Q2
2018

PAZ OIL COMPANY LTD.
Second Quarter 2018
Financial Results

Disclaimer

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PAZ OIL COMPANY LTD.

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A Director's Report on the State of the Company's Affairs

Report of the Board of Directors on the State of Affairs of the Corporation for the Period of Six Months ended June 30, 2018

We are pleased to present the report of the Board of Directors of Paz Oil Company Ltd. ("**Paz**" or "**the Company**") and the consolidation of the Group companies ("**the Paz Group**" or "**the Group**") for the period of six months ended June 30, 2018 ("**the Reporting Period**"), prepared in accordance with the Israeli Securities Regulations (Periodic and Immediate Reports), 1970.

Part One - Explanations of the Board of Directors regarding the Business Affairs of the Corporation

1. The corporation and its business environment

1.1 For details of the Company's organizational structure, see paragraph 1.1.1 to the Chapter of the Description of the Company's Business to the Periodic Report for 2017 ("**the Periodic Report**").

1.2 The global geopolitical and security situation has a direct and material impact on the economic situation, the import of crude oil into Israel, global prices of oil and oil distillates and the refining margins.

From the end of 2016 through the end of 2017 there was a trend of improvement in the refining margins but towards the end of 2017 this trend was reversed by an erosion in the refining margins which continued in the first half of 2018. See more information in paragraph 3.3.4 below.

In H1 2018 and particularly in Q2 2018, the price per oil barrel experienced a growth trend. The price per oil barrel was approximately \$ 67 at the beginning of 2018 compared to approximately \$ 78 at the end of the second quarter of 2018. The minimum price in the Reporting Period was approximately \$ 62 a barrel and the maximum price was about \$ 80 a barrel. The median barrel price was approximately \$ 71 in the Reporting Period and approximately \$ 74 in Q2 2018.

The market structure in the Reporting Period was in backwardation, in which the immediate supply price exceeds the future price. This position arises, among others, from the pricing of the risk level in the immediate time range due to geopolitical tension when there is no real physical shortage of oil and no such shortage is expected from a forward-looking perspective.

The backwardation market structure caused the Company to incur expenses from inventory hedges and adversely affected the refining margin. Moreover, the markup in oil prices per barrel and premiums impaired Paz Ashdod's refining margins. The mixed trend in product margins was expressed in the increase in diesel oil and jet fuel margins which compensated for the decrease in gasoline margins.

For additional data regarding the prices per barrel of Brent oil and the refining margin per barrel, see paragraph 3.3.4 below.

For information of impairment of inventories, see paragraphs 3.3.6 and 3.3.7 below.

1.3 The Company faces the challenges arising from the economic events in Israel and abroad from a position of business and financial strength, which is reflected in most of its activities:

1.3.1 The variety of the Company's activities in the areas of energy, industry and services, and the natural vertical synergy of all of Paz's value and supply chain, from the import, refining and distribution of crude oil and the production and sale of electricity by the Refining and Logistics Division ("**the Refining Division**" or "**Paz-Refining**" or "**the Refining Segment**" or "**Paz Ashdod**") through the marketing of oil distillates by the Retail and Wholesale Division ("**the R&W Division**" or "**Paz-R&W**" or "**the R&W Segment**") and the Industries and Services Division ("**the Industries Division**" or "**Paz-Industries**" or "**the Industries Segment**"), while taking into account the consolidated profitability of the Group, spreading out the risks of the Company and providing it a position of relative advantage.

1.3.2 The high level of complexity of the Ashdod Refinery that is operated by Paz Ashdod ("**the Ashdod Refinery**") allows manufacturing an optimal product mix that leans toward light distillates (gasoline and naphtha) and intermediate distillates, marketing distillates to various markets, expanding Paz Ashdod's operational flexibility and saving raw material costs. All these may reduce the negative impact on the profitability of the Company at times of low margins around the world. The information of the potential impairment of the Company's profits represents forward-looking information, as this term is defined in the Israeli Securities Law, which may not materialize or may materialize in a significantly different manner.

On April 20, 2017, Paz Ashdod began the periodic renovation of the Refinery's production facilities which is performed every 4-5 years ("**the periodic renovation**"). Due to the sanctions initiated by Paz Ashdod's employees, the return to full operation of Paz Ashdod's Refinery's production facilities and the manufacture of operational products took place in the first week of July 2017.

As a result of the shutdown of the Refinery's production facilities for the periodic renovation and the employees' sanctions, the refining quotas were reduced, which led to the subsequent decrease in gross profit and operating income. The periodic renovation also had a material impact on the Company's operating income in Q2 2017.

1.3.3 The Company acts in conformity with the financial policies established by the Company's Board according to market terms in order to create hedges against market exposures, including currency exposures and exposures to commodities/inventory and occasionally exposure to the refining margin. However, the risk from changes in the prices of crude oil and of oil distillates cannot be fully hedged. See further details in paragraph 3.3.2 below and in Note 30 to the financial statements as of December 31, 2017.

1.3.4 The Company's cautious financial policy is also reflected in its debt structure. The Company has no major debts to holders of debentures which mature before May 2019. In order to prepare for the expected repayment of debentures (series C) in May 2019, the Company placed an amount of NIS 2,886 million in bank deposits, thereby minimizing the amount that will be needed for said repayment to a mere NIS 100 million. See also paragraph 5 below.

The Group's average nominal adjusted interest rate on its financial liabilities in the Reporting Period was about 3.1% per annum.

1.3.5 The Company has been taking steps to maximize its proceeds from the disposal of real estate properties that are not at the core of its business.

In this context, the Company has been promoting transactions for selling its rights to the three following properties in Tel-Aviv in the coming 24 months:

1. Paz Salame on Salame Road - promoting building rights in the context of a detailed plan recommended for deposit by the local committee covering an area of some 20,000 sq. m. for employment, 5,800 sq. m. for retail and 24,000 sq. m. for residence. Paz's share of the project's building rights may range between 15% and 17%.

2. Paz Ben Zvi on Ben Zvi Road - the property allows approved building rights of about 7,800 sq. m. for employment and 1,600 sq. m. for retail alongside a filling station.

3. Paz Abu Kabir on Herzl Street - the property allows approved building rights of about 5,500 sq. m. for employment, 800 sq. m. for retail and 440 sq. m. for a sports center alongside a filling station.

Based on valuations prepared by external appraisers, assuming the deposited building plans are approved as is, the aggregate value of the Company's rights in the three properties mentioned above in the context of a cash transaction approximates NIS 100 million. Should the Company opt for a business combination, the consideration and the post-tax profit are expected to significantly increase both as a result of the sale of the building products and as a result of the lease of the properties as income-producing real estate to be carried over the years, all subject to the prevailing market terms as they will be at that time.

The Company estimates that insofar as all the three above properties are sold in cash transactions, they will yield an aggregate post-tax profit of approximately NIS 45 million.

It should be noted that the Company has yet to decide which course of action to take for disposing of each property - whether by selling the rights for cash or in a business combination - and the Company's decision will be made separately for each property based on offers accepted, the risk inherent in the transaction, the required expenses and etc. There is no certainty that the divestiture of the property rights, in whole or in part, will be completed.

It should be noted that the above information regarding the valuations and expected profit from the sale of the three properties represents forward-looking information, as this term is defined in the Israeli Securities Law, 1968, whose actual materialization might differ from the Company's expectations, among others, due to changes in market conditions and/or deterioration of the economic situation and value of properties in Israel and/or deterioration of the Israeli security situation and/or regulatory and legislative amendments and/or economic developments in the Israeli market in this sector and/or the Company's decisions.

In the Reporting Period and in the course of 2017, no material real estate properties were sold.

See more details of the Company's plan for real estate profit maximization in paragraph 6.10.1 to the Periodic Report.

2. Significant events during and after the Reporting Period

2.1 See details of the exercise of a call option by Shufersal Ltd. to purchase the Company's interests in Shufersal Finance Limited Partnership and in the general partner, Shufersal Finance Management Ltd., in Note 10.2 to the financial statements as of December 31, 2017 and in paragraph 3.20 to the Periodic Report.

It should be noted that in March 2018, the Company received an amount of approximately NIS 117 million of the total of NIS 146.5 million which reflects the consideration for the sale of the Company's interests as above. The remaining consideration is expected to be received by the end of 2018. See more information in paragraph 3.20 to the update to the Periodic Report.

2.2 See details of the Price Committee's resolution regarding the marketing margin and the effect of said resolution on the Company's operating results in paragraph 3.18.8.3 to the update to the Periodic Report.

2.3 See details of raising debentures (series G) by way of series expansion in Note 6.3 to the financial statements for the second quarter of 2017 and in paragraph 5.1 below.

2.4 See details of business efficiency measures adopted by the Company in July 2018 in paragraph 6.1 to the update to the description of the corporation's business affairs.

3. Operating results

3.1 **Following are condensed consolidated statements of profit or loss for accounting purposes and on an adjusted basis** (adjusted for certain effects as defined in paragraphs 3.3.2 and 3.5-3.10 below, so as to present the current income of the Group without the aforesaid effects ("**the adjusted income**")):

3.1.1 **Condensed reported profit or loss (NIS in millions)**:

	Total for the period 1-6/2018	**Q2/2018**	**Q1/2018**	**Total 2017**	**Q4/2017**	**Q3/2017**	**Q2/2017**	**Q1/2017**	**Total 2016**
Net sales	6,724	3,674	3,050	11,285	3,300	2,803	2,323	2,859	10,885
Cost of sales	5,837	3,210	2,627	9,480	2,839	2,367	1,988	2,286	9,102
Gross profit	**887**	**464**	**423**	**1,805**	**461**	**436**	**335**	**573**	**1,783**
Selling and marketing expenses	474	242	232	935	246	234	226	229	936
General and administrative expenses	73	30	43	191	57	49	41	44	183
Other expenses (income), net	*	(1)	1	13	(7)	3	20	(3)	(92)
Operating income	**340**	**193**	**147**	**666**	**165**	**150**	**48**	**303**	**756**
Financial expenses (income), net	126	79	47	(66)	(48)	32	(17)	(33)	58
Income before income tax	214	114	100	732	213	118	65	336	698
Income tax expense	47	24	23	157	43	28	19	67	150
Net income	**167**	**90**	**77**	**575**	**170**	**90**	**46**	**269**	**548**
Attributable to equity holders of the Company	166	90	76	572	169	90	45	268	545
Attributable to non-controlling interests	1	-	1	3	1	-	1	1	3

* Represents an amount lower than NIS 1 million.

3.1.2 **Condensed reported interim operating income (loss) according to operating segments (NIS in millions):**

	Total for the period 1-6/2018	Q2/2018	Q1/2018	Total 2017	Q4/2017	Q3/2017	Q2/2017	Q1/2017	Total 2016
Paz-R&W	206	107	99	415	94	122	109	90	420
Paz-Industries	99	33	66	206	48	42	40	76	269
Paz-Refining	65	60	5	144	52	13	(80)	159	100
Unallocated expenses	(30)	(7)	(23)	(99)	(29)	(27)	(21)	(22)	(33)
Total reported operating income	**340**	**193**	**147**	**666**	**165**	**150**	**48**	**303**	**756**
Total reported EBITDA	**519**	**283**	**236**	**1,020**	**257**	**239**	**133**	**391**	**1,141**
Total reported net income attributable to equity holders of the Company	**166**	**90**	**76**	**572**	**169**	**90**	**45**	**268**	**545**

3.1.3 **Condensed reported interim gross profit (loss) according to operating segments (NIS in millions):**

	Total for the period 1-6/2018	Q2/2018	Q1/2018	Total 2017	Q4/2017	Q3/2017	Q2/2017	Q1/2017	Total 2016
Paz-R&W	561	290	271	1,130	281	303	285	261	1,118
Paz-Industries	228	96	132	464	117	103	103	141	498
Paz-Refining	99	79	20	214	64	31	(53)	172	168
Intercompany transactions	(1)	(1)	-	(3)	(1)	(1)	-	(1)	(1)
Total reported gross profit	**887**	**464**	**423**	**1,805**	**461**	**436**	**335**	**573**	**1,783**

3.1.4 **Condensed adjusted profit or loss (NIS in millions):**

	Total for the period 1-6/2018	Q2/2018	Q1/2018	Total 2017	Q4/2017	Q3/2017	Q2/2017	Q1/2017	Total 2016
Net sales	6,724	3,674	3,050	11,285	3,300	2,803	2,323	2,859	10,885
Cost of sales	5,854	3,221	2,633	9,467	2,862	2,272	1,962	2,371	9,009
Gross profit	**870**	**453**	**417**	**1,818**	**438**	**531**	**361**	**488**	**1,876**
Selling and marketing expenses	474	242	232	935	246	234	226	229	936
General and administrative expenses	73	30	43	191	57	49	41	44	183
Other expenses (income), net	*	(1)	1	13	(7)	3	20	(3)	(92)
Operating income	**323**	**182**	**141**	**679**	**142**	**245**	**74**	**218**	**849**
Financial expenses (income), net	53	33	20	36	(33)	24	22	23	58
Income before income tax	**270**	**149**	**121**	**643**	**175**	**221**	**52**	**195**	**791**
Income tax expense	56	30	26	143	37	45	18	43	187
Net income	**214**	**119**	**95**	**500**	**138**	**176**	**34**	**152**	**604**
Attributable to equity holders of the Company	213	119	94	497	137	176	33	151	601
Attributable to non-controlling interests	1	-	1	3	1	-	1	1	3

* Represents an amount lower than NIS 1 million.

3.1.5 Condensed adjusted interim operating income (loss) according to operating segments (NIS in millions):

	Total for the period 1-6/2018	Q2/2018	Q1/2018	Total 2017	Q4/2017	Q3/2017	Q2/2017	Q1/2017	Total 2016
Paz-R&W	206	107	99	415	94	122	109	90	420
Paz-Industries	99	33	66	206	48	42	40	76	269
Paz-Refining	48	49	(1)	157	29	108	(54)	74	193
Unallocated expenses	(30)	(7)	(23)	(99)	(29)	(27)	(21)	(22)	(33)
Total adjusted operating income	**323**	**182**	**141**	**679**	**142**	**245**	**74**	**218**	**849**
Total adjusted EBITDA	**502**	**272**	**230**	**1,033**	**234**	**334**	**159**	**306**	**1,234**
Total adjusted net income attributable to equity holders of the Company	**213**	**119**	**94**	**497**	**137**	**176**	**33**	**151**	**601**

3.1.6 Condensed adjusted interim gross profit (loss) according to operating segments (NIS in millions):

	Total for the period 1-6/2018	Q2/2018	Q1/2018	Total 2017	Q4/2017	Q3/2017	Q2/2017	Q1/2017	Total 2016
Paz-R&W	561	290	271	1,130	281	303	285	261	1,118
Paz-Industries	228	96	132	464	117	103	103	141	498
Paz-Refining	82	68	14	227	41	126	(27)	87	261
Intercompany transactions	(1)	(1)	-	(3)	(1)	(1)	-	(1)	(1)
Total adjusted gross profit	**870**	**453**	**417**	**1,818**	**438**	**531**	**361**	**488**	**1,876**

3.2 Revenues from sales and services

3.2.1 Sales less government levies ("**net sales**") in H1 2018 amounted to approximately NIS 6,724 million, compared with approximately NIS 5,182 million in H1 2017, an increase of approximately NIS 1,542 million or about 30%.

Net sales in Q2 2018 amounted to approximately NIS 3,674 million, compared with approximately NIS 2,323 million in Q2 2017, an increase of approximately NIS 1,351 million or about 58%.

The increase in net sales in the reporting periods compared with the corresponding periods of last year mainly arises from the periodic renovation executed last year in the Ashdod Refinery which led to a decrease in export sales by Paz-Refining in the Q2 2017 and the increase in the price of an oil barrel between the periods.

3.2.2 Net sales of Paz-R&W amounted to approximately NIS 3,744 million in H1 2018, compared with approximately NIS 3,260 million in H1 2017, an increase of approximately NIS 484 million or about 15%.

The increase in net sales of Paz-R&W in the Reporting Period compared to the corresponding period of 2017 mainly arises from the increase in the prices of fuels which was partly offset by the decrease in quantities sold to the Palestinian Authority.

Net sales of Paz-R&W in Q2 2018 amounted to approximately NIS 1,990 million, compared with approximately NIS 1,567 million in Q2 2017, an increase of approximately NIS 423 million or about 27%.

