and Financial Expertise[31]: **4**. With Professional Qualifications[32]: **6**. In the event that there were changes in the number of directors as stated in the Reporting Year, provide the data regarding the lowest number (excluding in a period of 60 days from the occurrence of the change) of directors of each type serving during the Reporting Year.		
10.		a.	During the Reporting Year, the total composition of the Board of Directors included members of both genders. If your answer is "incorrect" – state the period of time (in days) in which the above was untrue: ___. You may answer "correct" to this question if the time period in which directors of both genders were not serving does not exceed 60 days. However, for either answer (correct/incorrect), state the	√	

[31] Following the evaluation of the Board of Directors, pursuant to the directives of the Companies Regulations (Conditions and Tests for a Director with Accounting and Financial Expertise and for a Director with Professional Qualifications), 5766 – 2005.
[32]See FN 29.

			period of time (in days) in which directors of both genders were not appointed in the Company: ______.		
		b.	The number of directors of each gender serving in the Board of Directors of the Company, as of the publication date of this Questionnaire: Men: 7, Women: 3.	_____	_____

MEETINGS OF THE BOARD OF DIRECTORS (AND CONVENING A GENERAL MEETING)					
				Correct	**Incorrect**
11.		a.	The number of meetings of the Board of Directors which occurred during each quarter of the Reporting Year: **First quarter (2016): 5.** **Second quarter: 3.** **Third quarter: 4.** **Fourth quarter: 9.** **Regarding this question, see note at the end of the questionnaire.**	_____	_____
		b.	Beside each of the names of the directors who served in the Company during the Reporting Year, note the participation rate[33] in the meetings of the Board of Directors (in this subsection – including meetings of the Board of Director committees of which the director is a member, as stated below) occurring during the Reporting Year (and relating to the term of their office):	_____	_____

Name of the director	Participation rate in the Board of	Participation rate in the Audit	Participation rate in the Committee	Participation rate in the	Participation rate in meetings of

[33] See FN 22.

	Directors meetings	Committee meetings[34]	for the Examination of Financial Statements meetings[35]	Remuneration Committee meetings[36]	additional committees of the board of directors in which they are a member
Amikam Cohen	90%				100% Security Committee Government Relations and Regulation Committee Corporate Governance Committee Human Resources Committee Executive Committee
Tamar Mozes-Borovitz	100%				100% Government Relations and Regulation Committee Human Resources Committee Executive Committee Market Risk

[34]Regarding a director who is a member of this committee.

[35]Regarding a director who is a member of this committee. In accordance with Amendment No. 27 to the Companies Law, as of March, 2016 the Company's Audit Committee and Remuneration Committee were consolidated. The number of meetings noted in this section includes the meetings of the Audit Committee prior to consolidation, as well as the meetings of the consolidated "Audit and Remuneration Committee."

[36]Regarding a director who is a member of this committee. This section includes meeting of the Remuneration Committee prior to its consolidation with the Audit Committee.

								Management Committee		
			Yehuda (Yudi) Levy	86%				94% Security Committee Government Relations and Regulation Committee Corporate Governance Committee Human Resources Committee Market Risk Management Committee Executive Committee		
			Sofia Kimerling	100%				100% Corporate Governance Committee		
			Pinchas Ginsburg	81%		75%		100% Budget and Finance Committee Market Risk Management Committee Executive Committee		

			Shlomo Hanael	100%				92% Market Risk Management Committee Security Committee Budget and Finance Committee Government Relations and Regulation Committee		
			Prof. Joshua (Shuki) Shemer	95%	100%	100%	100%	100% Budget and Finance Committee Security Committee Market Risk Management Committee		
			Ruth Dahan (Portnoy)	95%	94%	100%	100%	100% Budget and Finance Committee Market Risk Management Committee		
			Eyal Haimovsky	90%	76%	75%	100%	60% Budget and Finance Committee Corporate Governance		

