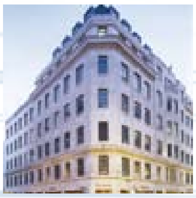
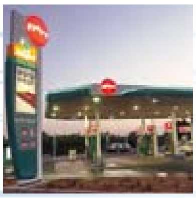
Delek Group

ANNUAL REPORT 2007







1.13 The Energy Sector[1]

1.13.1 General

A. The energy sector is primarily under Delek Energy Systems Ltd., a public company whose shares have been listed on the TASE since 1982 (Delek Energy).

B. Delek Energy is engaged, via partnerships and subsidiaries, in oil and gas exploration and production in Israel and other countries. Gas is produced at the Yam Tethys project in the Mediterranean Sea off the shores of Israel, and oil and gas are produced in Southern USA. Oil and gas explorations are conducted in assets in Israel, Vietnam, US, Guinea-Bissau and through Matra Petroleum Plc. (Matra) in Russia and Hungary). In addition, from July 2007 Delek Energy holds 24.2% of the shares of Viking Oil and Gas International Ltd. (Vogil). Vogil focuses on conversion of tankers to floating production, storage and offloading platforms (FPSO) and leasing and operation of the FPSO. As of the report date, Delek Energy's major project, producing most of its revenues, is the Yam Tethys project.

C. From 2007 and until the date of this report, Delek Energy, through the companies it controls, purchased and invested in oil assets and companies. The main acquisitions are as follows:

1. Purchase of 29.87% of Matra shares in the second quarter of 2007 (see section 1.13.8.A below)
2. Purchase of 24.2% of Vogil shares in the third quarter of 2007 (see section 1.13.9 below)
3. Purchase of all of the shares in Elk Resources LLC (Elk) in the first quarter of 2008 (see section 1.13.5.A below).

D. **Structure of sector of operations and changes therein**

1. Operations in Israel: Delek Energy operates in Israel through its holdings in the limited partnerships Delek Drilling (Delek Drilling Partnership) and Avner Oil Exploration (Avner Partnership) (Delek Drilling Partnership and Avner Partnership collectively in this Chapter 10: the partnerships or the limited partnerships).

   The general partner of Delek Drilling Partnership is a wholly owned subsidiary of Delek Energy, and the general partner of Avner Partnership is a company in which Delek Energy holds half of the shares.

   In addition to managing the partnerships, Delek Energy holds participation units issued by the limited partners in the partnerships as follows:

   - Direct and indirect holding of 62.32% of participation units issued by the limited partner of Delek Drilling Partnership (Delek units). The limited partner and trustee of this partnership is Delek Trustees Drilling Ltd., wholly owned by Delek Energy. These holdings in the limited partnership do not grant Delek Energy any management rights or rights to profits.
   - Direct and indirect holding of 39.02% of participation units issued by the limited partner of Avner Partnership (Avner units). The limited partner and trustee of this partnership is Avner Trustees Ltd., 50% owned by Delek Energy. These holdings in the limited partner do not grant Delek Energy any management rights or rights to profits.

   It is noted that Delek Investments directly holds 6.53% of Delek units and 12.59% of Avner units.

   The primary activity of the partnerships is the Yam Tethys project, which includes two oil leases (Noa and Ashkelon) in the Mediterranean Sea off the shores of Israel, where proved gas reservoirs have been found. This project includes production of natural gas and further exploration. In 2004 the partnerships started selling natural gas produced from the Mari reservoir in the Ashkelon lease, and Delek Energy started recognizing significant revenues as a result. Delek Drilling Partnership, Avner Partnership and Delek Investments hold 25.5%, 23% and 4.441%, respectively, of the Yam Tethys project and of Yam Tethys Ltd. which

[1] For definitions of some of the professional terms included in this section, see the glossary at the end of the section

1.13.2 Yam Tethys Project

A. The limited partnerships mainly operate through offshore oil leases and licenses for the Yam Tethys project. As of the report date, the Yam Tethys project includes mainly the I/7 Noa and I/10 Ashkelon leases. The Yam Tethys project previously included additional permits and licenses for exploration, however these operations did not yield any discoveries (see section 1.13.1.R.3 below).

B. Operations in the areas of Yam Tethys project are conducted through a joint venture managed under a joint operation agreement dated February 24, 1999. The partners in the joint venture are Noble Energy Mediterranean Limited (Noble) – 47.059%, Delek Drilling Partnership – 25.50%, Avner Partnership – 23.00% and Delek Investments – 4.441%.

