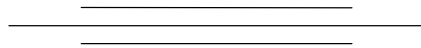


CASTRO MODEL LTD.
2007 ANNUAL REPORT

CASTRO MODEL LTD.
2007 ANNUAL REPORT

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AUDITORS' REPORT

To the shareholders of

CASTRO MODEL LTD.

We have audited the financial statements of Castro Model Ltd. ("the Company") and the consolidated financial statements of the Company and its subsidiaries as follows: balance sheets as of December 31, 2007 and 2006 and the related statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these financial statements based on our audit.

We did not audit the financial statements of an associated company, the Company's interest in which, as reflected in the balance sheet as of December 31, 2007 and 2006, is NIS 3,212,000 and NIS 1,974,000 respectively and the Company's share in the losses of which for 2007 is NIS 13,778,000, for 2006 is NIS 12,771,000 and for 2005 is NIS 6,127,000 respectively. The financial statements of the above associated company were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to amounts included for that company, is based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in Israel, including those prescribed by the Auditors' (Mode of Performance) Regulations, 1973. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Company's Board of Directors and management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report of the other auditors noted above, the financial statements referred to above present fairly, in all material respects, the financial position of the Company and on a consolidated basis as of December 31, 2007 and 2006 and the results of operations, changes in shareholders' equity and cash flows of the Company and on a consolidated basis for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in Israel. Furthermore, in our opinion, the financial statements referred to above are prepared in accordance with the Securities (Preparation of Annual Financial Statements) Regulations, 1993.

As explained in Note 1b, the financial statements referred to above are presented in New Israel Shekels, in conformity with accounting standards issued by the Israel Accounting Standards Board.

Without qualifying our opinion, we would draw attention to the fact that, on January 1, 2007, a new accounting standard published by the Israel Accounting Standards Board entered into force, the provisions of which have been implemented by the Company in the preparation of these financial statements. As stated in Notes 1j and 1t, the comparative data included with these financial statements are stated after the retroactive application of the changes in accounting policy relating to the treatment of intangible assets required by the provisions of the relevant standard.

Tel Aviv,
March 5, 2008

Kesselman and Kesselman
Certified Public Accountants

CASTRO MODEL LTD.
CONSOLIDATED BALANCE SHEETS

		December 31		
		Note	2007	2006
		NIS (thousands)		
		(see note 1b)		
A s s e t s		12		
CURRENT ASSETS:		11		
Cash and cash equivalents			45,661	26,631
Short-term investments		13a	206,078	59,045
Accounts receivable:		13b		
Trade			83,972	85,904
Other			31,875	33,265
Inventories			81,962	64,237
T o t a l current assets			449,548	269,082
INVESTMENTS AND LONG-TERM RECEIVABLES:				
Associated company		2, 11	15,441	17,528
Prepaid expenses, loan and deposits, after deduction of current maturities		3, 11	12,826	11,726
Deferred income taxes		10e	6,187	6,728
			34,454	35,982
FIXED ASSETS:			135,026	137,416
Cost			70,278	77,627
L e s s – accumulated depreciation		4	64,748	59,789
INTANGIBLE ASSETS, NET OF ACCUMULATED AMORTIZATION		5	1,198	*521
			549,948	365,374

Aharon Castro
Chairman of the Board
of Directors

Gabriel Rotter
General Manager and
member of the Board of
Directors

Ron May-Tal Weinfeld
Deputy General Manager
and VP Finance

Date of approval of financial statements: March 5, 2008

* after retroactive application of change in accounting policy (see Note 1t below)

	Note	December 31	
		2007	2006
		NIS (thousands) (see note 1b)	
Liabilities and shareholders' equity			
CURRENT LIABILITIES:	11, 12		
Current maturities of long term bank loans	6	23,775	18,529
Accounts payable and accruals:	13d		
Trade		32,401	29,035
Other		45,736	41,496
T o t a l current liabilities		101,912	89,060
LONG-TERM LIABILITIES:			
Bank loans, net of current maturities	6, 11, 12	194,877	37,122
Liability for employee rights upon retirement, net of amount funded in severance pay funds	7	8,680	7,924
T o t a l long-term liabilities		203,557	45,046
COMMITMENTS AND CONTINGENT LIABILITIES	8		
T o t a l liabilities		305,469	134,106
SHAREHOLDERS' EQUITY	9	244,479	231,268
		549,948	365,374

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

CASTRO MODEL LTD.
BALANCE SHEETS OF COMPANY

		December 31		
		Note	2007	2006
		NIS (thousands)		
		(see note 1b)		
A s s e t s		12		
CURRENT ASSETS:		11		
Cash and cash equivalents			13,581	7,742
Short-term investments		13a	188,513	35,356
Accounts receivable:		13b		
Trade			30,923	27,401
Other			29,289	20,071
Inventories		13c	12,098	9,017
T o t a l current assets			274,404	99,587
INVESTMENTS AND LONG-TERM RECEIVABLES:				
Investee companies		2, 11	254,308	214,964
Prepaid expenses, loan and deposits, after deduction of current maturities		3, 11	7,277	7,810
Deferred income taxes		10e	1,166	1,000
			262,751	223,774
FIXED ASSETS:				
Cost		4	59,565	*58,999
Less – accumulated depreciation			23,696	*21,686
			35,869	37,313
INTANGIBLE ASSETS, NET OF ACCUMULATED AMORTIZATION				
		5	1,198	*521
			574,222	361,195

Aharon Castro
Chairman of the Board
of Directors

Gabriel Rotter
General Manager and
member of the Board of
Directors

Ron May-Tal Weinfeld
Deputy General Manager
and VP Finance

Date of approval of financial statements: March 5, 2008

* after retroactive application of change in accounting policy (see Note 1t below)