The increase in net sales of Paz-R&W in Q2 2018 compared with Q2 2017 mainly arises from the increase in fuel prices and the increase in quantities sold.

The sales turnover of the Yellow convenience stores (including sales through concessionaires) in H1 2018 amounted to approximately NIS 434 million, compared with approximately NIS 403 million in H1 2017, an increase of about 8%, mainly due to the increase in the number of transactions.

3.2.3 Net sales of Paz-Industries in H1 2018 amounted to approximately NIS 792 million, compared with approximately NIS 805 million in H1 2017, a decrease of approximately NIS 13 million or about 2%.

The decrease in net sales of Paz-Industries in H1 2018 compared to H1 2017 is mainly due to the decrease in quantities sold in Pazgas as a result of a relatively warm winter, which was partly offset by the quantitative increase in sales of Pazkar and Paz Aviation.

Net sales of Paz-Industries in Q2 2018 amounted to approximately NIS 357 million, compared with approximately NIS 329 million in Q2 2017, an increase of approximately NIS 28 million or about 9%.

The increase in net sales of Paz-Industries in Q2 2018 compared with Q2 2017 mainly arises from the increase in quantities sold by all the segment's companies.

3.2.4 Net sales of Paz-Refining in H1 2018 amounted to approximately NIS 4,990 million, compared with approximately NIS 3,489 million in H1 2017, an increase of approximately NIS 1,501 million or about 43%.

The increase in net sales of Paz-Refining in the Reporting Period compared to the corresponding period of 2017 arises mainly from the periodic renovation executed last year in the Ashdod Refinery which led to a decrease in export sales in the Q2 2017 and the increase in the price of an oil barrel between the periods.

Net sales of Paz-Refining in Q2 2018 amounted to approximately NIS 2,810 million, compared with approximately NIS 1,487 million in Q2 2017, an increase of approximately NIS 1,323 million or about 89%.

The increase in net sales of Paz-Refining in Q2 2018 compared with Q2 2017 mainly arises from the periodic renovation executed last year in the Ashdod Refinery which led to a decrease in export sales in the Q2 2017 and the increase in the price of an oil barrel between the quarters.

3.3 **Gross profit**

3.3.1 Reported gross profit in H1 2018 amounted to approximately NIS 887 million, compared with approximately NIS 908 million in H1 2017, a decrease of approximately NIS 21 million or about 2%.

The decrease in reported consolidated gross profit mainly derives from a decrease in the reported gross profit of Paz-Refining, mainly due to the erosion of the refining margin and the devaluation of the exchange rate in the Reporting Period as opposed to the corresponding period of last year, and from income from timing differences in respect of inventory hedges recorded in the corresponding period of 2017 compared to expenses in respect of inventory hedges recorded in the Reporting Period. The effects of these factors superseded the effect of the increase in profits as a result of the periodic renovation executed in Q2 2017.

Moreover, the decrease in profit also arises from the decrease in the gross profit of Paz-Industries which was partly offset by the increase in profits of Paz-R&W.

Reported gross profit in Q2 2018 amounted to approximately NIS 464 million, compared with approximately NIS 335 million in Q2 2017, an increase of approximately NIS 129 million or about 38%.

The increase in reported gross profit in Q2 2018 compared with Q2 2017 mainly arises from the periodic renovation executed in the Refinery in 2017 which resulted in reduced sales and a decrease in the gross profit of Paz-Refining in Q2 2017.

3.3.2 Adjusted gross profit in H1 2018 amounted to approximately NIS 870 million, compared with approximately NIS 849 million in H1 2017, an increase of approximately NIS 21 million or about 2%.

The increase in adjusted gross profit in H1 2018 as opposed to H1 2017 is mainly due to the increase in the gross profit of Paz-Refining and Paz-R&W, which was partly offset by the decrease in the gross profit of Paz-Industries.

Adjusted gross profit in Q2 2018 amounted to approximately NIS 453 million, compared with approximately NIS 361 million in Q2 2017, an increase of approximately NIS 92 million or about 25%.

The increase in adjusted gross profit in Q2 2018 as opposed to Q2 2017 is mainly due to the periodic renovation carried out in the Refinery in 2017 which led to reduced sales and a decrease in the gross profit of Paz-Refining in Q2 2017. The increase in oil barrel prices, the increase in premiums and the cost of inventory maintenance all adversely affected the refining margins. The mixed trend in product margins was expressed by the increase in diesel oil and jet fuel margins which compensated for the decrease in the gasoline margin, see more information in paragraphs 3.3.3, 3.3.5 and 3.5.5 below.

Adjusted gross profit is the profit after neutralizing the following effects: the timing differences between the date of purchase of crude oil and the date of sale of the products as a result of the economic hedge, unhedged inventory losses/gains, provision for impairment of inventory and the effect of timing differences, the classification of exchange rate differences on credit to finance inventory. These effects are detailed in paragraph 3.5.5 below ("**certain effects**"). According to the Company's policy, the effects of inventory hedges **are not adjusted** when the Company has unhedged inventories.

The Company has a policy of holding unhedged inventories at a scope that does not exceed 250 thousand tons but not more than US$ 300 million. The Company manages the unhedged inventories using a flexible approach based on market terms and forecasts of price fluctuations. See more details of the Company's inventory hedging policy in Note 30.4.3.2 to the financial statements as of December 31, 2017.

As of the financial statement date, the Company has unhedged inventories at a scope of about 79 thousand tons (excluding self-consumption and loss). The change in the prices of crude oil and related products affects the Company's financial statements.

3.3.3 **Paz Ashdod's adjusted refining margin ("the margin")**

The following table presents Paz Ashdod's margin in the Reporting Period. The margin includes the following: the gap between the prices of the crude oil mix and the prices of the distillates; the effects of the market structure; and the revenues from electricity and distribution and is presented less consumption and loss. As customary, the margin does not include variable and other fixed expenses, energy expenses for electricity production (natural gas), depreciation and amortization.

Margin in dollars/Period	Average 1-6/2018	Proforma average 1-6/2017 *	Average Q2 2018	Proforma average Q2 2017 *
Adjusted margin – dollar per ton	54	63	57	59
Adjusted margin – dollar per barrel	7.3	8.5	7.6	7.9

* As for the calculation of the proforma margin, see paragraph 3.3.3 to the Board of Directors' Report for 2017.

3.3.4 For the purpose of comparison to the business environment in which the Company operates, presented below are information of the Ural margin, the KBC margin and the price per barrel of Brent crude oil. These margins, similarly to other margins being published, offer a relevant indication, but do not sufficiently reflect the environment in which Paz Ashdod operates in terms of crude oil mix, composition of products and facility configuration.

Margin in dollars/ Average for the period	Average 1-6/2018	Average 1-6/2017	Change	Average Q2 2018	Average Q2 2017	Change
KBC margin *	4.1	5.6	(27%)	4.7	6.2	(24%)
Ural margin per barrel **	4.2	5.4	(22%)	4.4	5.7	(23%)
Price of crude oil barrel ***	71	52	36%	74	50	48%

* Source of data – IEA website.
** Source of data – Reuters.
*** Source of data – Platts.

Following is the average indicative margin in H1 2018, compared to the average indicative margin in HH1 2017, of the products detailed below [as published by Platts]:

The product ($/barrel)	H1 2018	H1 2017	Change	Q2 2018	Q2 2017	Change
Gasoline (Gasoline 10ppm CIF MED crk)	12.0	11.7	3%	10.6	12.6	(16%)
Diesel oil (ULSD Cif Med/ ICE Brent crk)	14.0	10.9	28%	14.5	10.8	34%
Jet fuel (Jet Cif MED crk)	15.0	10.5	42%	15.0	10.5	42%
Fuel oil (F.01% Fob Med/ICE Brent crk) *	(9.6)	(4.6)	(109%)	(9.7)	(3.9)	(149%)

The margin on the products represents the gap between the consideration from the sale of the products and the cost of the raw materials excluding timing differences.

Following is the breakdown of the Ashdod Refinery's production outputs according to products (in thousands of tons):

	H1 2018	%	H1 2017**	%	Q2 2018	%	Q2 2017**	%
Gasoline and naphtha	875	39%	500	37%	406	38%	83	36%
Diesel oil	625	28%	401	30%	298	28%	65	28%
Jet fuel and kerosene	258	11%	143	11%	118	11%	26	11%
Fuel oil *	381	17%	235	18%	174	17%	49	21%
Other	115	5%	50	4%	61	6%	8	4%
Total production	2,254	100%	1,329	100%	1,057	100%	231	100%
Total sales	2,275		1,864		1,213		821	

* The change in the prices of fuel oil has no significant effect on Paz Ashdod since the prices of fuel oil raw materials Paz Ashdod purchases are linked to the price of fuel oil products which it sells at similar volumes.

** Due to the periodic renovation conducted in Q2 2017, the refining volumes in the corresponding periods of last year are lower by about 1,000 tons.

3.3.5 As a result of the volatility in the prices of crude oil in the Reporting Period, the Company recorded in Q2 2018 expenses in the amount of approximately NIS 114 million in respect of hedges on the crude oil component, unrealized inventory at the end of Q2 2018, and the partial hedge of the refining margin.

Also, in Q2 2018, the Company recorded income totaling approximately NIS 58 million from the realization of the hedged inventory as it was at the end of Q1 2018 against expenses from hedges in Q1 2018.

Although these hedges are considered to be economic hedges, they are not recognized as accounting hedges for accounting purposes in conformity with generally accepted accounting principles.

The decision to enter into inventory hedges is an economic and business decision which is designed to minimize the effect of fluctuations in barrel prices on the Refinery's profits.

Moreover, in Q1 2018, the Company recorded income totaling approximately NIS 58 million from the realization of the hedged inventory as it was at the end of 2017 against expenses from hedges in Q4 2017.

The effect of the inventory hedges in H1 2018 and in Q2 2018 amounted to expenses totaling approximately NIS 56 million, which reduced the gross profit.

The backwardation market structure in H1 2018 impaired the refining margins.

3.3.6 In Q2 2018, the Company recorded income from the reversal of the provision for the write down of inventories to their net realizable value in the amount of approximately NIS 2 million.

3.3.7 In Q2 2018, the Company recorded gains on unhedged inventory totaling approximately NIS 27 million.

3.3.8 The adjusted gross profit margin (out of the Company's income) in H1 2018 was about 13%, compared with about 16% in H1 2017.

3.4 Expenses

Net operating expenses in H1 2018 amounted to approximately NIS 547 million, compared with approximately NIS 557 million in H1 2017, a decrease of approximately NIS 10 million or about 2%.

Net operating expenses in Q2 2018 amounted to approximately NIS 271 million, compared with approximately NIS 287 million in Q2 2017, a decrease of approximately NIS 16 million or about 6%.

The decrease in operating expenses in the reporting periods compared with the corresponding periods of last year mainly arises from non-recurring provisions totaling approximately NIS 21 million in respect of legal proceedings recorded in the corresponding quarter of 2017 in Paz-Refining.

3.5 Operating income

3.5.1 <u>Consolidated</u>

3.5.1.1 Reported operating income in H1 2018 amounted to approximately NIS 340 million, compared with approximately NIS 351 million in H1 2017, a decrease of approximately NIS 11 million or about 3%.

The decrease in reported operating income in H1 2018 compared with H1 2017 arises mainly from the decrease in the reported gross profit of Paz-Industries and Paz-Refining.

Reported operating income in Q2 2018 amounted to approximately NIS 193 million, compared with approximately NIS 48 million in Q2 2017, an increase of approximately NIS 145 million.

The increase in reported operating income in Q2 2018 compared with Q2 2017 arises mainly from the increase in the gross profit of Paz-Refining following the periodic renovation conducted last year which led to a decrease in export sales and in the gross profit of Paz-Refining in Q2 2017.

3.5.1.2 After neutralizing the certain effects, as described in paragraph 3.3 above and in the table in paragraph 3.5.5 below, the adjusted operating income in H1 2018 amounted to approximately NIS 323 million, compared with approximately NIS 292 million in H1 2017, an increase of approximately NIS 31 million or about 11%.

The increase in the adjusted operating income in H1 2018 compared with H1 2017 derives mainly from the increase in the gross profit of Paz-Refining and Paz-R&W, which was partly offset by the decrease in the profit of Paz-Industries.

The adjusted operating income in Q2 2018 amounted to approximately NIS 182 million, compared with approximately NIS 74 million in Q2 2017, an increase of approximately NIS 108 million or about 146%.

The increase in the adjusted operating income in Q2 2018 compared with Q2 2017 derives mainly from the increase in the gross profit of Paz-Refining following the periodic renovation conducted last year which led to a decrease in sales and in the profits of Paz-Refining in Q2 2017.

Following are details regarding the change in operating income according to operating segments:

3.5.2 **Paz-R&W**

The operating income of Paz-R&W in H1 2018 amounted to approximately NIS 206 million, compared with approximately NIS 199 million in H1 2017, an increase of approximately NIS 7 million or about 4%.

The increase in the operating income of Paz-R&W in H1 2018 compared with H1 2017 is mainly a result of the increase in sales in the Yellow convenience stores and the increase in the quantities of fuels sold at the public filling stations despite the ongoing decrease in the gasoline 95 octane marketing margin which began in May 2018.

The operating income of Paz-R&W in Q2 2018 amounted to approximately NIS 107 million, compared with approximately NIS 109 million in Q2 2017, a decrease of approximately NIS 2 million due to the decrease in the gasoline 95 octane marketing margin which began in May 2018 and was mostly offset by the increase in sold quantities, the growth in the number of convenience stores and the expansion of direct marketing.

3.5.3 **Paz-Industries**

The operating income of Paz-Industries in H1 2018 amounted to approximately NIS 99 million, compared with approximately NIS 116 million in H1 2017, a decrease of approximately NIS 17 million or about 15%.

The decrease in operating income in H1 2018 compared with H1 2017 mainly stems from the decrease in quantities sold by Pazgas due to a relatively arid and warm winter season and due to the erosion of the gas margins.

The operating income of Paz-Industries in Q2 2018 amounted to approximately NIS 33 million, compared with approximately NIS 40 million in Q2 2017, a decrease of approximately NIS 7 million or about 17%.

The decrease in operating income in Q2 2018 compared with Q2 2017 mainly stems from the erosion in the margins of Pazgas and Paz Lubricants.

3.5.4 **Paz-Refining**

3.5.4.1 The reported operating income of Paz-Refining in H1 2018 amounted to approximately NIS 65 million, compared with approximately NIS 79 million in H1 2017, a decrease of approximately NIS 14 million.

The decrease in Paz-Refining's reported operating income in H1 2018 compared with H1 2017, despite the periodic renovation conducted in Q2 2017, mainly resulted from the erosion of the refining margins in Q1 2018 compared to Q1 2017 as well as from income from timing differences in respect of inventory hedges recorded in the corresponding period of last year as opposed to expenses on inventory hedges recorded in the Reporting Period.

The reported operating income of Paz-Refining in Q2 2018 amounted to approximately NIS 60 million, compared with reported operating loss of approximately NIS 80 million in Q2 2017, an increase of approximately NIS 140 million.

The increase in Paz-Refining's reported operating income in Q2 2018 compared with Q2 2017 mainly stems from the periodic renovation conducted in the Refinery in 2017 which impaired the profits of Paz-Refining in Q2 2017. As opposed to income from timing differences on inventory hedges recorded in Q2 2017, in Q2 2018, expenses were recorded on inventory hedges.

3.5.4.2 The adjusted operating income of Paz-Refining in H1 2018 amounted to approximately NIS 48 million, compared with adjusted operating income of approximately NIS 20 million in H1 2017, an increase of approximately NIS 28 million.

The adjusted operating income of Paz-Refining in Q2 2018 amounted to approximately NIS 49 million, compared with adjusted operating loss of approximately NIS 54 million in Q2 2017, an increase of approximately NIS 103 million in adjusted operating income.

The increase in the adjusted operating income in the reporting periods compared with the corresponding periods of 2017 mainly arises from the periodic renovation conducted in the Refinery last year which led to a decrease in sales and in the profits of Paz-Refining in Q2 2017. The increase in adjusted operating income was partly offset by the erosion of the refining margins between the periods.