C. The Yam Tethys project partners hold two proved gas reservoirs. The Noa reservoir was discovered in June 1999 and the Mari reservoir was discovered in February 2000. In view of the findings concerning these reservoirs, the partners in the Yam Tethys project started developing the reservoirs in 2001 by establishing a production infrastructure and a gas pipeline to the shore. Construction of phase 1 of the production system was completed at the end of 2003. This included manufacture and installation of the production platform above the Mari-B reservoir (Mari-3B drilling), drilling of production drillings Mari-4B, 5 and 6, completion of the Mari-2B underwater drilling and its connection to the platform, and installation of a 42 km pipeline from the production platform to the reception terminal in Ashdod. Phase 1 also included production drilling at Mari-7B and establishment of a permanent reception terminal on Ashdod shore, completed in Q1 2008.

D. Mari 7-B drilling in Q4 2006 and Q1 2007 aimed to improve gas production capacity from the Mari field. The total cost of drilling for the Yam Tethys project (for 100% of the rights) amounted to $36 million. Establishment costs of phase 1 of the production facility (for 100% of the rights) amounted to $400 million (for a description of the expenses included in this project for January 1, 2006 and December 31, 2007, see section 1.13.1.R.2 above). Phase 2 of the production facility, which has yet to be started, is expected to include the sub-sea completion of the Noa field and its connection to the production platform. Their total cost for the Yam Tethys project (for 100% of rights) could amount to $150-200 million, assuming there is no participation in costs by other entities. The Yam Tethys project partners are reviewing potential cooperation with British Gas (BG), *inter alia,* regarding joint development of the Noa field and the adjoining natural gas field, located off the shores of the Gaza Strip, which BG operates, as well as for transmission of natural gas from these fields through the Yam Tethys project production and transmission facility. This phase could also include the examination of potential connection to the Or field, to the production facility that will connect the Noa field to the production platform, if the owners of the Or field decide that development is financially feasible. In addition, the operator is currently examining technical and economic aspects of adding compressing facilities to the Yam Tethys project, which will be required when the pressure level in the Mari reservoir drops, in view of the anticipated consumption rate of natural gas from the reservoir.

Notice regarding forward-looking information: The above estimate is forward-looking information, based on preliminary assessments by Delek Energy of completion costs for phase 2. These assessments are based on a preliminary opinion provided to Delek Energy by the operator. The actual completion cost for phase 2 may differ (be higher or lower) from the above estimate, and is contingent, inter alia, on detailed planning of phase 2 which is yet to be executed, bids from contractors, changes to global supplier and raw material markets, such as metals, and in joint development, if any, with BG as set forth above.

E. Permits and licenses for production and transmission systems: In the framework of the development of gas discoveries by the Yam Tethys project partners, the partners have been granted permits and licenses under the Oil Law, 5712-1952 (the Oil Law) and the Natural Gas Sector Law, 5762-2002, which are mandatory for construction and operation of the production system and the pipeline from the production platform to shore.

F. Joint operating agreement: Exploration and production in the Yam Tethys project are conducted under a joint operating agreement (JOA) dated February 24, 1999. The parties to the JOA are the limited partnerships and other partners in the Yam Tethys project as set forth below. According to the JOA, Noble was appointed operator of the Yam Tethys project. Noble

is an indirect subsidiary of Noble Energy Inc., a US oil company for exploration and production of oil and natural gas. Noble Energy Inc. is a public company traded on the NYSE under the symbol NBL.

G. The joint operating agreement includes the following provisions:

1. Noble will be the operator under the joint operating agreement and will bear sole responsibility for management of the joint operations. In managing the joint operations, Noble is subject to obligations concerning, inter alia, compliance with instructions of the operating committee, agreements, licenses and legislation.

2. The operator will determine the number and identity of the workers, their work hours and their salary regarding the joint operation.

3. Provisions were specified for indemnification and restriction of responsibility of the operator, its officers and affiliates regarding its duties as operator. According to the provisions, the operator is indemnified for any damage, expense or responsibility regarding its duties as an operator (apart from exceptional cases of gross negligence of its senior employees, in which case the indemnification shall apply to damages, expenses or responsibility for over one million dollars), as set forth in the JOA.

4. The operator is entitled to reimbursement of all direct expenses resulting from the fulfillment of its duties as an operator and reimbursement of its indirect expenses resulting from the rate of expenses of the joint transaction, ranging from 1% of venture expenses when the annual venture expenses exceed $12 million, to 4% of venture expenses when these are below $4 million annually. For expenses associated with development and production operations of the Yam Tethys project, the parties agreed that for development and production expenses starting on January 1, 2004 the operator will be paid 1% of indirect expenses up to a limit of $20 million in expenses, and 0.85% of expenses exceeding that threshold.

5. The partners to the joint operating agreement have committed to protect and indemnify the operator, on a pro-rata basis in line with their share of participation in Yam Tethys licenses. The operator's liability is limited to certain cases, such as gross negligence.

6. According to the JOA, Avner Oil and Gas Ltd. was appointed as the Israeli operator to fulfill tasks, functions, roles and services in Israel to benefit the joint operations, subject to coordination with Noble. The proceeds from these services are not material.