	<u>Note</u>	<u>December 31</u>	
		<u>2007</u>	<u>2006</u>
		<u>NIS (thousands)</u> <u>(see note 1b)</u>	
Liabilities and shareholders' equity			
CURRENT LIABILITIES:	11, 12		
Current maturities of long-term bank loans	6	23,733	17,638
Accounts payable and accruals:	13d		
Trade		14,346	12,866
Other		93,772	59,648
T o t a l current liabilities		<u>131,851</u>	<u>90,152</u>
LONG-TERM LIABILITIES:			
Bank loans, net of current maturities	6, 11, 12	194,877	37,080
Liability for employee rights upon retirement, net of amount funded in severance pay funds	7	3,015	2,695
T o t a l long-term liabilities		<u>197,892</u>	<u>39,775</u>
COMMITMENTS AND CONTINGENT LIABILITIES	8		
T o t a l liabilities		<u>329,743</u>	<u>129,927</u>
SHAREHOLDERS' EQUITY	9	<u>244,479</u>	<u>231,268</u>
		<u>574,222</u>	<u>361,195</u>

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

CASTRO MODEL LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS

	<u>Note</u>	<u>For the year ended December 31,</u>		
		<u>2007</u>	<u>2006</u>	<u>2005</u>
				<u>NIS (thousands) (see note 1b)</u>
REVENUES, net		580,454	533,612	421,683
COST OF REVENUES	13e	245,725	222,682	176,225
GROSS PROFIT		334,729	310,930	245,458
SELLING AND MARKETING EXPENSES	13f	222,774	200,343	160,014
GENERAL AND ADMINISTRATIVE EXPENSES	13g	36,595	32,451	27,581
INCOME FROM ORDINARY OPERATIONS		75,360	78,136	57,863
FINANCING INCOME (EXPENSES), net	13h	(11,096)	(4,030)	2,814
OTHER INCOME, net	13i	2,123	2,907	2,232
INCOME BEFORE TAXES ON INCOME		66,387	77,013	62,909
TAXES ON INCOME	10	22,017	19,492	17,928
OPERATING INCOME OF COMPANY AND SUBSIDIARIES		44,370	57,521	44,981
SHARE IN LOSSES OF ASSOCIATED COMPANY	2	13,778	12,771	6,127
NET INCOME		30,592	44,750	38,854
		<u>NIS (see note 1b)</u>		
EARNINGS PER SHARE	1r			
NET EARNINGS PER SHARE:				
Basic		5.81	8.48	7.29
Fully-diluted		5.81	8.48	7.28
Number of shares used in computation of basic earnings per share		5,265	5,276	5,333
Number of shares used in computation of diluted earnings per share		5,265	5,276	5,335

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

CASTRO MODEL LTD.
STATEMENTS OF OPERATIONS OF COMPANY

	<u>Note</u>	<u>For the year ended December 31,</u>		
		<u>2007</u>	<u>2006</u>	<u>2005</u>
				<u>NIS (thousands) (see note 1b)</u>
REVENUES, net		188,138	165,108	78,579
COST OF REVENUES	13e	110,469	83,706	25,826
GROSS PROFIT		77,669	81,402	52,753
SELLING AND MARKETING EXPENSES	13f	51,902	44,600	13,429
GENERAL AND ADMINISTRATIVE EXPENSES	13g	14,183	14,327	9,100
INCOME FROM ORDINARY OPERATIONS		11,584	22,475	30,224
FINANCING EXPENSES, net	13h	(12,449)	(100)	(1,169)
OTHER INCOME, net	13i	3,000	3,190	2,505
INCOME BEFORE TAXES ON INCOME		2,133	25,565	31,560
TAXES ON INCOME	10	3,314	3,441	7,488
OPERATING INCOME (LOSS)		(1,181)	22,124	24,072
PROFITS OF INVESTEE COMPANIES	2	31,773	22,626	14,782
NET INCOME		30,592	44,750	38,854
				<u>NIS (see note 1b)</u>
EARNINGS PER SHARE	1r			
NET EARNINGS PER SHARE:				
Basic		5.81	8.48	7.29
Fully-diluted		5.81	8.48	7.28
Number of shares used in computation of basic earnings per share		5,265	5,276	5,333
Number of shares used in computation of diluted earnings per share		5,265	5,276	5,335

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

CASTRO MODEL LTD.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	<u>Share capital</u>	<u>Capital reserves</u>	<u>Differences arising on translation of foreign currency financial statements of associated company</u>	<u>Retained earnings</u>	<u>Appropriation for payment of dividend declared subsequent to balance sheet date</u>	<u>Cost of Company shares held by subsidiary and cost of treasury shares</u>	<u>Total</u>
	NIS (thousands) (see note 1b)						
BALANCE AT JANUARY 1, 2005	11,248	32,343	383	130,965	11,773	(4,295)	182,417
MOVEMENT IN 2005:							
Net income				38,854			38,854
Issue of bonus shares	6	414		(420)			
Conversion of warrants into shares	8	67					75
Tax benefit stemming from options granted to employee and with respect to which, no expense was entered in accounting records		141					141
Differences arising on translation of financial statements			(274)				(274)
Acquisition of treasury shares						(6,775)	(6,775)
Dividend paid					(11,773)		(11,773)
Dividend proposed				(14,456)	14,456		
BALANCE AT DECEMBER 31, 2005	11,262	32,965	109	154,943	14,456	(11,070)	202,665
MOVEMENT IN 2006:							
Net income				44,750			44,750
Differences arising on translation of financial statements			(9)				(9)
Acquisition of treasury shares						(1,682)	(1,682)
Dividend paid					(14,456)		(14,456)
Dividend proposed				(18,660)	18,660		
BALANCE AT DECEMBER 31, 2006	11,262	32,965	100	181,033	18,660	(12,752)	231,268