								Committee Government Relations and Regulation Committee		
			Eli Defes	76%				67% Security Committee Budget and Finance Committee Government Relations and Regulation Committee		
12.		During the Reporting Year, the Board of Directors held at least one meeting regarding the business management of the Company by the CEO and executives subordinate to him, in their absence, and they were given the opportunity to express their positions.							√	

SEPARATION BETWEEN THE ROLES OF CEO AND CHAIRMAN OF THE BOARD				
			Correct	**Incorrect**
13.		A chairman of the Board served throughout the Reporting Year. This question can be answered with “correct” if the period of time in which no chairman served on the Board of Directors does not exceed 60 days, as stated in Section 363A(2) of the Companies Law. However, for either answer (correct/incorrect), please state the period of time (in days) in which no chairman of the Board served in the Company, as stated: ___.	√	

14.		A CEO served in the Company throughout the Reporting Year. This question can be answered with "correct" if the period of time in which no CEO served in the Company does not exceed 90 days, as stated in Section 363A(6) of the Companies Law. However, for either answer (correct/incorrect), please state the period of time (in days) in which no CEO served in the Company, as stated: ________.	√	
15.		In a Company in which the chairman of the Board also serves as the CEO of the Company and/or utilizes its authorities, the double appointment was approved pursuant to Section 121(c) of the Companies Law.[37] ☐ N/A (if there is no double appointment, as stated, in the Company).	_____	_____
16.		The CEO is <u>not</u> a Relative of the Chairman of the Board. If your answer is "incorrect" (meaning, the CEO is a Relative of the Chairman of the Board) -	√	
		a. State the familial relationship between the parties: ________________.	_____	_____
		b. The appointment was approved pursuant to Section 121(c) of the Companies Law: ☐ Yes ☐No	_____	_____
17.		A Controlling Shareholder or Relative does <u>not</u> serve as CEO or a Senior Executive of the Company, other than as a director. ☐N/A (there is no controlling shareholder of the Company).	√	

[37] In a Bond Company – approval pursuant to Section 121(d) of the Companies Law.

AUDIT COMMITTEE

				Correct	Incorrect
18.		The following did not serve on the Audit Committee during the Reporting Year -		_____	_____
		a.	The Controlling Shareholder or their relative. □N/A (there is no controlling shareholder of the Company).	√	
		b.	Chairman of the Board	√	
		c.	A director employed by the Company or by the Controlling Shareholder of the Company or by a company controlled thereby.	√	
		d.	A director providing the Company or the Controlling Shareholder of the Company or a company controlled thereby with services on a permanent basis.	√	
		e.	A director whose main income is from the Controlling Shareholder. □N/A (there is no controlling shareholder of the Company).	√	
19.		No person who is forbidden to serve on the Audit Committee, including a Controlling Shareholder or Relative thereof, has been present in meetings of the Audit Committee during the Reporting Year, other than pursuant to the provisions of Section 115(e) of the Companies Law.		√	
20.		The legal quorum for a discussion and for passing resolutions in all meetings of the Audit Committee occurring during the Reporting Year was the majority of the members of the Committee, while the majority present was Independent Directors, and at least one was an External Director. If your answer is "incorrect" – state the rate of meetings in which this requirement, as stated, was not met: _____.		√	
21.	The Audit Committee held, during the Reporting Year, at least one meeting in the presence of the Internal Auditor and Auditing Accountant and without the presence of the executives of the Company			√	

	who are not members of the Committee, regarding deficiencies in the business management of the Company. **Regarding this question, see note at the end of the questionnaire.**		
22.	In all meetings of the Audit Committee in which person were present who were not permitted to be members of the Committee, the foregoing was approved by the Chairman of the Committee and/or at the request of the Committee (regarding the legal consultant and the Company's secretary which is not a Controlling Shareholder of Relative thereof).	√	
23.	In the Reporting Year, arrangements were in force that were determined by the Audit Committee regarding the manner of handling complaints of employees of the company in connection with deficiencies in the management of its business and the protection that will be provided to employees who complain, as stated.	√	
24.	The Audit Committee (and/or the Committee for the Examination of the Financial Statements) is of the opinion that the scope of work of the Auditing Accountant and his wages in relation to the financial statements in the Reporting Year were appropriate for the performance of proper audit and review work.	√	