7. Operating committee: Under the agreement, the parties established an operating committee with the authority to approve and supervise the required joint operations to comply with terms of licenses to which the joint operating agreement applies. The operating committee is composed of representatives of the parties, with each representative having voting rights commensurate with rights of the party being represented. Unless otherwise determined in the JOA, all decisions, approvals and other acts by the operating committee on any proposal brought before it shall pass by affirmative vote of two or more parties (which are not associated / affiliated parties) which jointly hold at the time of the vote at least 51% of total participation rights in the area of the license to which the decision applies.

H. Proved gas reserves in the Yam Tethys project[1]

The following table shows changes to proved[2] gas reserves at Mari and Noa gas reservoirs in 2004-2007. The changes to reserves are due to sale of gas to IEC and others, as well as to updated estimates of the proved and developed gas reserves at Mari reservoir.

---

1 Rules of the US Securities Exchange Commission (SEC) which are binding on reservoir engineering companies, stipulate that proven gas reserves are the gas volume which, according to geological, engineering and financial information may be produced at high probability (90% or higher) from the relevant reservoir

2 The data are for proved gas reserves at "proved" probability only (excluding "probable" or "possible" quantities). See also section 1.13.32.D regarding risk factors

	BCM[1]
Proved gas reserves (Mari and Noa) pre-production[2]	32
Gas sold in 2004	(1.2)
Gas sold in 2005	(1.7)
Gas sold in 2006	(2.3)
Gas sold in 2007	(2.8)
Balance of proved gas reserves as of December 31, 2007	24.0

I. Planned activities for the Yam Tethys project

1. In the first half of 2008, the permanent reception terminal at Ashdod is expected to connect to the reception terminal of the Israel Natural Gas Lines Company Ltd. (INGL), which is under construction, and from there to the national natural gas pipeline.

2. On February 20, 2008 the socio-economic cabinet in Israel decided on the establishment of a natural gas facility with an annual capacity for delivery of four billion cubic meters (BCM) of natural gas. Operation is expected to commence at the beginning of 2015. The cabinet ordered the general director of the Ministry of Finance to appoint a tender committee to issue a BOT tender for planning, financing, establishment and operation of an onshore or offshore natural fluid gas facility and for import, storage, supply and sale of natural gas for consumers by one private entity. The final stage of the tender is expected to be published by July 1, 2009. The Yam Tethys group decided to conduct a techno-economic analysis of possible conversion and operation of the natural gas production facilities and pipeline in the Yam Tethys project, in favor of the project stipulated in the cabinet decision. The results of this analysis and additional data will allow the Yam Tethys group to consolidate its position regarding its participation in the tender, if it is issued.

1.13.3 Exploration Operations of the Limited Partnerships Other Than the Yam Tethys Project

In addition to the production operations of the Yam Tethys project, the partnerships are engaged in further oil and gas exploration pursuant to permits, licenses and leases granted under the Oil Law.

Explorations are usually conducted under terms of the lease or license specified by the Oil Supervisor in the Ministry of National Infrastructures (the Oil Supervisor), including provisions concerning drilling schedules, insurance requirements and environmental protection guidelines. The partners in the lease signed a JOA which specifies, inter alia, responsibilities of the operator; charging of expenses to partners; setting up an operating committee and the required majority for to adopt resolutions in the committee; and sanctions against any party in breach of obligation. The partnerships do not serve as operators of the lease or license.

Below is a brief description of the oil and gas exploration operations of the limited partnerships in areas that are not part of the Yam Tethys project

---

1 The data in this section are for 100% of the reservoir (including the share of other participants and royalties).

2 Pre-production reserves are in line with the reserve estimate report for the Mari and Noa reservoirs of March 2001, issued at the request of the operator of the Yam Tethys project by a leading independent foreign company, specializing in estimating oil and gas reserves in reservoirs, as amended in four additional reserve estimate reports referring solely to the developed reservoir at the Mari gas field (following the first report in 2004, the original evaluation was reduced by 0.8 BCM; the 2005 report in led to a further reduction by 0.2 BCM; the 2006 report led to an increase of 0.2 BCM, and the 2007 report led to a further increase of 0.1 BCM). The aforementioned amendment reports were obtained from a different independent foreign company, which is also one of the leading companies specializing in estimating oil and gas reserves.

1.13.10 Other Projects

Delek Energy is also currently working to locate and investigate additional investment opportunities in oil and gas exploration, development and production worldwide.

1.13.11 Products and Services

As of the report date, the limited partnerships provide natural gas to IEC, Paz Ashdod, AIPM and Delek Ashkelon and to ORL from Mari reservoir. AriesOne and Elk provide natural gas and oil to various customers. In the USA, oil and gas are commodities. The USA market is large and sophisticated and Delek Energy is able to contract with a wide range of customers. As gas and/or fuel are found in the exploration operations of Delek Energy and/or the limited partnerships, the Company will act to sell them.