CASTRO MODEL LTD.
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	<u>Share capital</u>	<u>Capital reserves</u>	<u>Differences arising on translation of foreign currency financial statements of associated company</u>	<u>Retained earnings</u>	<u>Appropriation for payment of dividend declared subsequent to balance sheet date</u>	<u>Cost of Company shares held by subsidiary and cost of treasury shares</u>	<u>Total</u>
	NIS (thousands) (see note 1b)						
BALANCE AT DECEMBER 31, 2006	11,262	32,965	100	181,033	18,660	(12,752)	231,268
MOVEMENT IN 2007:							
Net income				30,592			30,592
Differences arising on translation of financial statements			1,279				1,279
Dividend paid					(18,660)		(18,660)
Dividend proposed				(23,327)	23,327		
BALANCE AT DECEMBER 31, 2007	<u>11,262</u>	<u>32,965</u>	<u>1,379</u>	<u>188,298</u>	<u>23,327</u>	<u>(12,752)</u>	<u>244,479</u>

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

CASTRO MODEL LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	<u>2007</u>	<u>2006</u>	<u>2005</u>
	<u>NIS (thousands) (see note 1b)</u>		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	30,592	44,750	38,854
Adjustments required to reflect cash flows from operating activities (see below)	27,441	3,259	(3,150)
Net cash provided by operating activities	<u>58,033</u>	<u>48,009</u>	<u>35,704</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of fixed assets	(15,953)	(15,515)	(5,908)
Proceeds from sale of fixed assets	1,022	*1,593	*1,705
Acquisition of intangible assets	(825)	*(545)	*(128)
Investment in shares of, and loans granted to, associated company	(10,693)	(19,221)	(9,921)
Long-term prepayments and deposits, net	(2,315)	(2,622)	(715)
Sale (acquisition) of marketable securities, net	(147,777)	8,742	(14,847)
Deposits made with banks, net		4,603	(4,603)
Net cash used in investing activities	<u>(176,541)</u>	<u>(22,965)</u>	<u>(34,417)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Receipt of long-term bank loans	180,000		50,000
Repayment of long-term bank loans	(23,802)	(26,791)	(29,920)
Repayment of other long-term loans			(92)
Consideration received on exercise of warrants			75
Acquisition of treasury shares		(1,682)	(6,775)
Dividend paid (net of dividend paid to subsidiary)	(18,660)	(14,456)	(11,773)
Net cash provided by (used in) financing activities	<u>137,538</u>	<u>(42,929)</u>	<u>1,515</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>19,030</u>	<u>(17,885)</u>	<u>2,802</u>
BALANCE OF CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>26,631</u>	<u>44,516</u>	<u>41,714</u>
BALANCE OF CASH AND CASH EQUIVALENTS AT END OF YEAR	<u><u>45,661</u></u>	<u><u>26,631</u></u>	<u><u>44,516</u></u>

* After retroactive application of change in accounting policy (see Note 1t below)

CASTRO MODEL LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the year ended December 31,		
	2007	2006	2005
	NIS (thousands) (see note 1b)		
Adjustments required to reflect cash flows			
from operating activities:			
Income and expenses not involving cash flows:			
Depreciation and amortization	12,161	11,428	12,472
Share of losses of associated company	13,778	12,771	6,127
Unrealized gains on sales to associated company, net	(918)	274	980
Loss (gain) on marketable securities, net	744	(577)	(2,999)
Deferred income taxes, net	446	(525)	(1,098)
Liability for employee rights upon retirement, net	756	1,904	799
Gain on disposal of fixed assets	(495)	(151)	(1,785)
Amortization of long-term prepaid expenses	1,536	1,643	1,769
Linkage differentials on (erosion of) principal of long-term repayable loans and long-term loans granted	7,949	(488)	2,369
	<u>35,957</u>	<u>26,279</u>	<u>18,634</u>
Changes in operating assets and liabilities:			
Decrease (increase) in accounts receivable:			
Trade	1,590	(16,036)	(8,416)
Other	1,559	(14,030)	(5,569)
Increase in inventories	(17,725)	(2,313)	(7,934)
Increase (decrease) in accounts payable:			
Trade	1,820	6,345	(961)
Other	4,240	3,014	1,096
	<u>(8,516)</u>	<u>(23,020)</u>	<u>(21,784)</u>
	<u>27,441</u>	<u>3,259</u>	<u>(3,150)</u>

Supplementary information on investing activities not involving cash flows:

During the course of 2007, the Company purchased fixed assets at a cost of NIS 1.546 million. This purchase price has not yet been paid, and is accordingly not reflected in investing activities in 2007.

During the course of 2005, the Company sold fixed assets for a consideration of NIS 2.202 million. Of this amount, NIS 958,000 was paid in 2006 and was thus reflected in investing activities in that year.