3.5.5 The following table presents the operating income in the reporting periods according to operating segments as compared with the corresponding periods of last year, adjusted for certain effects as explained below, in order to present the Group's current operating income without extraordinary influences ("**the adjusted operating income**"):

The adjustments to operating income, broken down into the Company's operating segments, as detailed in the following table, allow an understanding of the Group's business results, less the effects detailed in the following table. The Company estimates that the income from the Group's business operations without such effects provides a better comparison of the business results of the Group in the Reporting Period compared with the corresponding period of last year and demonstrates the trends in ordinary operations without such effects.

	Paz-R&W	Paz-Industries	Paz-Refining	Unallocated expenses	Total
Item/Segment	**NIS in millions**				
H1 2018					
Reported operating income (loss) in H1 2018	**206**	**99**	**65**	**(30)**	**340**
Expenses (income) from timing differences in respect of inventory hedges (1)	-	-	56	-	56
Classification of financial income (expenses) in respect of inventory credit (2)	-	-	(37)	-	(37)
Expenses (income) from provision for write down of inventory to net realizable value (3)	-	-	-	-	-
Losses (gains) of economically unhedged inventories (4)	-	-	(36)	-	(36)
Adjusted operating income (loss) in H1 2018	**206**	**99**	**48**	**(30)**	**323**
H1 2017					
Reported operating income (loss) in H1 2017	**199**	**116**	**79**	**(43)**	**351**
Expenses (income) from timing differences in respect of inventory hedges (1)	-	-	(226)	-	(226)
Classification of financial income (expenses) in respect of inventory credit (2)	-	-	52	-	52
Expenses (income) from provision for write down of inventory to net realizable value (3)	-	-	92	-	92
Losses (gains) of economically unhedged inventories (4)	-	-	23	-	23
Adjusted operating income (loss) in H1 2017	**199**	**116**	**20**	**(43)**	**292**

	Paz-R&W	Paz-Industries	Paz-Refining	Unallocated expenses	Total
Item/Segment	**NIS in millions**				
Q2 2018					
Reported operating income (loss) in Q2 2018	**107**	**33**	**60**	**(7)**	**193**
Expenses (income) from timing differences in respect of inventory hedges (1)	-	-	56	-	56
Classification of financial income (expenses) in respect of inventory credit (2)	-	-	(38)	-	(38)
Expenses (income) from provision for write down of inventory to net realizable value (3)	-	-	(2)	-	(2)
Losses (gains) of economically unhedged inventories (4)	-	-	(27)	-	(27)
Adjusted operating income (loss) in Q2 2018	**107**	**33**	**49**	**(7)**	**182**
Q2 2017					
Reported operating income (loss) in Q2 2017	**109**	**40**	**(80)**	**(21)**	**48**
Expenses (income) from timing differences in respect of inventory hedges (1)	-	-	(94)	-	(94)
Classification of financial income (expenses) in respect of inventory credit (2)	-	-	23	-	23
Expenses (income) from provision for write down of inventory to net realizable value (3)	-	-	84	-	84
Losses (gains) of economically unhedged inventories (4)	-	-	13	-	13
Adjusted operating income (loss) in Q2 2017	**109**	**40**	**(54)**	**(21)**	**74**

(1) Expenses (income) deriving from hedging transactions on the prices of crude oil, classified as speculative in accordance with IFRS.
(2) Exchange rate differences on liabilities in dollars used to finance inventory, which are included in financial expenses, with the difference in respect of exchange rate changes on the inventory carried to cost of sales.
(3) Provision/reversal of provision for write down of inventory to net realizable value at the end of the period.
(4) Effects of change in crude oil prices and distillates in respect of unhedged inventory activity.

3.6 Operating income before depreciation and amortization (EBITDA)

3.6.1 The reported EBITDA in H1 2018 amounted to approximately NIS 519 million, compared with approximately NIS 524 million in H1 2017, a decrease of approximately NIS 5 million.

The reported EBITDA in Q2 2018 amounted to approximately NIS 283 million, compared with approximately NIS 133 million in Q2 2017, an increase of approximately NIS 150 million or about 113%.

3.6.2 After neutralizing the special effects, the adjusted EBITDA in H1 2018 amounted to approximately NIS 502 million, compared with approximately NIS 465 million in H1 2017, an increase of approximately NIS 37 million or about 8%.

The adjusted EBITDA in Q2 2018 amounted to approximately NIS 272 million, compared with approximately NIS 159 million in Q2 2017, an increase of approximately NIS 113 million or about 71%.

The increase in adjusted EBITDA in the reporting periods compared with the corresponding periods of 2017 mainly arises from the increase in the gross profit of Paz-Refining, as explained above.

3.7 Financial expenses, net

3.7.1 Net financial expenses in H1 2018 amounted to approximately NIS 126 million, compared with net financial income of approximately NIS 50 million in H1 2017, an increase of approximately NIS 176 million in financial expenses.

Net financial expenses in Q2 2018 amounted to approximately NIS 79 million, compared with net financial income of approximately NIS 17 million in Q2 2017, an increase of approximately NIS 96 million in financial expenses.

The increase in reported financial expenses between the periods mainly arises from exchange rate losses on inventory recorded in the reporting periods compared with exchange rate gains recorded in the corresponding periods of last year.

See additional information in the table in paragraph 3.7.2 below.

3.7.2 The adjusted financial expenses in H1 2018, as set out in the table below, amounted to approximately NIS 53 million, compared with approximately NIS 45 million in H1 2017, an increase of approximately NIS 8 million.

The increase in financial expenses in H1 2018 compared with H1 2017 mainly arises from the increase in interest expenses in respect of debentures following the issuance of a new series of debentures (series G) in December 2017.

The adjusted financial expenses in Q2 2018 amounted to approximately NIS 33 million, compared with approximately NIS 22 million in Q2 2017, an increase of approximately NIS 11 million.

The increase in financial expenses in Q2 2018 compared with Q2 2017 mainly arises from the increase in interest expenses in respect of debentures following the issuance of a new series of debentures (series G) in December 2017 and from dividend income recorded in Q2 2017.

The following table presents the financial expenses for the reporting periods compared with the corresponding periods of last year, adjusted for certain effects as explained above.

The Company estimates that the Group's financial expenses without such effects allow a better analysis of the financial expenses in the reporting periods compared with the corresponding periods of last year and give expression to ordinary financial costs:

	H1 2018	H1 2017	Difference
	NIS in millions		
Reported net financial expenses (income)	**126**	**(50)**	**176**
Income (expenses) from exchange rate differences on unrealized inventory (1)	(36)	43	(79)
Classification of financial income (expenses) in respect of inventory credit (2)	(37)	52	(89)
Adjusted financial expenses (income)	**53**	**45**	**8**

	Q2 2018	Q2 2017	Difference
	NIS in millions		
Reported net financial expenses (income)	**79**	**(17)**	**96**
Income (expenses) from exchange rate differences on unrealized inventory (1)	(8)	17	(25)
Classification of financial income (expenses) in respect of inventory credit (2)	(38)	22	(60)
Adjusted financial expenses (income)	**33**	**22**	**11**

(1) The neutralization of exchange rate differences on liabilities relating to unrealized inventory as of the statement of financial position date.

(2) Exchange rate differences on liabilities in dollars for financing inventory which are included in financial expenses whereby the difference in respect of the exchange rate differences on inventory is included in cost of sales.

3.8 The Company's share of the results of companies accounted for at equity

The Group's share of results of companies accounted for at equity is immaterial.

3.9 Income tax

3.9.1 Income tax in H1 2018 amounted to a tax expense of approximately NIS 47 million, compared with approximately NIS 86 million in H1 2017, a decrease of approximately NIS 39 million.

The decrease in the reported tax expense in H1 2018 compared with H1 2017 stems from the decrease in pre-tax income.

Income tax in Q2 2018 amounted to a tax expense of approximately NIS 24 million, compared with approximately NIS 19 million in Q2 2017, an increase of approximately NIS 5 million.

3.9.2 After neutralizing the tax component in respect of the certain effects defined in paragraph 3.3.2 above, the adjusted tax expenses in H1 2018 amounted to approximately NIS 56 million compared with approximately NIS 61 million in H1 2017, a decrease of approximately NIS 5 million, mainly deriving from the decrease in the adjusted pre-tax income between the periods.

The adjusted tax expenses in Q2 2018 amounted to approximately NIS 30 million compared with approximately NIS 18 million in Q2 2017. The increase in adjusted tax expense in Q2 2018 compared with Q2 2017 mainly arises from the increase in the adjusted pre-tax income.

3.10 Net income

3.10.1 Reported net income (excluding non-controlling interests) in H1 2018 amounted to approximately NIS 166 million, compared with reported net income of approximately NIS 313 million in H1 2017, a decrease of approximately NIS 147 million.

The decrease in reported net income in H1 2018 compared with H1 2017 is mainly a result of the increase in financial expenses in respect of inventory hedges, the erosion of the refining margins in Q1 2018 and the effect of the change in the US$ exchange rate.

Reported net income (excluding non-controlling interests) in Q2 2018 amounted to approximately NIS 90 million, compared with reported net income of approximately NIS 45 million in Q2 2017, an increase of approximately NIS 45 million.

The increase in reported net income between the quarters mainly stems from the increase in the gross profit and operating income in view of the periodic renovation conducted in the Refinery in 2017 which reduced export sales and impaired the gross profit of Paz-Refining in Q2 2017.

3.10.2 After neutralizing certain effects as shown in the table below, the adjusted net income in H1 2018 amounted to approximately NIS 213 million compared with approximately NIS 184 million in H1 2017, an increase of approximately NIS 29 million or about 16%.

The adjusted net income in Q2 2018 amounted to approximately NIS 119 million compared with approximately NIS 33 million in Q2 2017, an increase of approximately NIS 86 million or about 261%.

The increase in adjusted net income in the reporting periods compared with the corresponding periods of 2017 mainly derives from the increase in adjusted gross profit of Paz-Refining, as explained above.

The following table presents the net income (excluding non-controlling interests) in the reporting periods compared with the corresponding periods of last year, adjusted for certain effects, in order to present the current net income of the Group without extraordinary effects.

The Company estimates that the Group's net income without such effects, as detailed in the following table, allows a better analysis of the Group's business results in the reporting periods compared with the corresponding periods of last year and demonstrates the trends underlying the Group's operating activities:

NIS millions (net of tax effect)	H1 2018	H1 2017	Difference
Net income in the statement of profit or loss	**166**	**313**	**(147)**
Expenses (income) from timing differences in respect of inventory hedges (1)	47	(190)	237
Expenses (income) in respect of provision for write down of inventory to net realizable value (3)	-	78	(78)
Expenses (income) from exchange rate differences on unrealized inventory (2)	30	(36)	66
Losses (gains) on economically unhedged inventory (4)	(30)	19	(49)
Adjusted net income less the above effects	**213**	**184**	**29**

NIS millions (net of tax effect)	Q2 2018	Q2 2017	Difference
Net income in the statement of profit or loss	**90**	**45**	**45**
Expenses (income) from timing differences in respect of inventory hedges (1)	47	(78)	125
Expenses (income) in respect of provision for write down of inventory to net realizable value (3)	(1)	69	(70)
Expenses (income) from exchange rate differences on unrealized inventory (2)	6	(14)	20
Losses (gains) on economically unhedged inventory (4)	(23)	11	(34)
Adjusted net income less the above effects	**119**	**33**	**86**

Note: the tax effect on the adjustments in H1 2018 was calculated mainly according to the tax rate applicable to Paz Ashdod, which is 16%.

(1) Expenses (income) deriving from hedging transactions on the prices of crude oil, classified as speculative in accordance with IFRS.

(2) The neutralization of exchange rate differences on liabilities relating to unrealized inventory as of the statement of financial position date.

(3) Provision/reversal of provision for impairment of inventory to net realizable value at the end of the period.

(4) Effects of change in crude oil prices and distillates in respect of unhedged inventory activity.

4. <u>Financial position</u>

The Company's consolidated statement of financial position as of June 30, 2018 amounted to approximately NIS 12,631 million, compared with approximately NIS 13,020 million as of December 31, 2017.

4.1 Current assets

4.1.1 Total current assets as of June 30, 2018 amounted to approximately NIS 5,895 million, compared with approximately NIS 4,053 million as of December 31, 2017, an increase of approximately NIS 1,842 million.

The increase in current assets derives mainly from an increase in the balances of short-term bank deposits following reclassification from long-term assets and from an increase in inventory and trade receivable balances, partly offset by the decrease in balances of cash and other investments.

The balance of trade receivables as of June 30, 2018 amounted to approximately NIS 1,766 million, which includes balances of over NIS 350 million with respect to indirect taxes (VAT and excise tax).

4.1.2 Total current assets as of June 30, 2018 constitute about 47% of the total statement of financial position, compared with about 31% of the total statement of financial position as of December 31, 2017.

4.2 Non-current assets

4.2.1 Total non-current assets as of June 30, 2018 amounted to approximately NIS 6,736 million, compared with approximately NIS 8,967 million as of December 31, 2017, a decrease of approximately NIS 2,231 million, mainly arising from the reclassification of short-term bank deposits.

It should be noted that the investments in fixed assets in the Reporting Period consist of the purchase of real estate rights to filling stations.

4.2.2 Total non-current assets as of June 30, 2018 constitute about 53% of the total statement of financial position, compared with about 69% of the total statement of financial position as of December 31, 2017.

4.3 Current liabilities

4.3.1 Current liabilities as of June 30, 2018 amounted to approximately NIS 5,501 million, compared with approximately NIS 2,647 million as of December 31, 2017, an increase of approximately NIS 2,854 million.

The increase in current liabilities derives mainly from the reclassification of current maturities of debentures (series C) which are scheduled for repayment in May 2019 to current liabilities.

Current liabilities as of June 30, 2018 constitute about 43% of the total statement of financial position, compared with about 20% of the total statement of financial position as of December 31, 2017.

4.4 Working capital

Operating working capital (trade receivables and inventory less trade payables) as of June 30, 2018 amounted to approximately NIS 960 million, compared with approximately NIS 572 million as of December 31, 2017, an increase of approximately NIS 388 million which derives mainly from the increase in balances of inventories and trade receivables and the decrease in trade payables.

The accounting working capital (current assets less current liabilities) as of June 30, 2018 amounted to approximately NIS 394 million, compared with approximately NIS 1,406 million as of December 31, 2017.

4.5 Non-current liabilities

4.5.1 Non-current liabilities as of June 30, 2018 amounted to approximately NIS 3,235 million, compared with approximately NIS 6,241 million as of December 31, 2017, a decrease of approximately NIS 3,006 million, mainly arising from the reclassification of current maturities of debentures (series C) which are scheduled for repayment in May 2019 to current liabilities.

4.5.2 Non-current liabilities as of June 30, 2018 constitute about 26% of the total statement of financial position, compared with about 48% of the total statement of financial position as of December 31, 2017.

4.6 Equity

4.6.1 Equity attributable to the equity holders of the Company as of June 30, 2018 amounted to approximately NIS 3,883 million, compared with approximately NIS 4,119 million as of December 31, 2017.

4.6.2 The decrease in equity in the amount of approximately NIS 236 million mostly derives from a dividend paid in the amount of approximately NIS 400 million, offset by the addition to income in H1 2018.

4.6.3 Total equity as of June 30, 2018 constitutes about 31% of the total statement of financial position, compared with about 32% of the total statement of financial position as of December 31, 2017.

Total equity as of June 30, 2018 constitutes about 37% of the total statement of financial position after neutralizing bank deposits held for the repayment of debentures in 2019.

5. <u>Financing sources</u>

5.1 The average scope of loans and debentures, net (less deposits) in H1 2018 amounted to approximately NIS 3,703 million, compared with approximately NIS 4,009 million in H1 2017, a decrease of approximately NIS 306 million, mainly due to the placement of a long-term bank deposit in December 2017, held for the repayment of debentures (series C) in May 2019.

On June 28, 2018, the Company raised debentures (series G) by way of series expansion in a total of approximately NIS 647 million. The net proceeds, less issuance expenses of approximately NIS 641 million, were received after the statement of financial position date on July 1, 2018 and therefore will only be reflected in the financial statements for Q3 2018. The debentures (series G) were rated by S&P Maalot at ilAA(-) with a stable outlook.

The issuance proceeds were used by the Company to extend the scope of available bank deposits by NIS 650 million to an overall amount of approximately NIS 2,886 million to be used by the Company for repaying debentures (series C) in May 2019.

See details of debentures in Appendix A below.

As of June 30, 2018, the scope of short-term bank credit (including current maturities of debentures) amounted to approximately NIS 3,048 million.