1.13.12 Segmentation of Revenues and Profitability - Products and Services

Most of Delek Energy's revenues and profits as of December 31, 2007 are due to the sale of natural gas and royalties from the Yam Tethys project. The rest of the Company's revenues are derived from the rights acquired in 2006 in the AriesOne partnership. Delek Energy's share of AriesOne revenues (net, less royalties) in Q4 2006 amounted to NIS 9.6 million from oil sales and NIS 0.5 million from gas sales. In 2007 the Company's share in AriesOne revenues (net, less royalties) amounted to NIS 43.1million from oil sales and $2.7million from gas sales. In 2008 Delek Energy expects revenues from the operations f Elk.

1.13.13 Customers

A. Customers in Israel

As of the report date, the limited partnerships (together with other partners in Yam Tethys project) have signed five contracts to provide natural gas, totaling 24 BCM (excluding the volumes purchases under the addendum to the IEC agreement with IEC), which account for 75% of the total estimated gas reserves (proved) in Yam Tethys project (see table in section 1.13.2.H above) As of December 31, 2007, 8 BCM have been supplied. Revenues of the partnerships from IEC accounted for 99% of revenues in 2005, 97% of revenues in 2006 and 92% of revenues in 2007.

Delek Energy is dependent on IEC, since cancellation or termination of the contract with IEC would materially impact Delek Energy's operations and profitability. For details of the agreement with IEC, see section 1.13.28.A below.

For a summary of the limited partnerships' agreements for the sale of natural gas, see section 1.13.28 below.

B. Customers in the United States

In 2005-2007 AriesOne and Elk sold oil to numerous customers, since in the USA oil, gas and natural gas liquids are commodities with prices determined by global fluctuations in supply and demand. The USA market is large and sophisticated and Delek Energy is able to contract with a wide range of customers. No single customer in the USA accounts for 10% or more of Delek Energy's total revenues.

1.13.14 Marketing and Distribution

A. The Yam Tethys project partners act to market gas from Mari and Noa reservoirs to potential customers beyond the current ones, and are at various stages of negotiations. There is no certainty that these negotiations will culminate in signing of binding agreements for gas delivery.

B. Delivery of gas to additional customers will only by possible after Israel Natural Gas Lines (INGL) completes the construction of the national gas pipeline. As of the report date, INGL has yet to complete said pipeline for the delivery of gas to additional customers and to additional IEC power plants.

C. The US oil market is highly developed, with appropriate infrastructure for delivery of oil and/or gas. Therefore marketing and distribution are through existing infrastructure, and Delek Energy is not required to invest in additional facilities.

D. If and as more commercial oil and/or gas discoveries are made in the exploration project in Vietnam, Delek Vietnam and its partners will be required to market the oil and gas to the local market in Vietnam and to markets outside Vietnam. On the other hand, marketing and sale of natural gas in Vietnam is contingent on agreements regarding transmission of natural gas in pipes to the shore and selling it at appropriate prices to the Vietnam market.

1.13.15 Order Backlog

For binding contracts by the limited partnerships for delivery of natural gas, see sections 1.13.28.A through 1.13.28.C. As of the report date, it is not possible to estimate at a high certainty level the forecasted gas consumption under current contracts for sale of gas, primarily due to the uncertainty and possible delays in schedule for connection of additional power plants to the gas pipeline system in view of the uncertainty of the supply of natural gas to IEC by EMG and the prices of coal supplied to IEC. For this matter, see section 1.13 below. For the minimum quantity which IEC has committed to purchase from the partnership, see section 20.13.25A above.

Below the minimum annual quantities for 2008-2009 determined in the agreement for supply of natural gas:[1]

Minimum total annual quantity in the contracts (BCM)	
2008	2009
1.6	1.9

1.13.16 Competition

A. In the natural gas sector, sales are generally intended for local markets only due to impracticality of transporting gas other than by pipeline (which requires large reserves that justify establishment of an LNG system), and therefore the competition is with entities operating in the same markets. In Israel as of December 31, 2007, the Yam Tethys project partners are the only actual suppliers of natural gas to consumers in Israel. However, there are two other suppliers of natural gas competing in the Israeli market.

To the best of the Company's knowledge, EMG, which holds import licenses for gas from Egypt, has started to deliver natural gas from El Arish to its reception terminal in Ashkelon. To the best of the Company's knowledge, EMG is expected to start supplying natural gas to IEC in the second quarter of 2008.