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

CASTRO MODEL LTD.
STATEMENTS OF CASH FLOWS OF COMPANY

	For the year ended December 31,		
	2007	2006	2005
	NIS (thousands) (see Note 1b)		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	30,592	44,750	38,854
Adjustments required to reflect cash flows from operating activities (see below)	(30,494)	(38,400)	(20,400)
Net cash provided by operating activities	<u>98</u>	<u>6,350</u>	<u>18,454</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of fixed assets	(1,199)	*(2,001)	*(1,951)
Proceeds from sale of fixed assets	729	1,143	1,705
Acquisition of intangible assets	(825)	*(545)	*(128)
Loan and current accounts with subsidiaries, net	23,096	15,963	(18,363)
Long-term prepayments and deposits, net	228	(21)	(57)
Sale (acquisition) of marketable securities, net	(153,323)	13,777	(7,406)
Net cash used in (provided by) investing activities	<u>(131,294)</u>	<u>28,316</u>	<u>(26,200)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Receipt of long-term bank loans	180,000		50,000
Repayment of long-term bank loans	(22,905)	(22,266)	(25,496)
Consideration received on exercise of warrants			75
Acquisition of treasury shares		(1,682)	(6,775)
Dividend paid	(20,060)	(15,542)	(12,642)
Net cash provided by (used in) financing activities	<u>137,035</u>	<u>(39,490)</u>	<u>5,162</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	5,839	(4,824)	(2,584)
BALANCE OF CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>7,742</u>	<u>12,566</u>	<u>15,150</u>
BALANCE OF CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>13,581</u>	<u>7,742</u>	<u>12,566</u>

* After retroactive application of change in accounting policy (see Note 1t below)

CASTRO MODEL LTD.
STATEMENTS OF CASH FLOWS OF COMPANY

	2007	2006	2005
	NIS in thousands (see note 1b)		
Adjustments required to reflect cash flows from operating activities:			
Income and expenses not involving cash flows:			
Profits of investee companies, net of dividends received	(27,707)	(22,626)	(14,782)
Unrealized profits on sales to associated company, net	789		
Depreciation and amortization	3,028	3,134	3,064
Loss (gain) on marketable securities, net	166	(708)	(2,567)
Deferred income taxes, net	(762)	(445)	219
Liability for employee rights upon retirement, net	320	515	437
Gain on disposal of fixed assets	(495)	(76)	(1,785)
Amortization of long-term prepayments	890	880	828
Linkage differentials on (erosion of) principal of long-term repayable loans and long-term loans granted	6,452	(208)	1,519
	(17,319)	(19,534)	(13,067)
Changes in operating assets and liabilities:			
Increase in accounts receivable:			
Trade	(3,836)	(9,850)	(8,941)
Other	(8,548)	(17,103)	(206)
Decrease (increase) in inventories	(3,081)	(545)	3,141
Increase (decrease) in accounts payable:			
Trade	1,009	5,925	(866)
Other	1,281	2,707	(461)
	(13,175)	(18,866)	(7,333)
	(30,494)	(38,400)	(20,400)

Supplementary information on investing activities not involving cash flows:

During the course of 2007, the Company purchased fixed assets at a cost of NIS 471,000. This purchase price has not yet been paid, and is accordingly not reflected in investing activities in 2007.

During the course of 2005, the Company sold fixed assets for a consideration of NIS 2.202 million. Of this amount, NIS 958,000 was paid in 2006 and was thus reflected in investing activities in that year.

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

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

The financial statements are prepared in conformity with accounting principles generally accepted in Israel and in accordance with the provisions of the Securities (Preparation of Annual Financial Statements) Regulations, 1993. The Company's significant accounting policies set out below have been applied on a consistent basis during the course of preparation of the financial statements after taking account, by way of retroactive application, of the changes in accounting policy relating to intangible assets, these changes stemming from the initial application of a new accounting standard published by the Israel Accounting Standards Board in 2007.

For information relating to the adoption of international financial reporting standards for reporting periods commencing on or after January 1, 2008, see Note 1n below. For information relating to the anticipated effect of the application of international financial reporting standards on the balance sheet data as of January 1, 2007, the balance sheet data as of December 31, 2007 and the statement of income data for the year ended December 31, 2007, see Note 17.

a. General:

1) Castro Model Ltd. ("the Company") is a public company, the shares of which have been traded on the Tel Aviv Stock Exchange since February 1992. The Company and its subsidiaries are principally engaged in two areas of operation, the retail selling of its fashion goods designed and manufactured by subcontractors through retail outlets operated by a subsidiary and others, and the wholesaling of the same fashion goods to overseas franchisees. For information relating to operating segments, see Note 16.

2) Definitions:

Subsidiary	-	A company controlled by the Company through a shareholding of at least 50%, the financial statements of which are consolidated with those of the Company, other than a company consolidated by means of the proportionate consolidation method.
Proportionately-consolidated company	-	A jointly-owned company, none of the shareholders of which exercise exclusive control, and the financial statements of which are consolidated with those of the Company by means of the proportionate consolidation method.

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)

Associated company	-	A company, including a partnership, which is not a subsidiary or a company consolidated by means of the proportionate consolidated method, over which the Company exercises significant influence with respect to financial and operating policy, and the investment in which is presented on the basis of the equity method. Significant influence is considered to exist if the rate of holding is at least 20%, unless circumstances exist that refute this assumption.
Investee company	-	A subsidiary, an associated company, or a company consolidated by means of the proportionate consolidation method
The group	-	The Company, the subsidiaries and the company consolidated by means of the proportionate consolidation method
Interested party	-	As defined in the Securities (Preparation of Annual Financial Statements) Regulations, 1993

3) Use of estimates in the preparation of financial statements

The preparation of financial statements in conformity with generally-accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as at the dates of the financial statements, as well as the amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

b. Basis of presentation of financial statements:

- 1) The Company prepares and presents its financial statements in New Israel Shekels (NIS) in accordance with the provisions of Accounting Standard No. 12, 'Cessation of Adjustment of Financial Statements' published by the Israel Accounting Standards Board ("the IASB"), which contains transitional provisions relating to the transfer to nominal reporting as from January 1, 2004 ("the transition date").