In addition, Paz Ashdod has documentary credit with crude oil suppliers for purchases of crude oil which as of June 30, 2018 aggregate to approximately NIS 1,017 million, of which approximately NIS 309 million was not included in suppliers' credit in the books, as opposed to approximately NIS 394 million as of December 31, 2017, of which approximately NIS 218 million was not included in suppliers' credit in the books.

The average scope of documentary credit with crude oil suppliers in the Reporting Period amounted to approximately NIS 321 million of which an average of approximately NIS 121 million was not included in suppliers' credit, as opposed to an average scope of approximately NIS 189 million in 2017 of which an average of approximately NIS 62 million was not included in suppliers' credit.

It should be noted that the increase in the scope of documentary credit arises from engaging with new suppliers and from the markup of crude oil prices.

The Group's net financial debt balance for accounting purposes less cash balances and bank deposits (of approximately NIS 550 million and NIS 2,236 million, respectively) approximates NIS 3,097 million as of the report date.

5.2 As of June 30, 2018 and as of the report date, the Company has non-binding credit facilities from financial institutions.

5.3 The average scope of customer credit in H1 2018 totaled approximately NIS 1.7 billion. The average scope of supplier credit in H1 2018 totaled approximately NIS 1.9 billion.

It should be noted that the Company has an agreement with an oil supplier according to which the credit days can be extended in return for market interest. In the Reporting Period, the credit days with the above oil supplier were extended and an interest-bearing credit agreement was signed with another supplier.

6. Liquidity

6.1 The current ratio as of June 30, 2018 was about 1.1, compared with about 1.5 as of December 31, 2017.

6.2 On March 28, 2018, S&P Maalot reaffirmed the rating of the Company (including the debentures of the Company and of Paz Ashdod) at ilAA (-) with a stable outlook. See more information in an immediate report of March 28, 2018 (TASE reference: 2018-01-025578). On June 27, 2018, S&P Maalot reaffirmed the rating of the Company's debentures (series G) at ilAA- with a stable outlook. See more information in an immediate report of June 27, 2018 (TASE reference: 2018-01-061648).

6.3 Cash flows provided by operating activities in H1 2018 amounted to positive cash flows of approximately NIS 42 million, compared with negative cash flows of approximately NIS 422 million in H1 2017.

Cash flows provided by operating activities in Q2 2018 amounted to positive cash flows of approximately NIS 79 million, compared with negative cash flows of approximately NIS 402 million in Q2 2017.

The main increase in cash flows from operating activities in the reporting periods mainly arises from the increase in the balance of trade payables between the period, since during the renovation period in 2017, the balance of trade payables does not represent normal activity.

6.4 Cash flows used in investing activities in H1 2018 amounted to approximately NIS 28 million, compared with cash flows used in investing activities of approximately NIS 215 million in H1 2017.

The decrease in cash flows used in investing activities in H1 2018 compared with H1 2017 is mainly a result of the consideration received from the sale of the investment in Shufersal Finance and from the repayment of a long-term deposit in respect of employees, which both offset the investments in fixed assets.

Cash flows used in investing activities in Q2 2018 amounted to approximately NIS 67 million, compared with cash flows used in investing activities of approximately NIS 105 million in Q2 2017.

6.5 Cash flows used in financing activities in H1 2018 amounted to approximately NIS 471 million, compared with approximately NIS 106 million in H1 2017. The change is mainly a result of the decrease in short-term credit received from banks to replace suppliers' credit and of the increase in a dividend paid.

Cash flows used in financing activities in Q2 2018 amounted to approximately NIS 445 million, compared with cash flows provided by financing activities of approximately NIS 220 million in Q2 2017. The decrease in cash flows used in financing activities between the quarters is mainly a result of the dividend paid in Q2 2018 and the decrease in short-term bank credit received.

6.6 The balance of cash and cash equivalents as of June 30, 2018 amounted to approximately NIS 550 million, a decrease of approximately NIS 492 million compared with December 31, 2017. In contrast, short-term bank deposits increased by NIS 2,236 million.

It should be noted that after the reporting date, the Company placed an additional amount of approximately NIS 650 million originating mostly from the proceeds from the expansion of debentures (series G) in short-term bank deposits, thereby enhancing the balance of short-term deposits to approximately NIS 2,886 million, designed to finance the scheduled repayment of debentures (series C) in May 2019.

7. Information on sensitivities of instruments to changes in market factors

There has been no material change in the sensitivity analysis compared with the information provided in the Report of the Board of Directors as of December 31, 2017.

Part Two – Corporate Governance Issues

8. The Company's authorized signatories

As of the report date, the Company does not have any independent authorized signatory, as defined in the Securities Law, 1968.

9. The Board of Directors of the Company

9.1 Directors possessing accounting and financial expertise

As of the report date, all members of the Board are directors possessing accounting and financial skills in accordance with the provisions of Section 92(A)(12) of the Companies Law and the Skills Regulations, based on their education and experience. For additional information regarding the experience of these directors, see paragraph 15 (Regulation 26) to Chapter D of the Periodic Report.

9.2 Independent directors

See details of the Company's independent directors in paragraph 15 (Regulation 26) to Chapter D of the Periodic Report and the corporate governance questionnaire in the Chapter D of the Periodic Report.

9.3 **Changes in the Board of Directors of the Company**

In the Reporting Period, there were no changes in the composition of directors in the Company. The changes in the members of the Group's Management are as follows:

On February 1, 2018, Mr. Hagai Zohar terminated his service as CEO of Paz Lubricants and Chemicals and of Pazkar.

On February 1, 2018, Mr. Shmuel Gotshal terminated his service as CEO of Paz Aviation Services and of Paz Aviation Assets.

On February 1, 2018, Mr. Shmuel Gotshal was appointed as CEO of Paz Lubricants and Chemicals and of Pazkar.

On February 1, 2018, Mr. Israel Klepper was appointed as CEO of Paz Aviation Services and of Paz Aviation Assets in addition to serving as VP of Wholesale in the Company.

Ms. Iris Penso, VP and General Counsel in the Company, announced her resignation which will take effect from September 30, 2018.

Part Three – Disclosure Provisions regarding the Corporation's Financial Reporting

10. Critical accounting estimates

10.1 For information of critical accounting estimates, see Note 2.5 to the annual financial statements as of December 31, 2017.

10.2 For data pertaining to a material valuation pursuant to Regulation 8B of the Securities Regulations (Periodic and Immediate Reports), 1970, see Appendix C to the Report of the Board of Directors as of December 31, 2017.

Part Four – Repurchases

11. Repurchase of debentures and shared by the Company

See information of the Company's repurchase plan of debentures (series C-F) in paragraph 15.1 to the Report of the Board of Directors as of December 31, 2017.

Part Five – Designated Disclosure to Debenture Holders

12. Liability certificates

For information regarding the Company's liability certificates - see Appendix A herein.

The Board of Directors of the Company would like to thank the employees and managements of the Group companies for their contribution to the results in the first half of 2018 and for the efforts dedicated by them toward the advancement of the Company.

Yitzhak Ezer – Chairman of the Board	Yona Fogel – CEO

Date: August 26, 2018.

Appendix A – Information Regarding the Liability Certificates of the Corporation

	Date of issue	Name of rating company	Current rating	Total par value as of date of issue (NIS in millions)	Interest type	Nominal interest	Effective interest as of report date	Listed for trade (yes / no)	Interest payment dates	Principal payment dates	Linkage basis	Nominal par value as of 30.6.2018 (NIS in million)	Revalued nominal par value pursuant to indexation terms as of 30.6.2018 (NIS in million)	Carrying amount of debentures as of 3.6.2018 (NIS in million)*	Interest payable accrued as of 30.6.2018 (NIS in million)	Market value as of 30.6.2018 (NIS in millions)
Series C	5/2009 and expanded in 4/2010, 4/2011, 12/2012 and 06/2013	Ma'alot	AA-	3,117	Variable quarterly interest	BoI +2.2%	0.80%	Yes	Four times a year, 30/3, 29/6, 29/9 and 30/12 between 2009 – 2019	May 25, 2019	None	2,976	2,976	2,976	0.2	3,016
Series D	06/2014 and expanded in 2/2016	Ma'alot	AA-	1,445	Variable quarterly interest	BoI +1.65%	1.41%	Yes	Four times a year, 28/2, 31/5, 31/8 and 30/11 between 2014 – 2024	May 31, 2024	None	1,445	1,445	1,447	2.1	1,475
Series E	12/2016	Ma'alot	AA-	408	Semi-annual fixed interest	2.96%	2.10%	Yes	Twice a year, 31/5 and 30/11 between 2017 – 2022	November 30, 2022	None	408	408	409	4.0	424

Appendix A – Information Regarding the Liability Certificates of the Corporation (Cont.)

	Date of issue	Name of rating company	Current rating	Total par value as of date of issue (NIS in millions)	Interest type	Nominal interest	Effective interest as of report date	Listed for trade (yes / no)	Interest payment dates	Principal payment dates	Linkage basis	Nominal par value as of 30.6.2018 (NIS in million)	Revalued nominal par value pursuant to indexation terms as of 30.6.2018 (NIS in million)	Carrying amount of debentures as of 30.6.2018 (NIS in million)*	Interest payable accrued as of 30.6.2018 (NIS in million)	Market value as of 30.6.2018 (NIS in millions)
Series F	12/2016	Ma'alot	AA-	723	CPI-linked semi-annual fixed interest	1.94%	0.89%	Yes	Twice a year, 31/5 and 30/11 between 2017 – 2028	Once a year, November 30 between 2017-2028	CPI for October 2016	662	668	669	1.1	700
Series G **	12/2017	Ma'alot	AA-	400	CPI-linked semi-annual fixed interest	1.23%	1.63%	Yes	Twice a year, 31/5 and 30/11 between 2018 – 2030	Once a year, November 30 between 2020-2030	CPI for October 2017	400	402	403	0.4	390

Appendix A – Information Regarding the Liability Certificates of the Corporation (Cont.)

* Excluding issuance expenses in the amount of approximately NIS 23 million and net premium of approximately NIS 2 million.

** See details of the expansion of the series of debentures (series G) in paragraph 5.1 above.

(1) The trustee for the debentures (Series C) is Reznik Paz-Nevo Trustees 2007 Ltd. , 14 Yad Harutzim, Tel Aviv, Tel: 03-6389200, Fax: 03-6389222, Contact: Adv. Snir Lotan.

(2) The trustee for the debentures (Series D, E, F and G) is Strauss Lazer Trustees (1992) Ltd., 17 Yitzhak Sadeh Street, Tel-Aviv 67775, Tel: 03-6237777, Fax: 03-5613824, Contact: Adv. Ori Lazer.

All of the debentures series outstanding, as detailed in the table above, are material.

As of the report date and during the Reporting Period, the Company is in compliance with all the terms and obligations under the trust deeds and the financial covenants established in the trust deeds of the debentures (series D-G), and no conditions are in place that give rise to cause for the immediate repayment of the debentures.

The Company's (consolidated) net financial debt to CAP ratio, as defined in the deed of trust of the debentures (series D-G) (CAP - equity with the addition of net financial debt) as of June 30, 2018 is 44% (the mandatory ratio is a maximum of 75%-77%).

Regarding the updated rating of the debentures see the Company's immediate report of March 28, 2018 (TASE reference: 2018-01-025578).

On June 27, 2018, S&P Maalot reaffirmed the rating of the Company's debentures (series G) at ilAA- with a stable outlook. See more information in an immediate report of June 27, 2018 (TASE reference: 2018-01-061648).

Following is the history of the rating of the debentures as of their issuance date: November 2009: Negative ilAA; March 2010: Stable ilAA-; August 2011: Negative ilAA-; December 2011: Stable ilA+; July 2013: Negative ilA+; April 2014: Stable ilA+; April 2015: Stable ilAA-; April 2016: Stable ilAA-; November 2016: Stable ilAA-; April 2017: Stable ilAA-; March 2018: Stable ilAA-; June 2018: Stable ilAA-.

B Major Changes and Developments in the Description of the Company's Business

Update to the Description of the Corporation's Business Affairs for the Periodic Report for 2017

Pursuant to Regulation 39a to the Israeli Securities Regulations (Immediate and Periodic Reports), 5730-1970 ("**the Reporting Regulations**"), following is a description of the material changes or developments in the Company's business affairs during Q2 2018 through the date of issuance of this report. These updates are presented herein based on the original order and number of the sections in the Chapter on the Description of the Corporation's Business Affairs in the Company's Periodic Report for 2017 issued on March 18, 2018 (TASE reference: 2018-01-020730) ("**the Periodic Report**"). The terms used in this document are ascribed the same meaning as in the Periodic Report, unless expressly stated otherwise. In certain cases, in order to present a complete picture of the Company's business affairs, the Company might also provide details of changes and developments that are independently immaterial but might assist in understanding the Company's business.

Part 1 - Description of the General Development of the Company's Business

1.1 - The Company's Activity and Description of its Business Development

1.1.5 - Chart of the Companies in the Paz Group

On August 26, 2018, the Company's Board decided to submit a merger offer in connection with the merger of Pazomat a Member of Paz Group Ltd. ("**Pazomat**") (a wholly owned and controlled subsidiary of the Company) into and with the Company. The merger date was determined for December 31, 2018, subject to obtaining the approval of the Israeli Tax Authority ("**the ITA**") for the merger under a tax exemption track. The merger will be conducted in accordance with the provisions of Section 103 in Chapter E2 to the Israeli Income Tax Ordinance (Revised), 1961 ("**the ITO**") and of Chapter One to Part Eight to the Israeli Companies Law, 1999. The Company submitted a tax exempt merger application to the ITA as described above and also submitted the merger outline to the Israeli Registrar of Companies. The merger consists solely of a business restructuring and Pazomat will continue to operate in the context of the Company's operations. See more information in an immediate report of August 26, 2018 (TASE reference: 2018-01-078697).

Part 2 - Other Information

2.2 - General Environment and Effect of External Factors on the Company's Activity

2.2.15 - Hybrid Cars and Plug-in Electric Vehicles (PEVs)

In August 2018, the Ministry of Energy published a call to the public for applying for grants from the Ministry of Energy for setting up PEV charging stations in the context of the Ministry of Energy's functions, in collaboration with other Government ministries, aimed at reducing the use of oil-powered fuels and transitioning to green transportation ("**the document**"). According to the document, the Ministry of Energy plans to issue four calls for assisting in the construction of PEV charging stations in the context of construction grants. Responses to the document may be submitted by September 16, 2018. At this stage, the Company cannot assess the long-term effect of the document.

Part 3 - The Retail and Wholesale Division

3.1 - The Structure of the Division and Changes therein

3.1.11 - Methods of Operating Filling Stations and the Company's Rights therein

3.1.11.2 - Types of Filling Stations from the Viewpoint of Property Rights

(a) Filling Stations Owned by the Company

The west section of National Infrastructure Plan 70A, "Tel-Aviv Metropole Light Rail - the Purple Line", marks a filling station owned by the Company in Ramat Gan as designated for expropriation. It is estimated that the evacuation of the station will be performed in or near the middle of 2019. An expropriation agreement which provides for the evacuation and the compensation to which the Company will be entitled has not yet been signed but the Company predicts that the compensation (whether in the agreement or in a legal proceeding) will cover the entire damage to be sustained by the Company.

The above information regarding the expected compensation for the entire damage that will be caused to the Company represents forward-looking information, as defined in the Israeli Securities Law, whose actual materialization might differ from the Company's expectations as of the date of the Periodic Report, among others, as a result of regulatory requirements and/or court decisions and/or general developments in the relevant sector.

3.2 - Products and Services in the Division

3.2.2.2 - Advanced Services at Yellow Convenience Stores

In April 2018, the Company launched a mobile application which allows its customers to pay for the purchase of fuel from the Company's filling stations and/or for the purchase of products from the Yellow convenience stores.

3.5 - Customers in the Division

3.5.2.2 - The Palestinian Authority

In March 2018, the Palestinian Authority issued a tender requesting offers for the supply of fuels for 2019 through 2020. The Company submitted its offer.

3.18 - Restrictions and Supervision of the Company's Activity in the Division

3.18.6 - Restrictions on the Location of Filling stations

In July 2018, the Israeli Government issued the Petroleum Sector Law (Promoting Competition) (Revised) (Amendment No. 2), 5778-2018 which extends the validity of Section 4 to the Petroleum Sector Law (Promoting Competition), 5754-1994 enacted to impose distance restrictions in regional engagements between filling stations of a single fuel company (in the construction of a filling station or in an exclusivity contract for interurban and other roads) until July 29, 2021.