The other supplier is BG. To the best of Delek Energy's knowledge, BG and its partner have discovered natural gas reservoirs off the Gaza shore. These reservoirs are of similar size to current discoveries at Yam Tethys. BG recently announced that it was reducing its operation in Israel and according to information published in the media, it has closed its office in Israel. The State of Israel has been negotiating for some time to purchase from BG and its partners natural gas produced from the above discoveries, which have yet to be developed. Development and connection to the national pipeline is expected to continue for a number of years. Such a purchase, should it materialize, may have a material adverse effect on the ability of the partnerships to market the gas reserves that it holds at that time.[2]

Natural gas suppliers also compete with other fuels, including coal, and the level of gas consumption and price are affected by the prices of these fuels. In this context, it is noted that

---

1 Based on the minimum quantities stipulated in the agreements with IEC, Paz Ashdod, Delek Ashkelon, AIPM and ICL. The Company estimates that the actual quantities will be higher

2 On December 25, 2007 the High Court of Justice ruled to impose restrictions on the State of Israel for natural gas purchased from BG and sold in Israel (see section 1.13.29 B below). To the best of the partnership's knowledge, the government is initiating, following the High Court ruling, an amendment to the Natural Gas Sector Law. This amendment will allow negotiations for the purchase of natural gas from BG and its sale in Israel

holding in gas rights, other than those directly and exclusively arising from the Matan and/or Michal licenses, which they held jointly on the decision date, whether on their own or with other holders, unless such joint holding is expressly permitted in writing by the Commissioner.

2. In any arrangement, agreement or understanding, verbally or in writing, with regard to setting a mechanism or system for decision making between holders of Matan and Michal licenses for marketing natural gas produced under the Matan and Michal licenses, none of the "local corporations" shall individually own, directly or indirectly, any right or power to prevent the other holders from taking any decision or action for marketing natural gas produced under the Matan and Michal licenses.

3. Definitions: The "local corporations" – "Delek Group" and "Isramco"; "Delek Group" – Avner Oil Exploration Limited Partnership and/or Delek Drilling Limited Partnership and/or any person affiliated with any of them; "Isramco" – Isramco Negev 2 Limited Partnership and any person affiliated with it.

C. On January 18, 2007 the partnership applied to the Commissioner to waive approval of a restrictive agreement by the Antitrust Court. The above application was filed in connection with joint exploration operations by the partnerships and Isramco in the area of licenses 331/Ohad and 332/Shimshon. In the application, the partnerships claimed that such joint exploration operations do not constitute a restrictive agreement as defined in the Antitrust Law, 5748-1988 and that the application is filed merely for the sake of caution and in view of the Commissioner's decision on the Matan and Michal licenses. The Commissioner's approval was still pending by August 2, 2007, and consequently a decision was made to separate the leases so that the full leases of the 332/Shimshon license would be transferred to Isramco and the full leases in the 331/Ohad license would be transferred to the partnerships.

D. On November 18, 2007 the partnership applied to the Commissioner to waive the need for approval of a restrictive agreement by the Antitrust Court. The above request was filed in connection with joint exploration operations by the partnerships and Isramco in the area of 346/Hof licenses. The decision of the Commissioner is still pending and Delek Energy does not know the nature of the decision or when it will be received.

1.13.28 Material Agreements

Delek Energy contracted certain material agreements which were effective in the period described in the report, as follows:

A. Agreement to sell natural gas to IEC

1. On June 25, 2002 the partners of Yam Tethys project (in this section: the sellers) and Israel Electric Corporation (in this section: IEC or the buyer) signed an agreement for delivery of natural gas to IEC.

2. The agreement is valid until July 1, 2014 or by such date as the sellers have delivered to the buyer a cumulative gas volume equal to 643 million MMBTU[1] (18 BCM) (total contracted volume), whichever is earlier.

3. The buyer or the sellers may terminate the agreement with prior written notice of at least 30 days, should the other party (and for the sellers, any of them) take any bankruptcy action (as defined in the agreement) which is likely to have an adverse effect on the discharge of their obligations pursuant to the agreement. The buyer and sellers agreed not to exercise any right they may have to lawfully terminate the agreement other than in connection with significant or continued breach of material provisions of the agreement, and only after granting a 90-day period to the party in breach to remedy such breach (unless a shorter period is stipulated in the agreement).

4. The agreement further stipulates that, without prejudice to the sellers' obligations under the agreement with regard to maintaining reserves, the sellers would not be limited to any

[1] MMBTU equals one million BTU, which is one billion cubic meters. As of March 31, 2007, 5.7 BCM of gas has been supplied to IEC. See also section 1.13.2.1.D below

sources of natural gas (either from Israel or imported) which they supply to the buyer under the agreement.

5. The sellers will ensure that at any time during the term of the agreement they shall have available remaining reserves in reservoirs amounting to 130% of the remaining total contracted volume (TCQ). The agreement sets forth instructions for reporting on and supervision of the remaining reserves and for adjustment of certain provisions in the agreement should the sellers fail to maintain sufficient reserve balances as required. It is noted that as of the date of the report, the sellers are in compliance with the requirements of the reserve balances.

6. The agreement stipulates the annual contracted volume of gas, which changes over the term of the agreement, *inter alia,* according to the pace of completion of the transmission system and its connection to IEC power stations for delivery of gas to the stations (hereinafter in this section: the annual contracted volume).