FUNCTIONS OF THE COMMITTEE FOR THE REVIEW OF THE FINANCIAL STATEMENTS (HEREINAFTER – THE COMMITTEE) IN ITS PRELIMINARY WORK FOR THE APPROVAL OF THE FINANCIAL STATEMENTS

			Correct	**Incorrect**
25.	a.	State the period of time (in days) that the Board of Directors determined as the reasonable timeframe for the delivery of recommendations of the Committee prior to the meetings of the Board in which the Financial Statements were approved: **2**.	_____	_____
	b.	The number of days that actually transpired between the delivery of the recommendations to the Board and the date of the discussion approving the Financial Statements: First quarterly report: **2 business days**.	_____	_____

		Second quarterly report: **2 business days**. Third quarterly report: **2 business days**. Annual report: **2 business days**.		
	c.	The number of days that actually transpired between the delivery of the draft financial statements to the Board and the date of the discussion approving the Financial Statements: First quarterly report: **5 business days**. Second quarterly report: **5 business days**. Third quarterly report: **5 business days**. Annual report: **5 business days**.		
26.	The Auditing Accountant of the Company attended all meetings of the Committee and the Board of Directors in which the Financial Statements of the Company that relate to the periods included in the Reporting Year were discussed. If your answer is "Incorrect," please state the participation rate: ______		√	
27.	During each Reporting Year and until the publication of the annual report, all of the conditions detailed below were met by the Committee:		_____	_____
	a.	The number of its members was not less than three (on the date of the Committee discussion and the approval of the Financial Statements, as stated).	√	
	b.	All of the conditions set forth in Section 115(b) and (c) of the Companies Law were met in connection therewith (regarding the appointment of members of the Audit Committee).	√	
	c.	The Chairman of the Committee is an External Director.	√	
	d.	All of its members are directors, and the majority of its members are Independent Directors.	√	
	e.	All of its members have the ability to read and understand financial statements, and at least one of the Independent Directors has financial and accounting expertise.	√	
	f.	The members of the Committee have provided a declaration prior to their appointment.	√	

	g.	The legal quorum for discussion and passing resolutions in the Committee was the majority of its members, provided that the majority present were Independent Directors and include at least one External Director.	√	
	If your answer is "incorrect" regarding one or more of the subsections of this question, do state in regards to which report (annual/quarterly) the condition was not met as well as the condition that was not met: ______.		_____	_____

Remuneration Committee

				Correct	Incorrect
28.		The Committee numbered, in the Reporting Year, at least three members, and the majority was comprised of External Directors (on the date of the discussion in the Committee). ☐N/A (no discussion was held).		√	
29.		The terms of service and employment of each of the members of the Remuneration Committee during the Reporting Year are in accordance with the Companies Regulations (Rules Regarding Compensation and Expenses for an External Director), 5760-2000.		√	
30.		The following did not serve on the Remuneration Committee during the Reporting Year -		_____	_____
		a.	The Controlling Shareholder or their relative. ☐N/A (there is no controlling shareholder of the Company).	√	
		b.	Chairman of the Board	√	
		c.	A director employed by the Company or by the Controlling Shareholder of the Company or by a company controlled thereby.	√	
		d.	A director providing the Company or a Controlling Shareholder of the Company or a	√	

			company controlled thereby with services on a permanent basis.		
		e.	A director whose main income is from a Controlling Shareholder. □N/A (there is no controlling shareholder of the Company).	√	
31.		Neither a controlling shareholder nor their relative were present during the Reporting Year in meetings of the Remuneration Committee, unless the chairman of the Committee determined that one of them was required for the presentation of a certain matter.		√	
32.	The Remuneration Committee and board of directors did not use their authorities under Sections 267A(c), 272(c)(3) and 272(c1)(1)(c) to approve a transaction or remuneration policy, despite the objection of the general meeting. If your answer is “Incorrect,” please state - The type of transaction approved, as stated: ____________ The number of times in which use was made of this authority in the Reporting Year: _____			√	