3.18.8 - Restrictions on the Selling Prices of Oil Products

3.18.8.3(c) - Control of Prices of Products in the Division

On April 30, 2018, the Company was informed of the Ministry of Energy's Price Committee's resolution ("**the Resolution**") and of the publication of the Control of Prices of Commodities and Services Order (Maximum Prices in Filling Stations) (Amendment), 5778-2018 ("**the Order**") both of which stipulate, among others, that the marketing margin per liter of self-service gasoline 95 ("**the marketing margin**") will be approximately NIS 0.556 a liter (excluding VAT) - a decrease of approximately NIS 0.047 a liter (excluding VAT) compared to the marketing margin in effect before the Order was issued; the increment for full-service gasoline 95 will be NIS 0.21 per liter (including VAT) - an increase of approximately NIS 0.01 per liter (including VAT) compared to the increment in effect before the Order was issued; the ex-factory (CIF) price of gasoline 95 will be translated into NIS at the representative exchange rate published by the Bank of Israel on the day before the last two work days before the update, multiplied by a coefficient of 1.009 - instead of the indexation of the marketing margin to the Israeli CPI as was practiced before the publication of the Order; and the marketing margin will be updated based on an input basket as recommended by the Price Committee [according to which, among others, effective from September 1, 2018, an annual coefficient of performance (COP) of 0.39% will be levied (compared to an annual COP of 1% prior the publication of the Order)].

The Price Committee also resolved to examine whether there is need for regulatory amendments governing the nature of control over the gasoline 95 price such as lifting the control over full-service commission, limiting the control over new filling stations, instituting a new control policy for different sections of gasoline prices etc. After reaching a resolution, the matter will be heard before the Price Committee.

The Resolution and the Order are expected to have an adverse effect on the Company's financial results. The Company is planning to take steps to minimize such effect, among others by reducing actual marketing expenses, including cancelling certain discounts, lowering rent and minimizing operating costs.

The effect of the reduction of the marketing margin on the sales of gasoline 95 at the Company's filling stations in a given year, without taking into account the above plan for minimizing the effect of the marketing margin reduction, is estimated at an annual decrease of approximately NIS 35 million in pre-tax income. It should be noted that as per the Company's estimates, the adoption of the above plan has the potential of significantly mitigating the adverse effect of the marketing margin reduction on the Company's financial results.

The above information regarding the potential effect of the marketing margin reduction on the Company's financial results and the possible adoption of a plan for minimizing such effect represents forward-looking information, as defined in the Israeli Securities Law, which might materialize in a different manner than that anticipated by the Company as of the report date, among others, as a result of the steps which the Company intends to take, as above and the degree of their success, additional regulatory amendments or developments in the Israeli economy in general or in the Company's operating segments.

See more information in an immediate report of April 30, 2018 (TASE reference: 2018-01-034344).

3.18.12 - Restrictions on the Company's Activity under the Restrictive Trade Practices Law

3.18.12.4 - Report of the Antitrust Authority on the Inspection of Geographical Competition between Filling Stations

In March 2018, in the context of a hearing proceeding through written submissions, the Company delivered its response to the draft report for public comments issued by the Antitrust Authority regarding geographical competition in filling stations and the connection between market structure and gasoline prices ("**the report**") despite the fact that the Company had not received the entire information, documents and data underlying the report.

In its response, which is supported by both economic and legal opinions, the Company demonstrated a series of material misrepresentations in the preparation of the Antitrust Authority's report, relating to the core data used by the Antitrust Authority, the data analysis process and the empirical findings obtained as a result thereof. The Company also unveiled in its response a series of legal flaws underlying the Antitrust Authority's report, including the argument that the far-reaching conclusions in the report are not legally supported in any manner and that the report's recommendations represent a serious transgression of the Antitrust Authority's authorities, particularly since they seek to nullify the Company's proprietary rights in its filling stations without jurisdiction and in violation of statutes. The Company also presented the flaws underlying the Antitrust Authority's report which derive from the absence of analysis pursuant to the Restrictive Trade Practices Law and the detachment of the recommendations from the economic analysis in the report.

An oral hearing was held for the Company in June 2018. The Antitrust Authority's position in response to the Company's arguments has not yet been received.

3.20 - Collaboration Agreements in the Division

In keeping with the agreement signed between the Company and Shufersal Ltd. ("**Shufersal**") for the acquisition of the Company's interests in Shufersal Finance, Limited Partnership ("**the Partnership**"), in March 2018, Leumi Card Ltd. ("**Leumi Card**") filed a claim against Shufersal and the Company, requesting to receive a series of documents which it argues are needed for examining the exercise of the tag-along option granted to it in the Partnership agreement (signed in 2006 between Shufersal, Leumi Card and the Company) to joint Shufersal in the purchase of the Company's interests in the Partnership. Leumi Card also petitioned for a temporary declaratory relief. The Company responded to Leumi Card's petition for a temporary declaratory relief stating that it has no objection to the disclosure of the above documents (although it does not believe it is legally obligated to do so) and will accept any court decision. Based on its legal counsel, the Company estimates that it will receive the remaining consideration as stipulated in the agreement signed between it and Shufersal by the end of 2018.

Part 4 - The Industries and Services Division

4.11 - Fixed Assets, Land and Installations in the Division

4.11.1.1 - LPG Storage, Filling and Distribution Facilities

The Kiryat Ata facility - the Kiryat Ata facility's fire extinguishing permit was extended until March 19, 2019. The Kiryat Ata facility's toxin permit was extended to June 4, 2019.

The Rishon LeZion facility - the Rishon LeZion facility's toxin permit was extended to April 20, 2019.

4.11.5 - Pazkar Plant

Due to delays in the activity of the company which owns the license for the construction and operation of the natural gas distribution network in Hadera and the valleys region, the Company was informed that the planned date for completing the conversion of the Pazkar plant to LPG-backed production was delayed to the end of the third quarter of 2018.

4.17 - Environmental Protection in the Division Environmental Risks and Ways of Managing Them

4.17.2 - Major Ramifications of the Provisions of the Law on the Company

4.17.2.1 - LPG Marketing Activity

The Kiryat Ata facility's toxin permit was extended to June 4, 2019.

The Rishon LeZion facility's toxin permit was extended to April 20, 2019.

4.17.2.2 - Marketing Activity for Lubricants and Chemicals

The business licenses of Paz Lubricants were extended to December 2018.

4.17.2.6 - The Clean Air Law

As for the deferral of the planned date for the completion of the conversion of the Pazkar plant to LPG-backed production, see paragraph 4.11.5 above.

4.18 - Restrictions and Supervision of the Company's Activity in the Division

4.18.1 - Quality Standards

Paz Lubricants and Pazkar received certification for compliance with Israeli Standard 2015: ISO 9001 in 2018.

Paz Lubricants received certification for compliance with Israeli Standard 2015: ISO 14001 in 2018.

On June 20, 2018, the Public Proclamation of Standards (Official Standard), 5778-2018 was published to pronounce ISO 6294 as an official standard. The standard pertains to quality assurance and operation of aviation fuel (refueling services, fuel terminals and production, fuel storage and distribution) and is effective within 90 days from the date of issuance. Aviation Services has been in compliance with the provisions of ISO 6294 even before it has been pronounced as an official standard.

4.18.6 - The State Economy Arrangements (Legislative Amendments) (Sale of Gas by Refineries and Gas Suppliers), 5770-2009 ("the Gas Allocation Regulations")

The Amendment to the Gas Allocation Regulations issued in May 2018 revises the principles regarding gas allocation distribution, excess gas distribution and allocations underlying transition by large gas customers. The Amendment also adds a section that addresses the transfer of allocations in the transition of home consumers while granting incentives to small suppliers that offer competitive prices. The Amendment does not have a material impact on the Group's financial results.

Part 5 - The Refining and Logistics Division

5.16 - Investments in the Division

Investments in progress

Following a month of trial run, in July 2018, the off-gas recovery (OGR) facility began operating and separating the refinery gas into components (LPG, hydrogen, gasoline etc.). In August 2018, the OGR facility's contribution to production was partial. From September 2018, the OGR facility will begin full gas recovery capacity, contributing between $ 0.4 and $ 0.7 a barrel, among others, as presented by the Company in a presentation on IMO 2020 and Paz Ashdod. See more information in an immediate report of July 11, 2018 (TASE reference: 2018-01-066367).

Additional investments planned by Paz Ashdod

The CAT Cooler - the construction of a CAT Cooler will afford the Company a flexible production mix and adaptability to changing market conditions. The CAT Cooler will allow significant minimization of up to about 70% of fuel oil currently produced by Paz Ashdod, subject to various economic considerations pertaining to fuel oil prices, LSSR (raw material) availability and prices as they will be at the time. The CAT Cooler's operation is expected to improve Paz Ashdod's profits in the first years after IMO 2020 becomes effective by up to about $ 4.5 a barrel. The improvement in the raw material mix and in the energy balance as a result of the catalyst cooler is expected to contribute to Paz Ashdod at least some $ 0.7 a barrel in the long run.

The above information regarding the expected contribution of the OGR facility and of the CAT Cooler to Paz Ashdod's financial results is forward-looking information, as this term is defined in the Israel Securities Law. Its actual materialization may differ from the Company's expectations as they are on the date of this report, among others, due to regulatory amendments and/or changes in production costs and/or changes in the maritime sector and/or general developments in the local economy or in the sectors in which the Company operates and/or the effect of the risk factors to which the Company is exposed.

See more information in an immediate report of July 11, 2018 (TASE reference: 2018-01-066367).

5.17 - Environmental Risks in the Division and Methods of Managing Them

5.17.2.2 - Hazardous Substances Law

In keeping with the warning received by Paz Ashdod in January 2017 from the Ministry of Environmental Protection, in May 2018, Paz Ashdod received notice of the Ministry of Environmental Protection's intention to impose two monetary sanctions on the Company pursuant to the Hazardous Substances Law, 5753-1993 in an aggregate of approximately NIS 1.77 million, for the alleged violation of the terms of Paz Ashdod's poison permit in connection with hazardous substance storage and tagging deficiencies. Paz Ashdod has submitted its position in writing to the Ministry of Environmental Protection in which it presents claims, among others, relating to failures in documenting the alleged violations and misinterpretation of the terms underlying Paz Ashdod's toxin permit.

5.17.2.5 - The Clean Air Law

In keeping with a hearing held for Paz Ashdod in October 2017 at the Ministry of Environmental Protection regarding the alleged violation of the Clean Air Act and Clean Air Regulations (Air Quality Parameters) for irregular benzene values in the environment, in May 2018, Paz Ashdod received the Ministry of Environmental Protection's response which dismisses Paz Ashdod's arguments (disputing the methodology used by the Ministry of Environmental Protection and the violation argument) and also obtained an administrative decree, by virtue of Section 45 to the Clean Air Act, ordering the prevention or minimization of air pollution ("**the decree**"). The decree relies on the alleged irregular environmental benzene values detected on the Ashdod Refinery premises whose source, as per the Ministry of Environmental Protection, is most likely the Refinery's activity. The decree also relies on alleged irregular emission values detected in some of Ashdod Refinery's gas flares. According to the decree, Paz Ashdod is required to map potential sources of benzene emissions during routine and on the dates of irregular findings, install an ongoing emission monitoring system on the Refinery's fences (until the system prescribed by the Ministry of Environmental Protection for frequent air sampling is definitively installed), set up an emergency team for detecting and preventing benzene emissions, report all irregular findings and submit a plan for minimizing benzene emissions. Paz Ashdod applied to the Ministry of Environmental Protection and raised arguments pertaining, among others, to the need for issuing the decree, the decree's proportionality and provisions and the factual background which allegedly attributes the violations to Paz Ashdod.

Moreover, in May 2018, Paz Ashdod was summoned by the Ministry of Environmental Protection for a hearing pursuant to the Clean Air Act for the alleged violation of the provisions of the emission permit issued to Paz Ashdod due to alleged irregular emission values detected in surprise sampling conducted in some of the Refinery's gas flares by the Ministry of Environmental Protection. Paz Ashdod disputes the Ministry of Environmental Protection's findings and will present its position in the hearing held for it.

5.17.2.10 - Permit to Use Radioactive Substances

Paz Ashdod's permit to use a radioactive substance or a product that contains a radioactive substance was extended to June 2019.

5.18 - Restrictions and Supervision of the Company's Activity in the Division

5.18.3.5 - Special Permit to Work during the Weekly Rest and Essential Enterprise Certificate

Paz Ashdod's special permit to work during the weekly rest and essential enterprise certificate were extended to June 2020.

5.18.8 - State Economy Arrangements (Legislative Amendments) (Gas Sales by Refineries and Gas Suppliers) Regulations, 5769-2009 ("the Gas Allocation Regulations")

As discussed in paragraph 4.18.6 above, in May 2018, an amendment to the Gas Allocation Regulations was issued which, among others, imposes on refineries restrictions relating to the quantities of gas that can be supplied by the refineries to related corporations in the event of additional production. The amendment also prescribes various provisions regarding supply to small gas suppliers. See more information in paragraph 4.18.6 above.

5.18.15 - National Master Plan 1/32/D - National LPG Storage Site

In March 2018, Paz Ashdod received the decision of the National Master Planning Committee regarding National Master Plan ("NMP") 1/32/D underlying a national LPG storage site. The decision accepted some of Paz Ashdod's arguments, among others, regarding the impairment of the legally allowed building rights on the LPG storage site; the permitted uses of Paz Ashdod's land that will not house the LPG storage site; the retention of the allowed uses as per the valid plan prior to the approval of the NMP (and as will be amended from time to time); and the location of the national LPG storage site based on the building appendix attached to the NMP. In addition, regarding the other arguments raised by Paz Ashdod, the latter was assured that its building rights will not be impaired and if and insofar as it is decided to erect the site on Paz Ashdod's land, Paz Ashdod will be the performing and operating contractor and any other arrangement will be coordinated with Paz Ashdod. In view of the aforesaid, Paz Ashdod is not expected to sustain any impairment from the NMP.

This information is forward-looking information, as defined in the Securities Law. The actual construction of the national LPG storage site might impair Paz Ashdod's rights, among others due to failure to meet the assurance made to it (including that Paz Ashdod's rights will not be impaired) or any other requirements which might arise and/or new decisions made that impair Paz Ashdod's rights.

Part 6 - Further Information about the Company

6.1 - Human Resources

6.1.2 - Employees Employed by the Paz Group, according to its Divisions

See the Miscellaneous section below for details of corporate efficiency measures adopted by the Company.

6.1.6 - Benefits and the Nature of Employment Agreements

6.1.6.2 - Contracts with Senior Officers and Key Management Personnel

On May 29, 2018, following the approval of the Company's Remuneration Committee, the Company's Board approved the grant of a bonus for 2017 to officers in the Company (other than directors and the CEO) in the maximum amount of 5.44 monthly salaries to each officer in keeping with the Company's remuneration policy.

6.1.7 - Employment Agreements in Paz Ashdod

6.1.7.1 - Collective Agreements

On April 9, 2018, Paz Ashdod was laconically notified by the New General Federation of Workers in Israel ("**the Histadrut**") of the election of three retired Paz Ashdod employee for the Paz Ashdod Refinery Retired Employees' Representation. Based on its legal counsel, Paz Ashdod estimates that the retired employees are part of the bargaining unit for Paz Ashdod's entire employees and as such are bound by the collective agreement signed between Paz Ashdod, Paz Ashdod's workers' committee and the Histadrut and therefore this new employee union has no legal significance or impact on Paz Ashdod (including on any potential employee sanctions or strikes).

6.4 - Financing

6.4.2 - Raising of Debentures in the Company

6.4.2.1 - Debentures

On June 28, 2018, the Company issued debentures (series G) by way of series expansion based on a shelf offering report issued on June 27, 2018 (TASE reference: 2018-01-61852) and based on the Company's shelf prospectus of August 17, 2016 (TASE reference: 2016-01-104116). In total, NIS 659,511,000 par value of debentures (series G) were issued for gross proceeds of NIS 646,980,291. The issuance proceeds were received on July 1, 2018. See more information in an immediate report of July 1, 2018 (TASE reference: 2018-01-062863). The Company placed an amount of NIS 650 million in a deposit that will be used for the repayment of debentures (series C) in May 2019.