7. According to the agreement, gas is supplied on an hourly basis with a minimum and maximum volume per hour, according to procedures and mechanisms set forth in the agreement.

8. Minimum bill quantity: The agreement specifies the annual minimum bill quantity, at 80% of the annual contracted volume (subject to adjustments) for which the buyer has committed to pay even if the buyer does not consume said volume, subject to provisions of the agreement, as well as instructions regarding calculation and adjustments of the minimum bill quantity, including for cause of force majeure or failure to supply by the sellers. The agreement also specifies a mechanism for the accumulation of excess volume consumed by the buyer in the course of any year, and its use to reduce IEC's undertaking to purchase a minimum quantity, as set forth above, in subsequent years. Furthermore, the agreement specified provisions and mechanisms allowing IEC to receive gas at no additional charge up to the volume paid for, on account of gas not consumed due to activation of the minimum bill quantity mechanism. As of the date of this report, IEC consumes volumes exceeding the minimum bill quantity.

9. Financial value of the agreement: The Company estimates that total net receipts (net of royalties to the State and to third parties, including interested parties and Delek Energy) of Delek Drilling Partnership and to Avner Partnership, from the production start date for their share alone, will be $330 million and $300 million, respectively,[1] based on the partnerships' hedging agreements (see subsection 10 below).

   Notice regarding forward-looking information: The aforementioned estimate by the Group is forward-looking information, based on its estimates of future gas consumption by IEC, based on the professional opinions (geology, engineering, technical and marketing) obtained by the general partners in the limited partnerships. The estimate may not materialize should actual gas consumption by IEC be lower than the aforementioned projections.

10. Price of gas: The contracted price for the gas is denominated in USD per energy unit (BTU) and is linked to a basket of fuels and to the US Producer Price Index according to the mechanism in the agreement, including minimum and maximum prices. It is noted, in this context, that in view of the hedging agreements of the partnerships and Delek Investments as set forth in Note 16 to the financial statements, after signing the agreement with IEC, the partnerships effectively set the price for gas volumes to be sold under the agreement with IEC at $2.47 per million BTU.

11. Gas quality: According to the agreement, delivery of natural gas will comply with specifications set forth in the agreement and according to requirements of the transmission company as approved by the relevant authorities from time to time. The buyer has the right to refuse to receive non-compliant gas until such non-compliance is remedied. All disputes between the parties with regard to gas quality may be submitted to an expert for resolution at the request of any of the parties.

---

[1] In the matter of supply to IEC, see section 1.13.13.A above

12. Breach and damages: Under the agreement, should the sellers fail to supply, at any time, the gas volume ordered by the buyer according to the agreement, and should the non-supply exceed the deviation allowed by the agreement, the sellers shall compensate the buyers in the subsequent month by selling gas at a discounted price up to the volume of gas not supplied in breach of provisions of the contract. Furthermore, the agreement sets forth specific breaches by any party for which damages are payable at high rates (including financial compensation). The agreement also sets limits to liability of each party for breach of some of the agreement provisions at amounts specified in the agreement.

13. Collateral and guarantees: The agreement establishes collateral to be provided and maintained by each of the sellers in favor of the buyer, to guarantee the sellers' obligations pursuant to the contract, all at dates, terms and amounts set forth in the agreement. The shares of Delek Drilling Partnerships and Avner Partnership in said collateral are $7.65 million and $6.9 million, respectively, until March 15, 2006, and $12.75 million and $11.5 million, respectively, after March 15, 2006. The aforementioned collateral was provided by the partnerships as renewable bank guarantees. As of the date of the report, the date for increasing the said collateral in the agreement has passed, however the partnerships have yet to increase the collateral and are negotiating with IEC in respect of their increase.

14. Relationships between sellers and the sellers' coordinator: The sellers operate jointly on issues such as development of the reservoir, the sellers' facilities and gas production, delivery and supply pursuant to the agreement. Concurrently, the buyer declares that none of the provisions in the agreement shall be considered as creating mutual liability between the sellers, and each seller is individually liable to the buyer for its share of the oil rights and in connection with any liability arising from the agreement. Although the buyer may order gas volumes by a single notice to the sellers' coordinator, the volume considered ordered from each of the sellers will be the portion of each of the sellers out of the total volume ordered.

15. On August 15, 2006 the sellers contracted an addendum to the agreement for supply of additional volume of natural gas (the addendum to the agreement). Pursuant to the addendum to the agreement, the sellers granted IEC an option to purchase additional volumes of natural gas, primarily in response to IEC's gas supply requirements during peak consumption hours. The aforementioned option is valid until March 31, 2008 and pertains to additional gas volumes purchased since July 2006. The price for gas purchased under the addendum to the agreement is significantly higher than the price at which IEC purchases natural gas under the current agreement, mainly due to increased global fuel prices.