Accordingly, the amounts relating to non-monetary assets (and the associated depreciation and amortization), investments in investee companies and capital items originating prior to the transition date, are based on the previously-reported inflation-adjusted data for December 2003. All amounts originating in the period subsequent to the transition date are reflected in the financial statements at their nominal values.

As explained in paragraph (d) below, the foreign currency financial statements of group companies are translated or re-measured into shekels for the purposes of their incorporation within these financial statements.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)

- 2) The amounts of non-monetary assets represent the reported values only of those assets, as stated in paragraph (1) above, and do not necessarily represent realization value or current economic value. In these financial statements, the term 'cost' refers to cost in terms of reported amounts.
- 3) Condensed Company data in historic nominal terms for tax purposes is provided in Note 18.

c. Consolidation of financial statements:

- 1) These financial statements are a consolidation of the financial statements of the Company and those of its subsidiaries. For information relating to subsidiaries, see Note 2(d)(1).
- 2) In addition to the above wholly-consolidated companies, the consolidated financial statements also incorporate the financial statements of a jointly-controlled investee company which are consolidated with those of the Company by means of the proportionate consolidation method in accordance with the pronouncements on this matter in Opinion No. 57 of the Institute of Certified Public Accountants in Israel ("the Institute"). Information relating to the data of the above company reflected in the consolidated financial statements may be found in Note 2(d)(2).
- 3) Mutual balances and transactions as between the consolidated companies have been eliminated. Profits on inter-company sales that have not yet been realized outside the group have also been eliminated.

d. Translation of foreign currency financial statements of investee companies

As from January 1, 2004, the Company has applied the provisions of IASB Accounting Standard No. 13, 'Effect of Changes in Foreign Currency Exchange Rates' ("Standard No. 13"), which entered into force on the date of the transition to nominal reporting (see paragraph b(1) above). This standard superseded Clarifications 8 and 9 of Opinion No. 36 of the Institute ("Opinion No. 36") which had addressed the issue in the period prior to the transition date. Most of the provisions of Standard No. 13 reflect closely the pronouncements that were previously contained in the above clarifications.

Under the provisions of this standard, the amounts reflected in foreign currency financial statements of investee companies are recorded, for consolidation or incorporation purposes, on the equity basis, as follows:

- 1) Autonomous associated company

The results of operations and cash flows of this company are translated into shekels at the exchange rates prevailing on the date of each transaction or at the average exchange rate for the period, this being regarded as a close approximation of the actual exchange rate. The balances appearing in the balance sheet are translated at the exchange rate prevailing on the date of the balance sheet.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued):

Exchange rate differences stemming from the translation of the net investment in the associated company are presented as a separate item under shareholders' equity ('differences arising on the translation of foreign currency financial statements of associated company'). Upon realization of the investment in the associated company, these exchange rate differences will be credited or charged to the statement of income as part of the gain or loss recognized on realization.

2) Subsidiaries the operations of which are integral to those of the Company

In relation to these companies, the foreign currency amounts reflected in the financial statements of these companies are re-measured into shekels; the re-measurement is effected by translating the amounts into shekels on the basis of historic exchange rates.

Differences arising from the above accounting treatment are reflected in the statement of income under financing.

e. Inventories

As from January 1, 2007, the group has applied the provisions of Accounting Standard No. 26, 'Inventories' ("Standard No. 26") which determines the accounting treatment of inventories. The standard provides rules for determining the cost of inventory, the subsequent recognition thereof as an expense, and the recognition and accounting treatment of an impairment in value.

Under the provisions of Standard No. 26, inventory reflected in the group's financial statements are presented as follows:

Inventory is valued at the lower of cost and net realizable value.

The cost of inventory includes all acquisition costs, conversion costs and other costs incurred in order to bring the inventory to its required location and condition.

The cost of inventories is determined as follows:

- The cost of raw and auxiliary materials is determined on the 'first-in, first-out basis;'
- The cost of goods in process and finished goods is determined on the basis of manufacturing costs;
- Labor costs and indirect expenses are costed on specific bases;
- The cost of purchased goods is determined on the 'first-in, first-out' basis.

The provisions of Standard No. 26 are to be applied retroactively. Since, however, the group's accounting treatment of inventories in the past has not been significantly different from that prescribed in the standard, the initial implementation of the new provisions will not affect the financial statements of the group to any significant degree.

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)

f. Investment in investee companies

- 1) The investment in the associated company reflected in the consolidated financial statements, and the investments in subsidiaries and in the company consolidated by means of the proportionate consolidation method reflected in the financial statements of the Company, are presented on the equity basis. The equity value of the investment in the associated company has been based on that company's financial statements which were prepared in accordance with international accounting standards, this procedure being permitted by Opinion No. 68 of the Institute.
- 2) At each balance sheet date, the Company considers whether any events have occurred or whether there have been any changes in circumstances which provide indications that impairments of value have occurred with respect to its investments in associated companies (see paragraph i below).
- 3) Unrealized profits stemming from transactions between the associated company and group companies are eliminated to the extent of the rate of the group's holding in the associated company.

g. Marketable securities

Marketable securities are presented at market value, or, in the case of mutual fund participation certificates, at redemption value.