6.4.3 - Shelf Prospectus

On August 9, 2018, the Company received the ISA's approval for extending the period for offering securities based on its shelf prospectus until August 16, 2018. See more information in an immediate report of August 9, 2018 (TASE reference: 2018-01-074569).

6.4.9 - The Company's Credit Rating

On March 28, 2018, S&P Maalot reaffirmed the rating of the Company (including the debentures of the Company and of Paz Ashdod) at ilAA(-) with a stable outlook. See more information in an immediate report of March 28, 2018 (TASE reference: 2018-01-025578).

On June 27, 2018, S&P Maalot reaffirmed the rating of the Company's debentures (series G) at ilAA- with a stable outlook. See more information in an immediate report of June 27, 2018 (TASE reference: 2018-01-061648).

6.8 - Legal Proceedings

Update of the Table of Claims in the Periodic Report

Item 19 in the table of claims – in August 2018, the Labor Court rejected a motion for approval of a claim as a class action filed against the Company and Paz Ashdod ("**the defendants**") which argued that the defendants did not pay some of their employees the legally required convalescence pay (thereby violating the National Convalescence Pay Expansion Order) as well as violated the provisions of Amendment 24 to the Wage Protection Law in respect of some of their employees. The Labor Court's decision indicates that the defendants' employment agreements are in compliance with the provisions of applicable laws regarding convalescence pay.

Item 23 in the table of claims – in May 2018, the Court validated the petitioners' withdrawal of their motion for approval of the claim as a class action and request for dismissal of the claim against the Company, alleging that the cash withdrawal fee charged by the Company in its ATMs at the Yellow convenience stores represents interest on a loan that exceeds the rate allowed by the Off-bank Loan Arrangement Law.

Items 24, 25, 26 and 27 in the table of claims - in April 2018, the Court ordered to dismiss the claims filed against the Company and the motions for approval of the claims as class actions (which pertained to the alleged violation of the Business Licensing Regulations in the facilities in four filling stations) due to inaction.

Item 28 in the table of claims - in March 2018, the Court validated the plaintiff's notice of withdrawal of the motion for approval of the claim as a class action and dismissed the claim against Pazgas, which alleged surcharging customers for fixed usage fees by Pazgas.

Item 30 in the table of claims - in the case of a claim and motion to approve the claim as a class action from January 2018, for the alleged tagging of a windshield cleaning liquid made by Paz Lubricants in a manner that does not conform to Israeli standards, the Company's management estimates, based on the opinion of its legal counsel, that given the preliminary stage of the proceeding, there is a likelihood of less than 50% that the motion for approval of the claim as a class action will be accepted.

Item 35 in the table of claims - in July 2018, the indictment filed against the Company, a regional manager and a filling station manager for alleged illegal tagging and advertising of discounts was stricken.

Claim filed by disabled IDF veteran against the Company – in May 2018, the Company was notified of a claim filed by a disabled IDF veteran for declaring the set of agreements signed between him and the Company as null and void, among others, since the agreements constitute non-exempt restrictive arrangements that consist of depriving conditions in a standard contract. The claim also seeks monetary relief in an amount that is immaterial to the Company.

Motion to approve a claim as a class action - in May 2018, the Company was notified of a claim and motion to approve the claim as a class action filed against it in the amount of NIS 3 million, alleging violation of the Fuel Industry Law and the regulations published thereunder in six filling stations for failing to post a sign with fuel prices and self-service increments (applicable at night, on Saturdays and on holidays) which faces the outside of the station (in both self-service and full-service stations). Based on the opinion of its legal counsel, the Company's management estimates that at this preliminary stage of the proceeding, the chances of the claim and motion cannot be assessed.

Motion to approve a claim as a class action - in July 2018, the Company received notice of a claim and motion for approval of the claim as a class action filed against it alleging that the refunds made by Pazomat to its customers are at their nominal value without linkage differences and interest. The amount of the claim is unspecified. Based on its legal counsel, the Company's management estimates that at this preliminary stage of the proceeding, the chances of the motion to be accepted cannot be assessed.

Indictment - in May 2018, an indictment was filed against Pazgas and an officer therein for alleged nonperformance of a periodic functionality test for a customer in Kibbutz Be'eri. Based on its legal counsel, the Company's management estimates that there is a likelihood of more than 50% that the indictment against Pazgas will be overturned or converted into an administrative penalty in negligible amounts. There is also a likelihood of less than 50% that the proceeding against the officer will end in a conviction.

Indictment - in August 2018, an indictment was filed against Pazgas and an officer therein for alleged nonperformance of a periodic functionality test for a customer in Yavne. Based on its legal counsel, the Company's management estimates that at this stage, the outcome of the proceeding cannot be assessed.

6.10 - Goals and Business Strategy

6.10.1 - General

The Company is exploring potential investments in areas that interface with or supplement the Company's operations in order to diversify its revenue sources and exploit its existing capabilities and infrastructures for expanding the Group's activities and enhancing its profits in the long run. Among others, the Company is looking into the potential construction and/or purchase of power stations. In this context, the Company is studying the possibility for erecting a power station with a capacity of 400-650 megawatts on Paz Ashdod's premises.

Miscellaneous

Corporate efficiency measures

In keeping with the Company's Board's decision of June 2018 according to which the Company will take cost-efficiency measures to reduce NIS 100 million in corporate expenses, in July 2018, the Company began effecting cost-efficiency and other corporate measures which will be carried over 2018 and 2019 in an aim to save some NIS 100 million in corporate expenses, as will be fully reflected in 2020.

The above information represents forward-looking information, as defined in the Israeli Securities Law, whose actual materialization might differ from the Company's expectations as of the date of the Periodic Report, among others, as a result of regulatory requirements and/or general developments in the local economy and in the relevant sector which will make it difficult for the Company to achieve the abovementioned cost reduction and/or the effect of risk factors to which the Company is exposed and/or the Company's decisions.

Remuneration of interested parties and senior officers in the Company (Regulation 21 to the Reporting Regulations)

Each of the four senior officers (other than the CEO and the COB) included in the list of the highest paid officers in paragraph 8 to Chapter D - Additional Details about the Company in the Periodic Report - was approved a bonus for 2017, as discussed in paragraph 6.1.6.2 above.

Officers' liability insurance policy (Regulation 29a(4) to the Reporting Regulations)

According to the Company's remuneration policy, as approved by the general meeting of shareholders on August 25, 2016, on May 29, 2018, following the approval of the Remuneration Committee, and in keeping with Regulation 1b(1) to the Companies Regulations (Reliefs in Interested Party Transactions), 2000, the Company's Board approved the purchase of an officers' liability insurance policy for the period from April 1, 2018 through March 31, 2019 with a liability limit of NIS 452,760,000 per claim and on a cumulative basis, and for a premium of NIS 445,214 for said insurance period.

C Condensed Consolidated Interim Financial Statement

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Auditors' review report to the shareholders of Paz Oil Company Ltd.

Introduction

We have reviewed the accompanying financial information of Paz Oil Company Ltd. and its subsidiaries ("**the Group**"), comprising of the condensed interim consolidated statement of financial position as of June 30, 2018, and the related condensed interim consolidated statements of profit or loss, comprehensive income, changes in equity and cash flows for the periods of six and three months then ended. The Board of Directors and Management are responsible for the preparation and presentation of interim financial information for this period in accordance with International Accounting Standard (IAS) 34, "*Interim Financial Reporting*", and are also responsible for the preparation of interim financial information for these periods in accordance with Section D of the Securities Regulations (Periodic and Immediate Reports), 1970. Our responsibility is to express a conclusion on this interim financial information based on our review.

We did not review the condensed interim financial information of equity accounted investees, the investment in which amounted to approximately NIS 28,934 thousand as of June 30, 2018. The condensed interim financial information of those companies was reviewed by other auditors whose review reports were furnished to us and our conclusion, insofar as it relates to amounts emanating from the financial information of such companies, is based solely on the said review reports of the other auditors.

Scope of Review

We conducted our review in accordance with Standard on Review Engagements 1, "*Review of Interim Financial Information Performed by the Independent Auditor of the Entity*" of the Institute of Certified Public Accountants in Israel. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards in Israel and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review and the review reports of other auditors, nothing has come to our attention that causes us to believe that the accompanying interim financial information was not prepared, in all material respects, in accordance with IAS 34.

In addition to the matter mentioned in the previous paragraph, based on our review and the review reports of other auditors, nothing has come to our attention that causes us to believe that the accompanying interim financial information does not comply, in all material respects, with the disclosure requirements of Section D of the Securities Regulations (Periodic and Immediate Reports), 1970.

Somekh Chaikin
Certified Public Accountants (Isr.)

August 26, 2018

Chapter C - Financial Statements

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	June 30,		December 31,
	2018	2017	2017
	Unaudited		Audited
	NIS in millions		
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	550	84	1,042
Short-term bank deposits	2,236	-	-
Trade receivables	1,766	1,507	1,640
Other receivables	190	201	141
Inventories	1,068	1,215	955
Trust deposit for employee benefits	-	70	69
Other investments	31	91	149
Current tax assets	47	39	49
Assets held for sale	7	5	8
Total current assets	**5,895**	**3,212**	**4,053**
NON-CURRENT ASSETS:			
Long-term bank deposits	-	1,818	2,223
Long-term loans granted and receivables	202	228	235
Trust deposit for employee benefits	30	-	-
Investment property	12	12	12
Investments in investees accounted for at equity	29	29	29
Loans to investees accounted for at equity	7	7	7
Property, plant and equipment, net	5,667	5,611	5,663
Intangible assets, net	750	767	758
Prepaid lease fees	20	21	20
Deferred tax assets	19	20	20
Total non-current assets	**6,736**	**8,513**	**8,967**
Total assets	**12,631**	**11,725**	**13,020**

The accompanying notes are an integral part of the condensed interim consolidated financial statements.

Chapter C - Financial Statements

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	June 30, 2018	June 30, 2017	December 31, 2017
	Unaudited	Unaudited	Audited
	NIS in millions		
LIABILITIES AND EQUITY			
CURRENT LIABILITIES:			
Short-term loans and credit, including current maturities of debentures	3,048	336	73
Trade payables	1,874	985	2,023
Other payables	547	578	487
Current tax liabilities	3	14	12
Provisions	29	58	52
Total current liabilities	**5,501**	**1,971**	**2,647**
NON-CURRENT LIABILITIES:			
Debentures	2,835	5,475	5,810
Other long-term liabilities	49	49	49
Employee benefit liabilities	68	62	66
Deferred tax liabilities	283	296	316
Total non-current liabilities	**3,235**	**5,882**	**6,241**
Total liabilities	**8,736**	**7,853**	**8,888**
EQUITY:			
Non-controlling interests	12	12	**13**
Share capital	194	194	194
Treasury shares	(188)	(188)	(188)
Capital reserves	1,829	1,829	1,829
Retained earnings	2,394	2,371	2,630
	4,229	4,206	4,465
Capital reserve from translation differences	(346)	(346)	(346)
Total equity attributable to equity holders of the Company	**3,883**	**3,860**	**4,119**
Total equity	**3,895**	**3,872**	**4,132**
Total liabilities and equity	**12,631**	**11,725**	**13,020**

The accompanying notes are an integral part of the condensed interim consolidated financial statements.

Yitzhak Ezer	**Yona Fogel**	**Sharona Novak**
Chairman of the Board	CEO	VP, CFO

Date of approval of the financial statements: August 26, 2018.

Chapter C - Financial Statements
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF PROFIT OR LOSS

	Six months ended June 30,		Three months ended June 30,		Year ended December 31,
	2018	2017	2018	2017	2017
	Unaudited				Audited
	NIS in millions (except per share data)				
Revenues	6,724	5,182	3,674	2,323	11,285
Cost of sales	5,837	4,274	3,210	1,988	9,480
Gross profit	**887**	**908**	**464**	**335**	**1,805**
Selling and marketing expenses	474	455	242	226	935
General and administrative expenses	73	85	30	41	191
Other expenses (income), net	(*)	17	(1)	20	13
Total operating expenses	547	557	271	287	1,139
Operating income	**340**	**351**	**193**	**48**	**666**
Finance income	28	117	9	53	201
Finance expenses	154	67	88	36	135
Finance income (expenses), net	**(126)**	**50**	**(79)**	**17**	**66**
Income before taxes on income	**214**	**401**	**114**	**65**	**732**
Taxes on income	47	86	24	19	157
Net income for the period	**167**	**315**	**90**	**46**	**575**
Attributable to:					
Equity holders of the Company	166	313	90	45	572
Non-controlling interests	1	2	*	1	3
Net income for the period	**167**	**315**	**90**	**46**	**575**
Net earnings per share:					
Basic net earnings per share (in NIS)	16.31	30.83	8.81	4.45	56.35
Diluted net earnings per share (in NIS)	16.28	30.78	8.80	4.45	56.21

* Represents less than NIS 0.5 million.

The accompanying notes are an integral part of the condensed interim consolidated financial statements.

Chapter C - Financial Statements
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Six months ended June 30,		Three months ended June 30,		Year ended December 31,
	2018	2017	2018	2017	2017
	Unaudited				Audited
	NIS in millions				
Net income for the period	**167**	**315**	**90**	**46**	**575**
Items of other comprehensive income (loss) that will not be carried to profit and loss:					
Remeasurement of defined benefit plan	*	*	*	*	(4)
Taxes in respect of items of other comprehensive income (loss) not carried to profit and loss	*	*	*	*	*
Total other comprehensive income (loss) for the period that will not be carried to profit and loss, net of taxes	*****	*****	*****	*****	**(4)**
Total comprehensive income for the period	**167**	**315**	**90**	**46**	**571**
Total comprehensive income attributable to:					
Equity holders of the Company	166	313	90	45	568
Non-controlling interests	1	2	*	1	3
Total comprehensive income for the period	**167**	**315**	**90**	**46**	**571**

* Represents less than NIS 0.5 million.

The accompanying notes are an integral part of the condensed interim consolidated financial statements.

Chapter C - Financial Statements
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Attributable to equity holders of the Company							
	Share capital	**Capital reserves**	**Foreign currency translation reserve**	**Treasury shares**	**Retained earnings**	**Total**	**Non-controlling interests**	**Total equity**
	NIS in millions							
Six months ended June 30, 2018 (unaudited):								
Balance as of January 1, 2018 (audited)	**194**	**1,829**	**(346)**	**(188)**	**2,630**	**4,119**	**13**	**4,132**
Effects of initial adoption of IFRS 9 (2014) **	**-**	**-**	**-**	**-**	**(6)**	**(6)**	**-**	**(6)**
Balance as of January 1, 2018 after initial adoption	**194**	**1,829**	**(346)**	**(188)**	**2,624**	**4,113**	**13**	**4,126**
Total comprehensive income for the period:								
Net income for the period	-	-	-	-	166	166	1	167
Other comprehensive income for the period, net of tax	-	-	-	-	*	*	-	*
Total comprehensive income for the period	-	-	-	-	166	166	1	167
Transactions with owners, recorded directly in equity and distributions to owners:								
Dividend to non-controlling interests	-	-	-	-	-	-	(2)	(2)
Dividend paid	-	-	-	-	(400)	(400)	-	(400)
Allocation of treasury shares to employees	-	*	-	*	-	*	-	*
Share-based payments	-	-	-	-	4	4	-	4
Balance as of June 30, 2018	**194**	**1,829**	**(346)**	**(188)**	**2,394**	**3,883**	**12**	**3,895**

* Represents less than NIS 0.5 million.

** See details of the effects of the initial adoption of IFRS 9 (2014) regarding financial instruments in Note 3b below.

The accompanying notes are an integral part of the condensed interim consolidated financial statements.

Chapter C - Financial Statements
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Attributable to equity holders of the Company							
	Share capital	Capital reserves	Foreign currency translation reserve	Treasury shares	Retained earnings	Total	Non-controlling interests	Total equity
	NIS in millions							
Six months ended June 30, 2017 (unaudited):								
Balance as of January 1, 2017 (audited)	**194**	**1,830**	**(346)**	**(189)**	**2,056**	**3,545**	**13**	**3,558**
Total comprehensive income for the period:								
Net income for the period	-	-	-	-	313	313	2	315
Other comprehensive income for the period, net of tax	-	-	-	-	*	*	-	*
Total comprehensive income for the period	-	-	-	-	313	313	2	315
Transactions with owners, recorded directly in equity and distributions to owners:								
Dividend to non-controlling interests	-	-	-	-	-	-	(3)	(3)
Allocation of treasury shares to employees	-	(1)	-	1	-	-	-	-
Share-based payments	-	-	-	-	2	2	-	2
Balance as of June 30, 2017	**194**	**1,829**	**(346)**	**(188)**	**2,371**	**3,860**	**12**	**3,872**

* Represents less than NIS 0.5 million.