B. Agreement with Paz Ashdod:

On September 3, 2004 an agreement was signed between the Yam Tethys project partners and Paz Ashdod for supply of gas to the Ashdod Refinery. The total contracted volume that Yam Tethys group is required to supply to Oil Refineries Ltd. (ORL) is 1.3 BCM.

The term of the contract is ten years from the end of the trial period specified in the contract, or until ORL consumes the total contracted volume, whichever is earlier.

ORL has a take or pay agreement for a minimum annual volume of gas according to a mechanism set forth in the agreement.

The total financial value of the agreement (for all Yam Tethys project partners) is estimated at $120 million.

Gas supply to ORL started in November 2005.

C. Agreement with Delek Ashkelon

In August 2005 an agreement was signed and approved between Yam Tethys project partners and IPP Delek Ashkelon Ltd., a company controlled by Delek Group. (Delek Ashkelon) for supply of gas to Delek Ashkelon's power station adjacent to the desalination plant in Ashkelon. Gas supply under the agreement shall commence when natural gas is delivered to Delek Ashkelon's power station, subject to terms set forth in the agreement, and shall terminate after 15 years from the end of the run-in period of the power station, or on June 30, 2022.

The annual gas volume to be purchased by Delek Ashkelon is 0.12 BCM. The total financial value of the agreement (for all Yam Tethys project partners) is estimated at $160 million. Gas supply to Delek Ashkelon commenced in August 2007. Delek Ashkelon has a take or pay agreement for a minimum annual volume of gas according to a mechanism set forth in the agreement

Gas supply to Delek Ashkelon under this agreement commenced in August 2007.

D. Agreements for the sale of natural gas to AIPM

On July 29, 2005 an agreement was signed between the Yam Tethys project partners and American Israeli Paper Mills Ltd. (AIPM) for the supply of natural gas to AIPM. Gas supply under the agreement shall commence upon completion of the pipeline and required facilities, and shall terminate on the earlier of 5 years from commencement of gas flow or upon purchasing of 0.43 BCM, but no later than July 1, 2011.

The gas price formula specified in the agreement is based on the price of fuel oil with a discount component, including minimum and maximum prices. AIPM has a take or pay agreement for a minimum annual volume of gas according to a mechanism set forth in the agreement.

The total financial value of the agreement (for all Yam Tethys project partners) is estimated at $40 million. Actual revenues will be influenced by a number of conditions, primarily the price of fuel oil and rate of gas consumption.

Gas supply under this agreement commenced in August 2007.

E. Agreement for the sale of natural gas to Israel Chemicals Ltd.

On March 25, 2008 an agreement was signed between the Yam Tethys project partners and a subsidiary of Israel Chemicals Ltd. (ICL), guaranteed by ICL, for the supply of natural gas to plants in the ICL Group in Israel (ICL Group).

According to the agreement, the ICL Group undertook to purchase a total gas quantity of 2 BCM (2 billion cubic meters) from Yam Tethys partnership, subject to the provisions in the agreement (contractual gas quantity).

Gas supply shall commence upon completion of the gas pipeline to the south, which, based on information ICL received from Israel Gas Lines Ltd., will probably be towards the end of 2008, and upon ICL Group's conversion to gas-fuelled plants, planned to start gradually from the end of 2008 in the Sdom facilities, where most ICL gas consumption is expected, and to end on the earlier of: (1) five years after completion of the running in period, but no later than September 2015 (subject to extension as specified below); (2) on completion of purchase of the contractual gas amount.

The price of gas is based on the price of fuel oil, with a discount including maximum and minimum prices. The ICL Group has a take or pay agreement for a minimum annual volume of gas according to a mechanism set forth in the agreement.

The total financial value of the agreement (for all Yam Tethys project partners) is estimated at $260-330 million. Actual revenues will be influenced by a number of conditions, primarily the price of fuel oil and rate of gas consumption.

The agreement includes a number of contingent conditions. The main conditions are the attainment of permits for construction of connection facilities for gas and the signing of gas transmission agreements with Israel Gas Lines Ltd.

F. Operating agreement for Yam Tethys project (see section 1.13.2.F above)

G. Financing agreement for Yam Tethys project (see section 1.13.22 above)

H. Agreements for payment of royalties:

Royalties received from Delek Drilling partnership

Delek Energy and Delek Israel (hereinafter in this sub-section: the transferors**)** and the general partner of Delek Drilling Partnership, on behalf of the partnership, signed a rights transfer agreement in 1993. The right of Delek Israel was transferred on March 30, 2000 to Delek Investments as part of reorganization in Delek Group.

According to the agreement, the transferors transferred the rights in a number of licenses to Delek Drilling partnership (hereinafter in this sub-section: the transferred rights) and Delek

1.13.32 Risk Factors

Oil and gas exploration and the development of oil and gas discoveries involve large financial outlays with a high financial risk, primarily for reasons set forth below. This is even more significant for offshore oil exploration and production operations.