Changes in the value of the above securities are charged or credited to the statement of income under financing.

h. Fixed assets

As of January 1, 2007, the group has applied the provisions of Accounting Standard No. 27, 'Plant, Property and Equipment' ("Standard No. 27"), which determine the accounting treatment for fixed assets. Standard No. 27 contains provisions with respect to the recognition of an item of property, plant and equipment as an asset, the measurement of the initial cost of that asset, and the measurement thereof subsequent to the initial recognition, as well as provisions relating to the depreciation and retirement of an item of property, plant and equipment.

In accordance with the provisions of Standard No. 27, the accounting treatment of fixed assets in the financial statements of the group is as follows:

- 1) The cost of the fixed asset is measured at the time of its initial recognition. The cost includes the cost of the acquisition (including non-refundable import and purchase taxes and after the deduction of trade discounts), costs that are directly attributable to transporting the asset to its required location and placing it in the condition necessary for it to be capable of operating in the manner intended by management;
- 2) When the payment for the asset is deferred over and above the normal credit period, the group charges the difference between the cash price equivalent and the total payment as an interest expense over the period of the financing;

CASTRO MODEL LTD.
 NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)

- 3) The group has elected to use the cost model as its accounting policy for the measurement of its fixed assets after the initial recognition stage;
- 4) Fixed assets which are governed by the application of the cost model are presented at cost after deduction of accumulated depreciation;
- 5) The group applies the straight-line depreciation method, in accordance with which the depreciable amount of each asset is methodically spread over the useful life of the asset.

The group makes a separate depreciation calculation for each part of a fixed asset where the cost of that part is material in relation to the total cost of the asset.

The principal annual depreciation rates are as follows:

	<u>%</u>
Buildings and stores	2 – 4 (mainly 4%)
Machinery and equipment	10
Motor vehicles	15
Computers	20 – 33 (mainly 33%)
Office furniture and equipment	15 – 33 (mainly 15%)

Improvements to premises are amortized by means of the straight-line method over the shorter of the contractual rental period and the estimated life of the improvements.

- 6) At the end of each fiscal year, the group reviews the residual values and useful lives of its assets, together with the applicable depreciation method. If any significant changes in expectations with respect to residual values or useful lives, together with any significant changes in the forecast pattern of consumption of the economic benefits embodied in the asset, point to a need for the depreciation method to be changed, those changes should be accounted for as a change in an accounting estimate. During the course of the years under review, there were no such significant changes materially affecting the group's financial statements.

The provisions of Standard No. 27 are to be applied retroactively. Since, however, the group's accounting treatment of fixed assets in the past has not been significantly different from that prescribed in the standard, the initial implementation of the new provisions will not affect the financial statements of the group to any significant degree.

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)

i. Impairment in value of assets

The group considers, at each balance sheet date, whether any events have occurred or changes in circumstances have taken place, which might indicate that there has been an impairment in the value of its non-monetary assets, i.e., its fixed assets, intangible assets and investment in an associated company.

When such indicators of impairment are present, the group considers whether the carrying value of the asset in its accounting records can be recovered from the cash flows expected to accrue from that asset, and, if necessary, records an impairment provision in an amount not exceeding that required to adjust the carrying amount to the recoverable amount.

The recoverable value of an asset is determined by reference to the higher of the net selling price of the asset and its value in use to the group. The value in use is determined by reference to the present value of the cash flows expected to accrue to the group from the continued use of the asset, including those expected at the time of its future retirement and disposal.

When it is not possible to assess whether an impairment provision is required for a particular asset considered separately, the need for such a provision should be assessed in relation to the recoverable value of the cash-generating unit to which that asset belongs.

j. Intangible assets

As of January 1, 2007, the group has applied the provisions of Accounting Standard No. 30, 'Intangible Assets' ("Standard No. 30"). This standard contains provisions determining the accounting treatment for intangible assets not falling within the ambit of other accounting standards. The standard also describes how the carrying amount of such assets should be measured and prescribes specific disclosure requirements in respect thereof.

In accordance with Standard No. 30, the accounting treatment for intangible assets in the financial statements of the group is as follows:

The group recognizes intangible assets in its financial statements if, and only if, the following conditions are satisfied:

- a) It is probable that the anticipated future economic benefits attributable to the asset will flow to the group, and
- b) The cost of the asset may be reliably measured.

An intangible asset that meets the above qualifying conditions for recognition as an asset is initially measured at cost.

The group has elected to use the cost model as its accounting policy for the measurement of intangible assets even after initial recognition. In accordance with this model, intangible assets are presented at cost after deducting the related accumulated amortization (if the asset has a defined useful life) and accumulated value impairment losses. The group amortizes the depreciable amounts of those of its intangible assets which have defined useful lives over the period of their useful lives by means of the straight-line method.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)

At the end of each fiscal year, the group reviews the residual values and useful lives of its depreciable intangible assets, together with the applicable depreciation method. If any significant changes in expectations with respect to residual values or useful lives, together with any significant changes in the forecast pattern of consumption of the economic benefits embodied in the asset, point to a need for the depreciation method to be changed, those changes should be accounted for as a change in an accounting estimate. During the course of the years under review, there were no such significant changes materially affecting the group's financial statements.

The particular accounting treatment of the software and licenses classified as intangible assets in the group's financial statements was as follows:

The group has applied the provisions of Accounting Standard No.30 on a retroactive basis. Accordingly, upon initial application of the provisions of the standard, the group reclassified software and licenses, the amortized cost of which as of December 31, 2006 was approximately NIS 521,000, from a designation of 'fixed assets' to a designation of 'intangible assets.'

k. Taxes on income:

- 1) As from January 1, 2005, the group has applied the provisions of IASB Accounting Standard No. 19, 'Taxes on Income,' which prescribe rules for the recognition, measurement, presentation and disclosure of taxes on income in financial statements.