The accompanying notes are an integral part of the condensed interim consolidated financial statements.

Chapter C - Financial Statements
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Attributable to equity holders of the Company							
	Share capital	Capital reserves	Foreign currency translation reserve	Treasury shares	Retained earnings	Total	Non-controlling interests	Total equity
	NIS in millions							
Three months ended June 30, 2018 (unaudited):								
Balance as of April 1, 2018	**194**	**1,829**	**(346)**	**(188)**	**2,302**	**3,791**	**14**	**3,805**
Total comprehensive income for the period:								
Net income for the period	-	-	-	-	90	90	*	90
Other comprehensive income for the period, net of tax	-	-	-	-	*	*	-	*
Total comprehensive income for the period	-	-	-	-	90	90	*	90
Transactions with owners, recorded directly in equity and distributions to owners:								
Dividend to non-controlling interests	-	-	-	-	-	-	(2)	(2)
Allocation of treasury shares to employees	-	*	-	*	-	-	-	-
Share-based payments	-	-	-	-	2	2	-	2
Balance as of June 30, 2018	**194**	**1,829**	**(346)**	**(188)**	**2,394**	**3,883**	**12**	**3,895**

* Represents less than NIS 0.5 million.

The accompanying notes are an integral part of the condensed interim consolidated financial statements.

Chapter C - Financial Statements
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Attributable to equity holders of the Company							
	Share capital	Capital reserves	Foreign currency translation reserve	Treasury shares	Retained earnings	Total	Non-controlling interests	Total equity
	NIS in millions							
Three months ended June 30, 2017 (unaudited):								
Balance as of April 1, 2017	**194**	**1,830**	**(346)**	**(189)**	**2,325**	**3,814**	**14**	**3,828**
Total comprehensive income for the period:								
Net income for the period	-	-	-	-	45	45	1	46
Other comprehensive income for the period, net of tax	-	-	-	-	*	*	-	*
Total comprehensive income for the period	-	-	-	-	45	45	1	46
Transactions with owners, recorded directly in equity and distributions to owners:								
Dividend to non-controlling interests	-	-	-	-	-	-	(3)	(3)
Allocation of treasury shares to employees	-	(1)	-	1	-	-	-	-
Share-based payments	-	-	-	-	1	1	-	1
Balance as of June 30, 2017	**194**	**1,829**	**(346)**	**(188)**	**2,371**	**3,860**	**12**	**3,872**

* Represents less than NIS 0.5 million.

The accompanying notes are an integral part of the condensed interim consolidated financial statements.

Chapter C - Financial Statements
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Attributable to equity holders of the Company							
	Share capital	Capital reserves	Foreign currency translation reserve	Treasury shares	Retained earnings	Total	Non-controlling interests	Total equity
	NIS in millions							
Year ended December 31, 2017 (audited):								
Balance as of January 1, 2017	**194**	**1,830**	**(346)**	**(189)**	**2,056**	**3,545**	**13**	**3,558**
Total comprehensive income for the year:								
Net income for the year	-	-	-	-	572	572	3	575
Other comprehensive loss for the year, net of tax	-	-	-	-	(4)	(4)	-	(4)
Total comprehensive income for the year	-	-	-	-	568	568	3	571
Transactions with owners, recorded directly in equity and distributions to owners:								
Dividend to non-controlling interests	-	-	-	-	-	-	(3)	(3)
Share-based payments	-	-	-	-	6	6	-	6
Allocation of treasury shares to employees	-	(1)	-	1	-	-	-	-
Balance as of December 31, 2017	**194**	**1,829**	**(346)**	**(188)**	**2,630**	**4,119**	**13**	**4,132**

* Represents less than NIS 0.5 million.

The accompanying notes are an integral part of the condensed interim consolidated financial statements.

Chapter C - Financial Statements
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six months ended June 30,		Three months ended June 30,		Year ended December 31,
	2018	2017	2018	2017	2017
	Unaudited				Audited
	NIS in millions				
Cash flows from operating activities:					
Net income for the period	167	315	90	46	575
Adjustments:					
Depreciation and amortization	179	173	90	85	354
Capital loss (gain) from disposal of property, plant and equipment and investment property	(*)	(1)	(*)	(1)	5
Share-based payment transactions	4	2	2	1	6
Finance (income) expenses, net	126	(50)	79	(17)	(66)
Income tax expense	47	86	24	19	157
Income for the period after adjustments to income	**523**	**525**	**285**	**133**	**1,031**
Decrease (Increase) in trade receivables, other receivables and long-term receivables	(175)	104	(190)	139	27
(Increase) Decrease in inventories	(113)	(88)	304	177	172
Increase (Decrease) in trade payables and other payables	(164)	(807)	(317)	(802)	327
Increase (Decrease) in provisions and employee benefit liabilities	(20)	2	(3)	2	(6)
Change in derivative financial instruments in respect of goods	50	(61)	28	(14)	(51)
	(422)	(850)	(178)	(498)	469
Income tax paid	(59)	(97)	(28)	(37)	(160)
Net cash provided by (used in) operating activities	**42**	**(422)**	**79**	**(402)**	**1,340**

* Represents less than NIS 0.5 million.

The accompanying notes are an integral part of the condensed interim consolidated financial statements.

Chapter C - Financial Statements

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six months ended June 30,		Three months ended June 30,		Year ended December 31,
	2018	2017	2018	2017	2017
	Unaudited				Audited
	NIS in millions				
Cash flows from investing activities:					
Purchase of property, plant and equipment	(199)	(211)	(74)	(130)	(597)
Proceeds from sale of property, plant and equipment, investment property and intangible assets	25	6	23	4	22
Proceeds from sale of financial asset	117	-	-	-	-
Repayment of deposit	40	-	-	-	-
Investment in investees	-	-	-	-	(7)
Dividend received from investees and other investments	6	3	6	3	7
Loans granted to filling station operators, agents, employees, fuel companies and others	(2)	(7)	(1)	(4)	(22)
Investment in intangible assets and prepaid lease expenses	(3)	-	(3)	-	(1)
Repayment of loans granted to filling station operators, agents, employees, fuel companies and others	8	15	6	11	35
Interest received	6	5	2	1	6
Taxes paid in respect of capital gains and improvements levy	(26)	(18)	(26)	-	(18)
Placement of long-term deposits in banks	-	-	-	-	(400)
Receipts from (placement of) trust deposit for buyers	-	(8)	-	10	(8)
Net cash used in investing activities	**(28)**	**(215)**	**(67)**	**(105)**	**(983)**

The accompanying notes are an integral part of the condensed interim consolidated financial statements.

Chapter C - Financial Statements
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six months ended June 30,		Three months ended June 30,		Year ended December 31,
	2018	**2017**	**2018**	**2017**	**2017**
	Unaudited				**Audited**
	NIS in millions				
Cash flows from financing activities:					
Issuance of debentures, net of issuance expenses	-	-	-	-	396
Increase (Decrease) in short-term bank credit	(2)	261	(1)	262	(1)
Dividend to non-controlling interests in subsidiary	(2)	(3)	(2)	(3)	(3)
Repayment of debentures	(1)	(1)	(1)	(1)	(62)
Dividends paid	(400)	(300)	(400)	-	(300)
Interest paid	(66)	(63)	(41)	(38)	(129)
Net cash (used in) provided by financing activities	**(471)**	**(106)**	**(445)**	**220**	**(99)**
(Decrease) Increase in cash and cash equivalents	(457)	(743)	(433)	(287)	258
Cash and cash equivalents at beginning of period	1,042	726	994	327	726
Effect of exchange rate fluctuations on cash and cash equivalents held in foreign currency	(35)	101	(11)	44	58
Cash and cash equivalents at end of period	**550**	**84**	**550**	**84**	**1,042**

The accompanying notes are an integral part of the condensed interim consolidated financial statements.

NOTE 1:- THE REPORTING ENTITY

Paz Oil Company Ltd. ("**the Company**") is an Israeli-resident company incorporated in Israel whose registered address is Europark, Yakum Industrial Zone, Kibbutz Yakum. The condensed interim consolidated financial statements of the Company as of June 30, 2018 comprise the financial statements of the Company and its subsidiaries (collectively **-** "**the Group**"), and the Group's interests in associates and joint arrangements. Until September 18, 2016, the controlling shareholders in the Company were Bino Holdings Ltd., Dolphin Energy Ltd. and Instanz Holdings Ltd. whether by virtue of holding the Company's shares or based on agreements signed between them ("**the former controlling shareholders**").

Effective from September 18, 2016, following the decline in the controlling shareholders' interests in the Company to below 30% and the resignation of the former controlling shareholders and their related parties from the Company's Board, the Company has no control core.

Effective from March 30, 2017, the former controlling shareholders are no longer interested parties in the Company given that their cumulative interests in the means of control in the Company have dropped below 5%.

The Group is engaged mainly in the refining of crude oil into oil products and the sale thereof for industrial use and private consumption including in and out of filling stations, and in additional business activities in the field of retail marketing on the premises of the Company's filling stations, including the operation of the Yellow convenience store chain, and in complementary services and industries. The securities of the Company are listed for trade on the Tel-Aviv Stock Exchange ("**TASE**").

NOTE 2:- BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

2.1 Statement of compliance with International Financial Reporting Standards

These condensed interim consolidated financial statements have been prepared in accordance with IAS 34, "Interim Financial Reporting", and they do not include all of the information required for full annual financial statements. They should be read in conjunction with the financial statements as of December 31, 2017 and for the year then ended ("**annual financial statements**"). Furthermore, these financial statements have been prepared in accordance with the provisions of Chapter D of the Securities Regulations (Periodic and Immediate Reports), 1970.

These condensed interim consolidated financial statements were authorized for issue by the Company's Board of Directors on August 26, 2018.

NOTE 2:- BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS (Cont.)

2.2 **Use of estimates and judgments**

The preparation of these condensed interim consolidated financial statements in conformity with IFRSs requires Management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

The assessments and judgments used by Management in the adoption of the accounting policies and the preparation of the interim financial statements are identical to those used in the preparation of the annual financial statements.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES

The accounting policies applied by the Group in these condensed interim consolidated financial statements are consistent with those applied by the Group in the annual financial statements.

Initial adoption of new standards, amendments to standards and interpretations

a. On January 1, 2018, the Group initially adopted the provisions of IFRS 15, "*Revenue from Contracts with Customers*" (in this paragraph - "**the Standard**" or "**IFRS 15**"), which prescribes revenue recognition guidance.

The Standard establishes a new five-stage revenue recognition model:

(1) Identifying the contract with the customer.
(2) Identifying the contract's separate performance obligations.
(3) Determining the transaction price.
(4) Allocating the transaction price to the separate performance obligations.
(5) Recognizing revenue when the entity completes the performance obligations.

Following is a description of the new revenue recognition accounting policy applied from January 1, 2018 as a result of the adoption of IFRS 15:

Revenue

The Group recognizes revenue when the customer obtains control of the promised goods or services. Revenue is measured at the amount of the consideration which the Company expects to receive in return for the transfer of the goods or services promised to the customer, other than amounts charged in favor of third parties.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Initial adoption of new standards, amendments to standards and interpretations (Cont.)

a. (Cont.):

Contract identification

The Group accounts for contracts with customers only when all the following criteria are met:

(1) The parties to the contract have affirmed the contract (in writing, verbally, or based on other commonly used business practices) and are committed to performing the obligations attributed to them;
(2) The Group can identify each party's rights to the goods or services to be transferred;
(3) The Group can identify the payment terms for the goods or services to be transferred;
(4) The contract has commercial substance (namely, the risk, timing and amount of the entity's future cash flows are expected to change as a result of the contract); and
(5) The Group expects to collect the consideration payable to it for the goods or services to be transferred to the customer.

Contract costs

Incremental costs of obtaining a contract with a customer such as agent sales commissions are recognized as an asset when the Group expects to recover these costs. Costs of obtaining a contract that would have incurred whether or not the contract has been obtained are recognized as an expense when incurred, unless they can be charged to the customer.

Costs incurred in meeting a contract with a customer which are not subject to the guidance of other standards are recognized as an asset when: they are directly attributable to the contract that can be specifically identified by the Group; they generate or improve the Group's resources that will be used in meeting the performance obligations in the future; and they are recoverable. In any other instance, these costs are recognized as an expense when incurred.

The Group recognizes an asset arising from costs incurred in the construction of LPG sale infrastructures since these costs are directly attributable to a contract, or an anticipated contract, which the Company can specifically identify, they generate or improve the Company's resources which will be used for meeting (or sustaining) the performance obligations and are recoverable. Such asset is amortized over the period of expected economic benefits. Before the adoption of the Standard, these costs were recorded as an expense in profit or loss when incurred.

The Company also recognizes a liability for a contract (deferred revenues) relating to supply connection fees received from private LPG customers. The Company recognizes revenue when these future goods or services are transferred to the customer.

The initial adoption of the Standard did not have a material effect on the financial statements.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Initial adoption of new standards, amendments to standards and interpretations (Cont.)

b. **IFRS 9 (2014), "*Financial Instruments*"**

In the first quarter of 2018, the Group adopted the provisions of IFRS 9 (2014), "*Financial Instruments*" (in this paragraph - "**the Standard**" or "**IFRS 9**"). The Standard requires the Company to examine the financial debt assets that are not measured at fair value through profit or loss and record an adequate provision for expected credit losses. The effect of the initial adoption of the Standard on January 1, 2018 was reflected in a decrease of NIS 6 million in equity, after the tax effect.

The Group chose to apply the Standard for the first time from January 1, 2018 without restating comparative figures while adjusting the retained earnings in equity as of the date of initial adoption.

c. **IFRS 16, "*Leases*" ("the Standard")**

In keeping with the matters discussed in Note 3.18.3 to the annual financial statements, following are references to the method of adoption of the Standard and its expected implications.

The Group chose to adopt the transition provision according to which it will recognize on the date of initial adoption a lease liability at the present value of the outstanding future lease fees discounted at the lessee's incremental borrowing rate on said date concurrently with an identical amount in a right-of-use lease asset, adjusted to prepaid or accumulated lease fees which had been recognized as an asset or liability before the date of initial adoption. Consequently, the initial adoption of the Standard is not expected to have an effect on retained earnings as of the date of initial adoption.

As for leases in which the Group is the lessee which had been classified before the date of initial adoption as operating leases, and excluding cases in which the Group had chosen to adopt the reliefs permitted by the Standard as described below, the Group is required to recognize on the initial adoption date a right-of-use asset and lease liability for all leases for which it can be demonstrated that the Group has control over the use of the identifiable assets for a predetermined period of time.

Based on the lease agreements in effect as of June 20, 2018, the Company's management estimates that the initial adoption of the Standard will result in recognizing right-of-use assets of approximately NIS 1 billion in the financial statements as of the initial adoption date and an increase in same amount in the balance of the lease liability. In addition to said amounts, as of the initial adoption date, balances included in property, plant and equipment and in prepaid expenses which had been recognized in the financial statements before the initial adoption date will be reclassified to right-of-use assets.

NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Initial adoption of new standards, amendments to standards and interpretations (Cont.)

c. **IFRS 16, "*Leases*" ("the Standard") (Cont.)**

Accordingly, depreciation and amortization expenses will be recognized in respect of a right-of-use asset and the need to record impairment of the right-of-use asset will be tested based on the provisions of IAS 36. Moreover, finance expenses will be recognized for a lease liability. Therefore, from the initial adoption date, lease expenses relating to assets under operating leases which had been recognized in general and administrative expenses in the statement of profit or loss will be discounted as assets and depreciated in subsequent periods based on the depreciation and amortization method.

The Group is continuing to examine the expected quantitative impact of the adoption of IFRS 16 on its financial statements and in this context is studying the work assumptions underlying its adoption such as: exercise of future options for extending lease agreements, discount rates and additional adjustments which might be necessary, if any.

The Group does not expect a material change in the principal financial ratios which it is required to meet based on its current rating such as debt to EBITDA ratio and FFO to debt ratio. Moreover, the Group does not expect the effects on the financial statements described above to affect its ability to meet the required financial covenants, as described in Note 14.9 to the annual financial statements, underlying loans and borrowings from banks and other credit providers.