A. Fluctuations in the dollar exchange rate: Delek Energy is exposed to fluctuations in the dollar exchange rate. The international operations of Delek Energy are generally denominated in dollars. From January 1, 2008, the limited partnerships also measure their results in dollars, therefore every erosion in the dollar-shekel exchange rate will lower the revenues, net expenses and assets of Delek Energy, and consequently, will lead to a decrease in Delek Energy's equity and profitability. On the other hand, in 2007 Delek Energy started to raise dollar loans, which as of the date of the report constitute 14% of the total liabilities in the consolidated balance sheet. Therefore, every revaluation in the shekel-dollar exchange rate will result in revenue from exchange rate differences due to these loans.

B. Dependence on global oil prices: The prices paid by consumers for natural gas in reservoirs in which the partnerships are party, are derived, inter alia, from prices of alternative energy sources to gas, such as oil and coal. Fluctuations in prices of alternative fuels could influence the prices which Delek Energy is able to obtain from its customers for natural gas sold by the partnerships and/or may influence the viability of production from newly discovered reservoirs (if any) by Delek Energy and/or the limited partnerships. Oil prices have a direct impact on Delek Energy's income from sales of oil and gas in its overseas projects. Furthermore, assessments of reserves are also affected by oil and gas prices, for example, a decrease in oil and gas prices could result in depletion economically-viable production from reserves in Delek Energy's oil and gas reservoirs while an increase in oil prices could result in an increase in production from economically-viable reservoirs.

C. Competition for gas supply: To the best of Delek Energy's knowledge, as of the report date there are two major competitors for gas supply in the Israeli market (see section 1.13.16 above). In view of the relatively small gas market in Israel, competition could push down prices and consequently affect the ability of the limited partnerships to market the gas reserves they discovered or could discover. In the Vietnam project as well, if a potential commercial quantity of natural gas is discovered, Delek Energy could be required to compete with other gas suppliers for supply of gas to local markets in Vietnam.

D. Uncertainty regarding the construction of the national gas pipeline: The ability of the Yam Tethys project partners to sell their gas to other potential consumers and to increase the gas volume supplied to IEC is dependent, inter alia, on establishment of the national gas pipeline. As of the date of this report, there is still uncertainty with regard to the completion date of this system.

E. Insurance: Although Delek Energy is insured against possible damages with regard to projects it which it operates, these policies do not cover all potential risks and therefore the insurance payout may not cover all potential losses. Furthermore, there is no certainty that appropriate policies may be purchased in the future under reasonable commercial terms, if at all.

F. Operational risks: Oil and gas exploration and production operations are exposed to all risks involved in exploration and production of oil and gas, such as uncontrolled gushing from the well, explosion, collapse and conflagration of the well. Any of these could damage or destroy the oil or gas wells, production facilities, exploration equipment as well as cause bodily injury and damage to property. There is also a risk that equipment could be trapped in the borehole, preventing the continuation of drilling operations or incurring significant expenses. Should any of these events occur at sea, consequences could be extremely severe and major damage could be incurred. Furthermore, there is risk of liability for pollution damage due to gushing and/or leaking of oil and/or gas. There is no certainty that all required insurance to cover these risks can be obtained, nor that coverage provided by the insurance policies obtained will be sufficient. It is noted that the decision on the type and scope of insurance policy is usually made separately for each drilling, taking into account, inter alia, the cost of insurance, nature and scope of the proposed coverage and the anticipated risks. The operator of a specific project could decide not to take out certain policies.

G. Dependence on contractors, equipment and professional services: Currently in Israel there are no contractors who are able to conduct drillings or marine seismic surveys of the type conducted by the limited partnerships. Therefore, the partnerships are required to contract

The table below presents a summary of risk factors by type (macro risks, sector-specific risks and company-specific risks), according to the estimates of Delek Energy based on the degree of their effect on Delek Energy: major, moderate or minor effect.

	Impact of risk factors on Delek Energy's business		
	Major effect	**Moderate effect**	**Minor effect**
Macro risks			
Fluctuations in the dollar exchange rate	X		
Dependence on global oil prices	X		
Sector-specific risks			
Competition for gas supply	X		
Uncertainty regarding construction of the national gas pipeline	X		
Insurance		X	
Operational risks		X	
Dependence on contractors		X	
Exploration risks	X		
Estimated schedules and costs		X	
Field development on discovery	X		
Dependence on permits from external entities		X	
Regulatory changes		X	
Dependence on weather and sea conditions			X

Company-specific risks for Delek Energy			
Tax risks			X
Financing liabilities		X	
Dependence on primary customer	X		
Dependence on operator		X	
Arrears in payments for joint operations			X
Shortage of production and development resources and participation in operation		X	
Cancellation or expiration of oil rights and assets			X
Migrating reservoirs			X
Security and geo-political risks		X	

The impact of these risk factors on the energy sector is based on estimates alone and may actually differ.