The provisions of the standard are substantially similar to the accounting principles applied by the group in the period prior to the date on which the new standard entered into force.

- 2) In accordance with the pronouncements of Standard No. 19 and the accounting treatment applied by the group before the new standard entered into force, the group recognizes deferred taxes with respect to timing differences as between the carrying values of assets and liabilities and their values for tax purposes.

Deferred tax assets are recognized for all timing differences that may serve to reduce the tax expense, provided that the deferred tax assets may be expected to be capable of being utilized against chargeable income in the foreseeable future.

For information relating to the principal causative factors affecting the creation of deferred taxes, see Note 10e.

- 3) As stated in Note 9c, in the event of a dividend being paid out of the tax-free income of an approved enterprise, company tax will be payable on the amount of the dividend paid at the rate that would have been applicable if the income in question had not been exempt. If such a dividend should be paid, the consequent tax liability will be charged against income in the statement of income.
- 4) In computing the deferred tax provision, the tax that would be payable were the investments in the investee companies to be realized is not brought into account because the Company intends to retain these investments and not dispose of them.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued):

- 5) The group may be charged with additional tax if an intra-group dividend is paid. This additional tax charge is not reflected in the financial statements in light of the group policy not to cause a dividend to be paid if the payment of that dividend would involve the group in an additional tax liability in the foreseeable future.
- 6) The deferred tax provision is computed by reference to the rates of tax expected to be in force at the time of realization of the deferred tax asset or at the time of settlement of the deferred tax liability, insofar as the legislation with respect to these tax rates and other taxing legislation have, as at the date of the balance sheet, either already passed into law or the legislative procedures with respect thereto have been substantially completed.
- 7) Current taxes and changes to the deferred tax provision are reflected in the tax expense or in tax income for the year under review, other than in relation to taxes arising on initial recognition of a business combination and taxes relating to transactions that are recognized immediately within shareholders' equity (in this case, the relevant taxes are deducted from shareholders' equity (see also paragraph 8 below)).
- 8) In April 2005, the IASB published Clarification No. 7, 'The accounting treatment of tax benefits in connection with the grants of capital instruments to employees which benefits have not been allowed as an expense.' The provisions of this clarification are applicable to those tax benefits which, as of December 31, 2004, had still not been allowed as a deduction. The clarification determines that, as of January 1, 2005, tax benefits accruing to the Company as a result of the exercise of options granted to employees shall be added to shareholders' equity in the period in which the benefit is allowed as a deduction. In the past, the above tax saving has been credited to the tax expense in the statement of income.

I. Revenue recognition

As of January 1, 2006, the group has applied the provisions of IASB Accounting Standard No. 25, 'Revenues,' which prescribes recognition, measurement, presentation and disclosure rules for revenues stemming from the sale of goods either purchased or manufactured by the group, the supply of services, and the use made by others of the assets of the group (interest income, royalties and dividends).

Revenues are measured, as described below, by reference to the fair value of the consideration received or the consideration that the group is entitled to receive, taking into account trade and/or quantity discounts granted.

1) Sale of goods

Revenue from the sale of goods is recognized when all of the following conditions have been satisfied, viz.

- (a) the significant risks and rewards of ownership of the goods have been transferred to the buyer,

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued):

- (b) the Group retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold,
- (c) the amount of revenue can be measured reliably,
- (d) it is probable that the economic benefits associated with the transaction will flow to the group, and
- (e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

2) Revenues from royalties

Revenues from royalties stemming from the use made by others of assets of the group are recognized if conditions (c) and (d) above are met.

m. Concentration of credit risks and provision for doubtful debts

Most of the group's sales are made in Israel to a large number of customers in the retail market and to overseas franchisees that provide the Company with security. Accordingly, as of December 31, 2007, the group's trade receivables did not represent a significant credit risk.

A specific provision for doubtful debts is made for debts, the collectibility of which is doubtful.

n. Derivative financial instruments

The group makes use of foreign currency derivatives (forward transactions) in order to hedge expected cash flows relating to existing liabilities. From an accounting standpoint, these transactions are not defined as hedging transactions.

Profits and losses on these transactions are credited or charged to net financing expenses in the statement of income on a regular basis (see also Note 14).

o. Cash equivalents

Highly-liquid investments (including short-term bank deposits bearing maturity dates within three months of the date of deposit) which carry no restrictions as to withdrawal or use, are considered by the group to be cash equivalents.

p. Linkage basis

If, in accordance with the relevant linkage arrangements, the determining consumer price index is the last index to be published, balance sheet items subject to the above arrangements are reflected in the balance sheet on the basis of the last-published index as of the balance sheet date (i.e., the index for November).

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)

q. Company shares held by subsidiary and treasury shares

These shares are presented, either at their cost to the Company or their cost to the subsidiary, as a deduction from shareholders' equity, being described as 'cost of Company shares held by subsidiary and cost of treasury shares.'

Gains on the sale of these shares are credited directly to capital reserves.

r. Net earnings per share

As of January 1, 2006, the Company has applied the provisions of IASB Accounting Standard No. 21, 'Earnings per Share.' As a general rule, the computation of earnings per share is based on the profit distributable to Ordinary shareholders divided by the weighted average number of Ordinary shares in issue throughout the period.

In computing the diluted earnings or loss per share, the weighted average number of all potential diluting shares to be issued is added to the average number of Ordinary shares used in the computation of the basic earnings per share. Only those potential shares that have a dilutive effect (i.e., reduce the earnings or increase the loss per share from continuing operations) are considered for the purposes of the diluted earnings per share computation.