The information presented above is a mere estimate and therefore the actual date that will be presented and included in the financial statements upon the adoption of IFRS 16 might differ from the data disclosed above. The Group estimates that in the coming months it will make decisions regarding appropriate methodologies for adopting the Standard and will be able to disclose founded data in the financial statements to be issued in the future.

Reliefs

1) The Group intends not to adopt the requirement for recognizing a right-of-use asset and lease liability for leases under 12 months. The Group also intends not to adopt the requirement for recognizing a right-of-use asset and lease liability for leases whose lease term ends within 12 months from the initial adoption date.

2) For some of the leases, the Group intends not to separate non-lease components from lease components and instead account for each lease component and the related non-lease components as a single lease component.

NOTE 3.1:- INVENTORIES

As of June 30, 2018, no provision for impairment of inventories has been included (as of June 30, 2017, a provision for impairment of inventories was included in the amount of NIS 92 million). The impairment loss in respect of inventories was carried to cost of sales.

NOTE 4:- SEGMENT REPORTING

The Group has three reportable segments, as described in Note 29 to the annual financial statements.

The divisions and areas of activity, which are also the operating segments in the financial statements, are as follows:

Paz Retail and Wholesale ("**Paz-R&W**"), **Paz Industries and Services** ("**Paz-Industries**") and **Paz Refining and Logistics** ("**Paz-Refining**").

Information on profit and loss:

Six months ended June 30, 2018 (unaudited):

	Wholesale and Retail	Industries and Services	Refining	Adjustments to consolidation	Consolidated total
	NIS in millions				
Revenues from external customers	3,644	574	2,506	-	6,724
Revenues from intersegment sales	100	218	2,484	(2,802)	-
Segment revenues	3,744	*792	4,990	(2,802)	6,724
Segment results	**206**	***99**	**65**	**-**	**370**
Unallocated net expenses					(30)
Operating income					**340**
Finance expenses, net					126
Income before taxes on income					**214**
Depreciation and amortization	52	23	99		174
Unallocated depreciation and amortization					5
Total depreciation and amortization					179
EBITDA	258	122	164		

* The Industries and Services segment data include the results of Pazgas consisting of revenues of NIS 529 million and operating income of NIS 71 million.

NOTE 4:- SEGMENT REPORTING (Cont.)

Six months ended June 30, 2017 (unaudited):

	Wholesale and Retail	Industries and Services	Refining	Adjustments to consolidation	Consolidated total
	NIS in millions				
Revenues from external customers	3,191	574	1,417	-	5,182
Revenues from intersegment sales	69	231	2,072	(2,372)	-
Segment revenues	3,260	*805	3,489	(2,372)	5,182
Segment results	**199**	***116**	**79**	**-**	**394**
Unallocated net expenses					(43)
Operating income					**351**
Finance income, net					50
Income before taxes on income					**401**
Depreciation and amortization	50	24	91		165
Unallocated depreciation and amortization					8
Total depreciation and amortization					173
EBITDA	249	140	170		

* The Industries and Services segment data include the results of Pazgas consisting of revenues of NIS 568 million and operating income of NIS 80 million.

NOTE 4:- SEGMENT REPORTING (Cont.)

Three months ended June 30, 2018 (unaudited):

	Wholesale and Retail	Industries and Services	Refining	Adjustments to consolidation	Consolidated total
	NIS in millions				
Revenues from external customers	1,944	253	1,477	-	3,674
Revenues from intersegment sales	46	104	1,333	(1,483)	-
Segment revenues	1,990	*357	2,810	(1,483)	3,674
Segment results	**107**	***33**	**60**	**-**	**200**
Unallocated net expenses					(7)
Operating income					**193**
Finance income, net					79
Income before taxes on income					**114**
Depreciation and amortization	26	12	50		88
Unallocated depreciation and amortization					2
Total depreciation and amortization					90
EBITDA	133	45	110		

* The Industries and Services segment data include the results of Pazgas consisting of revenues of NIS 232 million and operating income of NIS 22 million.

NOTE 4:- SEGMENT REPORTING (Cont.)

Three months ended June 30, 2017 (unaudited):

	Wholesale and Retail	Industries and Services	Refining	Adjustments to consolidation	Consolidated total
	NIS in millions				
Revenues from external customers	1,538	239	546	-	2,323
Revenues from intersegment sales	29	90	941	(1,060)	-
Segment revenues	1,567	*329	1,487	(1,060)	2,323
Segment results	**109**	***40**	**(80)**	**-**	**69**
Unallocated net expenses					(21)
Operating income					**48**
Finance income, net					17
Income before taxes on income					**65**
Depreciation and amortization	25	12	44		81
Unallocated depreciation and amortization					4
Total depreciation and amortization					85
EBITDA	134	52	(36)		

* The Industries and Services segment data include the results of Pazgas consisting of revenues of NIS 223 million and operating income of NIS 27 million.

NOTE 4:- SEGMENT REPORTING (Cont.)

Year ended December 31, 2017 (audited):

	Wholesale and Retail	Industries and Services	Refining	Adjustments to consolidation	Consolidated total
	NIS in millions				
Revenues from external customers	6,523	1,117	3,645	-	11,285
Revenues from intersegment sales	153	461	4,195	(4,809)	-
Segment revenues	6,676	*1,578	7,840	(4,809)	11,285
Segment results	**415**	***206**	**144**	**-**	**765**
Unallocated net expenses					(99)
Operating income					**666**
Finance income, net					66
Income before taxes on income					**732**
Capital expenditures	154	26	417		597
Depreciation and amortization	104	47	190		341
Unallocated depreciation and amortization					13
Total depreciation and amortization					354
EBITDA	519	253	334		

* The Industries and Services segment data include revenues of Pazgas totaling NIS 1,066 million and operating income of NIS 135 million.

NOTE 4.1:- REVENUES FROM CONTRACTS WITH CUSTOMERS

The following table presents the Group's revenues in the periods of six and three months ended June 30, 2018 according to type of revenue. The table also reconciles revenue according to the Group's reportable segments, based on the segment recognized by the external customer. Net revenue represents the segment's revenue from external customers only after neutralizing intersegment revenue in the Group.

Six months ended June 30, 2018 (unaudited):

	Wholesale and Retail	Industries and Services	Refining	Adjustments to consolidation	Consolidated total
	NIS in millions				
Total sales of oil products	3,319	717	4,887	(2,778)	6,145
Yellow products and other revenues*	425	75	103	(24)	579
Total segment revenues	3,744	792	4,990	(2,802)	6,724
Revenues from intersegment sales	(100)	(218)	(2,484)	2,802	-
Total segment revenues from external customers	**3,644**	**574**	**2,506**	**-**	**6,724**
Local sales					3,986
Foreign sales**					2,738
Total					**6,724**

Three months ended June 30, 2018 (unaudited):

	Wholesale and Retail	Industries and Services	Refining	Adjustments to consolidation	Consolidated total
	NIS in millions				
Total sales of oil products	1,764	319	2,762	(1,472)	3,373
Yellow products and other revenues*	226	38	48	(11)	301
Total segment revenues	1,990	357	2,810	(1,483)	3,674
Revenues from intersegment sales	(46)	(104)	(1,333)	1,483	-
Total segment revenues from external customers	**1,944**	**253**	**1,477**	**-**	**3,674**
Local sales					2,054
Foreign sales**					1,620
Total					**3,674**

* This amount does not include franchise sales.

** Includes sales of Paz Ashdod's oil distillates to vendors. The oil distillates are loaded onto ships at the Ashdod Port with no final destination on the date of sale. Also includes sales to the Palestinian Authority, sales of jet fuel to airline companies and other sales.

NOTE 5:- CONTINGENT LIABILITIES

5.1 In the ordinary course of business, legal claims have been filed and various legal proceedings are pending against Group companies, including monetary claims that have not yet matured into legal claims (in this paragraph - "**legal claims**"). The managements of the Group companies believe, among others based on the opinion of legal counsel, that adequate provisions have been recorded in the financial statements in order to cover the potential exposure of these legal claims.

As of June 30, 2018, the overall amount in respect of legal claims filed against the Group companies regarding various issues whose likelihood to materialize is remote approximates NIS 329 million.

The abovementioned amount and any additional amounts in respect of the exposure presented in this Note are not linked to the CPI and do not include interest based on the interest and linkage rules.

Category of claims	**Nature of claims**	**Total provision**	**Total exposure**
		NIS in millions	
Restrictive arrangements	Mainly declaratory claims for the cancellation of filling station operating agreements alleging restrictive practices and/or depriving conditions in standard contract	-	43
Proceedings with local authorities and indictments	Mainly disputes regarding current and retroactive municipal taxes, fees and levies; indictments for absence of business license, legal violations and building permits	(a) 20	(b) 69
Class actions	Various motions for approval of claims as class actions against the Company and/or its subsidiaries, among others, alleging noncompliance with laws, damage to the environment, collection of various fees, misleading of consumers etc.	12	(c) 152
Various claims	Mainly various claims or monetary demands and Palkal related claims	(d) 8	105
Total		**40**	**369**

<u>Comments</u>

(a) The provision is included in the item of trade payables in the statement of financial position.

(b) Total claims do not include claims in which the amount claimed is expressed in investments in property, plant and equipment.

(c) In claims in respect of which the specific amount of the claim for the Group cannot be assessed, the amount of the claim was calculated based on the Group's relative share in the relevant market. Claims that do not define the amount of claim or for which the Group's relative share in the claim cannot be assessed are not included in total claims. Among others, this amount does not include a claim and motion to approve the claim as a class action regarding air pollution in Haifa Bay totaling NIS 14.4 billion (filed against industrial companies operating in the Haifa Bay, including the Company and Paz Lubricants). It should be noted that based on legal opinion and given the preliminary stage of the proceeding, the Company estimates that the chances of the motion to be approved are lower than 50%.

(d) The provision includes an amount of approximately NIS 1 million included in trade payables.

(e) Of the total exposure amount, approximately NIS 45 million are for claims whose chances cannot be assessed at this stage.

NOTE 6:- SIGNIFICANT EVENTS DURING AND AFTER THE REPORTING PERIOD

6.1 On April 30, 2018, the Company was informed of the Ministry of Energy's Price Committee's resolution ("**the Resolution**") and of the publication of the Control of Prices of Commodities and Services Order (Maximum Prices in Filling Stations) (Amendment), 5778-2018 ("**the Order**") both of which stipulate, among others, that the marketing margin per liter of self-service gasoline 95 ("**the marketing margin**") will be approximately NIS 0.556 a liter (excluding VAT) - a decrease of approximately NIS 0.047 a liter (excluding VAT) compared to the marketing margin in effect before the Order was issued; the increment for full-service gasoline 95 will be NIS 0.21 per liter (including VAT) - an increase of approximately NIS 0.01 per liter (including VAT) compared to the increment in effect before the Order was issued; the ex-factory (CIF) price of gasoline 95 will be translated into NIS at the representative exchange rate published by the Bank of Israel on the day before the last two work days before the update, multiplied by a coefficient of 1.009 - instead of the indexation of the marketing margin to the Israeli CPI as was practiced before the publication of the Order; and the marketing margin will be updated based on an input basket as recommended by the Price Committee [according to which, among others, effective from September 1, 2018, an annual coefficient of performance (COP) of 0.39% will be levied (compared to an annual COP of 1% prior the publication of the Order)].

The Price Committee also resolved to examine whether there is need for regulatory amendments governing the nature of control over the gasoline 95 price such as lifting the control over full-service commission, limiting the control over new filling stations, instituting a new control policy for different sections of gasoline prices etc. After reaching a resolution, the matter will be heard before the Price Committee.

The Resolution and the Order are expected to have an adverse effect on the Company's financial results. The Company is planning to take steps to minimize such effect, among others by reducing actual marketing expenses, including cancelling certain discounts, lowering rent and minimizing operating costs.

6.2 In keeping with the matter discussed in Note 10.2 to the annual financial statements for 2017, in March 2018, the Company received an amount of approximately NIS 117 million of the total consideration of NIS 146.5 million for the sale of its interests in Shufersal Finance Limited Partnership.

6.3 On June 28, 2018, the Company issued debentures (series G) in a total of approximately NIS 647 million by way of series expansion. The net proceeds, less issuance expenses of approximately NIS 641 million, were received after the statement of financial position date on July 1, 2018 and therefore will only be reflected in the financial statements for the third quarter of 2018. The debentures (series G) were rated by S&P Maalot at ilAA(-). The issuance proceeds were used by the Company to extend the scope of available bank deposits by NIS 650 million to an overall amount of approximately NIS 2,886 million to be used by the Company for repaying debentures (series C) in May 2019

NOTE 7:- FINANCIAL INSTRUMENTS

7.1 Financial instruments measured at fair value for disclosure purposes only

The carrying amount of certain financial assets and liabilities, including cash and cash equivalents, trade receivables, other receivables, other short-term investments, derivatives, trust deposit in favor of employee benefits, long-term bank deposits, short-term loans and credit, including current maturities of debentures, trade payables and other payables approximates their fair value.

The fair value of the other financial assets and liabilities and the carrying amount as shown in the statement of financial position are as follows:

	June 30, 2018 (unaudited)	
	Carrying amount	**Fair value**
	NIS in millions	
Non-current assets:		
Loans to operators and agents	128	134
Liabilities:		
Debentures (including accrued interest and current maturities)	5,876	6,005

	June 30, 2017 (unaudited)	
	Carrying amount	**Fair Value**
	NIS in millions	
Non-current assets:		
Loans to operators and agents	139	152
Non-current liabilities:		
Debentures (including accrued interest)	5,480	5,631

	December 31, 2017 (audited)	
	Carrying amount	**Fair Value**
	NIS in millions	
Non-current assets:		
Loans to operators and agents	134	142
Non-current liabilities:		
Debentures (including accrued interest)	5,875	6,074

NOTE 7:- FINANCIAL INSTRUMENTS (Cont.)

7.2 **Fair value hierarchy of financial instruments measured at fair value**

The table below analyzes financial instruments measured at fair value using a valuation technique.

The different levels have been defined as follows:

Level 1: quoted prices (unadjusted) in active markets for identical instruments.
Level 2: inputs other than quoted prices included within Level 1 that are observable, either directly or indirectly.
Level 3: inputs that are not based on observable market data (unobservable inputs).

	June 30, 2018 (unaudited)			
	Level 1	Level 2	Level 3	Total
	NIS in millions			
Financial assets at fair value through profit or loss:				
Financial assets - derivative instruments	1	*	-	1
Investments in unquoted shares	-	-	38	38
	1	*****	**38**	**39**
Financial liabilities at fair value through profit or loss:				
Financial liabilities - derivative instruments	41	-	-	41
	41	**-**	**-**	**41**

* Represents less than NIS 0.5 million.

	June 30, 2017 (unaudited)			
	Level 1	Level 2	Level 3	Total
	NIS in millions			
Financial assets at fair value through profit or loss:				
Financial assets - derivative instruments	-	3	-	3
Investments in unquoted shares	-	-	88	88
	-	**3**	**88**	**91**
Financial liabilities at fair value through profit or loss:				
Financial liabilities - derivative instruments	15	-	-	15
	15	**-**	**-**	**15**

NOTE 7:- FINANCIAL INSTRUMENTS (Cont.)

	December 31, 2017 (audited)			
	Level 1	Level 2	Level 3	Total
	NIS in millions			
Financial assets at fair value through profit or loss:				
Financial assets - derivative instruments	3	-	-	3
Investments in unquoted shares	-	-	153	153
	3	**-**	**153**	**156**
Financial liabilities at fair value through profit or loss:				
Financial liabilities - derivative instruments	5	2	-	7
	5	**2**	**-**	**7**

7.3 **Financial instruments measured at fair value according to the Level 3 fair value hierarchy**

The balance of the investment in the financial instrument - unquoted shares measured at Level 3 of the fair value hierarchy - amounts to approximately NIS 38 million, NIS 88 million and NIS 146 million as of June 30, 2018, June 30, 2017 and December 31, 2017, respectively. The net proceeds were recognized in profit and loss under financing.

7.4 **Valuation technique for determining the fair value of financial instruments measured at Level 2 and Level 3 according to the fair value hierarchy and the valuation processes used by the Company**

As for the valuation techniques for measuring the fair value of derivative instruments and investments in unquoted shares, see Note 30.5 to the annual financial statements as of December 31, 2017.

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