Internal Auditor			
		Correct	**Incorrect**
33.	The Chairman of the Board of Directors or CEO of the Company is the organizational supervisor over the Internal Auditor of the Company.	√	
34.	The Chairman of the Board of Directors or the Audit Committee has approved the work plan in the Reporting Year. In addition, the subjects of the audit in which the internal Auditor engaged during the Reporting Year will be listed: **<u>In 2016, a wide variety of subjects were examined including:</u>** Preparations for crisis scenarios, the Company’s representatives abroad, the Company’s posts	√	

	abroad, procurement, information security, computerization, club operations, upkeep, security, clearance, inventory management, human resources, interested party transactions, subsidiaries and more.		
35.	Scope of the employment of the Internal Auditor in the Reporting Year (in hours[38]): **16,000**.	_____	_____
	In the Reporting Year, a discussion was held (in the Audit Committee or in the Board of Directors) as to the findings of the Internal Auditor.	√	
36.	The Internal Auditor is not an interested party in the company, relative, auditing accountant or representative thereof, and has no material business relationship with the Company, its Controlling Shareholder, a relative thereof, or companies under their control.	√	

TRANSACTIONS WITH INTERESTED PARTIES			
		Correct	**Incorrect**
37.	The Controlling Shareholder or a Relative thereof (including a company under its control) are not employed by the Company and do not provide management services thereto. If your answer is "incorrect" (meaning, the Controlling Shareholder or a Relative is employed by the Company or provides management services thereto), then state – - The number of relatives (including the Controlling Shareholder) employed by the Company (including companies under their control and/or via management companies): **3**. - Were the employment agreements and/or management services agreements, as stated, approved by the lawful organs: x Yes		√

[38]Including working hours invested in investee corporations and audits outside of Israel, as applicable.

	☐No ☐N/A (there is no controlling shareholder of the Company). ________. **Regarding this question, see note at the end of the questionnaire.**		
38.	To the best of the Company's knowledge, the Controlling Shareholder does not have additional businesses in the field of the Company's business (in one or more field). If your answer is "incorrect" – please state whether an arrangement was determined to delineate operations between the Company and the Controlling Shareholder thereof: ☐Yes ☐No ☐N/A (there is no controlling shareholder of the Company).	√	

<u>**Notes**</u>**:**

Note to Question No. 6: In 2016, there were 21 Board meetings, in 6 of which Mr. Nimrod Borovitz was asked to present various topics relevant to his role in the Company.

Until December 31, 2016, Nimrod was employed in the role of head of the Business Development, Long-Term Planning and Equipment section, and starting January 1, 2017, serves as the Company's Strategy, Aircraft Equipment and Business Development manager.

Note to Question No. 11(a): The answer to Question No. 11(a) presents information only in respect of the number of Board of Director's meetings, not including the Board committees.

Note to Question No. 21: A discussion was held by the Company Auditor for the purpose of presenting shortcomings in the Company's business management.

Note to Question No. 37: The daughter-in-law of Ms. Sofia Kimerling, who is considered a controlling shareholder in the Company, began her employment in the Company as a stewardess (in 2010) prior to becoming a relative of the controlling shareholder (in 2015). Since becoming a relative of the controlling shareholder, she has spent some 10 months on maternity leave and unpaid leave, from which she returned on November 1, 2016. On February 28, 2017, she once again embarked on unpaid leave, until April, 2017; starting from this date, subject to the approvals of the authorized Company organs, Tamam Aircraft Food Industries (Ben Gurion Airport) Ltd. (a company held 100% by the Company) intends to employ her.

Amikam Cohen, Chairman of the Board: ___________________

Prof. Joshua (Shuki) Shemer, Chairman of the Audit and Remuneration Committee: _____________

Prof. Joshua (Shuki) Shemer, Chairman of the Committee for Examining the Financial Statements (the Balance Sheet Committee): _____________

Signature Date: March 21, 2017