The earnings per share data reflected in the comparative data in these financial statements are stated after retroactive application of the computation rules in the new standard.

In 2005, the weighted average number of shares used in the computation of diluted earnings per share incorporated an adjustment of 2,914 shares with respect to potential shares to be issued upon exercise of warrants.

s. Dividend declared after balance sheet date

The liability relating to a dividend proposed or declared after the date of the balance sheet is not reflected in the Company's financial statements until the period in which the dividend is declared. The above notwithstanding, the amount of the proposed dividend payment is nevertheless reflected in the statement of changes in shareholders' equity in tandem with a reduction in retained earnings.

t. Effect of retroactive application of new accounting standard

The table below describes the manner in which the comparative data in these financial statements were affected by the accounting changes stemming from the initial application of the new IASB Accounting Standard No. 30, 'Intangible Assets,' insofar as the provisions of that standard were applied retroactively:

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)

	As formerly reported	Effect of retroactive application	As reported in these financial statements
	NIS (thousands)		
Effect on balance sheets:			
a) Consolidated:			
Fixed assets	60,310	(521)	59,789
Intangible assets		521	521
	60,310	-, -	60,310
b) Company:			
Fixed assets	37,834	(521)	37,313
Intangible assets		521	521
	37,834	-, -	37,834

u. Recently-issued accounting standards

Accounting Standard No. 29, Adoption of International Financial Reporting Standards

In July 2006, the Israel Accounting Standards Board issued Accounting Standard No. 29, 'Adoption of International Financial Reporting Standards (International Financial Reporting Standards) ("Standard No. 29")'. Standard No. 29 determines that companies subject to the provisions of the Securities Law, 1968 and which are required to report in accordance with the regulations issued thereunder, shall prepare their financial statements in accordance with International Financial Reporting Standards (IFRS) as from reporting periods commencing on January 1, 2008, (i.e., commencing with the financial statements for the first quarter of 2008).

International Financial Reporting Standards are standards and clarifications adopted by the International Accounting Standards Committee. These standards include:

- a) International Financial Reporting Standards (IFRS);
- b) International Accounting Standards (IAS); and
- c) Clarifications issued by the International Financial Reporting Interpretations Committee (IFRIC) or by the predecessor body for the interpretation of International Accounting Standards – the Standing Interpretations Committee (SIC).

Under the provisions of Standard No. 29, the above companies and other companies may elect to apply the provisions of the standard before the above date, and prepare their financial statements in accordance with IFRS as from financial statements published subsequent to July 31, 2006.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)

The group will begin to prepare their financial statements in accordance with the provisions of International Financial Reporting Standards as from accounting periods commencing on January 1, 2008.

The standard prescribes that companies which currently do not prepare their financial statements under IFRS, and are newly required or elect, as stated above, to prepare their financial statements under IFRS, shall, for the purpose of the transition, apply the provisions specified in International Financial Reporting Standard No. 1 (IFRS 1), 'Initial Adoption of International Financial Reporting Standards.'

IFRS 1, which deals with the initial transition to reporting under IFRS, determines that, in the first annual financial statements prepared in accordance with IFRS (including the interim financial statements for that year), all the latest IFRS standards in force at the end of the reporting year for which the company is initially reporting under IFRS, shall be applied retroactively (subject to certain reliefs and prohibitions referred to below).

IFRS 1 specifies two groups of exceptions to the principle of retroactive application, viz. (1) reliefs from mandatory retroactive application with regard to certain matters, in conjunction with an option as to whether or not to utilize all or part of those reliefs, and (2) prohibitions concerning mandatory retroactive application with respect to certain specific matters.

Under the provisions of IFRS 1, the first financial statements drawn up under IFRS shall include comparative data for at least one year. Accordingly, a company that initially draws up its financial statements under IFRS for periods commencing on or after January 1, 2008, and elects to present comparative data for one year only, shall be required, under the provisions of IFRS 1, to prepare an opening balance sheet as of January 1, 2007 in accordance with the provisions of IFRS. In preparing this opening balance sheet, all the latest IFRS standards, as referred to above, with regard to recognition, non-recognition, classification and measurement of all the company's assets, liabilities and items of shareholders' equity, shall be applied.

IFRS 1 also establishes certain disclosure requirements that apply to the first annual financial statements prepared in accordance with IFRS. Under these disclosure requirements, companies newly applying IFRS are required to explain the effect of the transition from the previous generally-accepted accounting principles to IFRS on the reported financial position, operating results and cash flows. In addition, companies are required to prepare notes providing reconciliations of the data reported under the previous accounting principles with the data now reported under IFRS, in respect of shareholders' equity and statements of income as of certain dates and for certain prior periods.

IFRS differ from accounting principles generally accepted in Israel and, accordingly, financial statements prepared under IFRS might reflect a financial position, operating results and cash flows that are significantly different from those presented in these financial statements. Application of IFRS requires a company to make appropriate preliminary arrangements, including the making of certain decisions relating to the manner of determining the value of assets and liabilities as at the transition date and the determination of appropriate accounting policies on various matters.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)

In accordance with the above provisions of IFRS 1 and the provisions of the Securities (Preparation of Annual Financial Statements) (Temporary Provision) Regulations, 2006, the group's financial statements newly prepared under IFRS for accounting periods commencing on January 1, 2008 will present comparative data for just one year (2007). Accordingly, as required, the group's opening balance sheet will be drawn up for January 1, 2007.

Standard No. 29 also requires those entities newly preparing their financial statements under IFRS for accounting periods commencing on January 1, 2008 to present the balance sheet data as of December 31, 2007 and data relating to the statement of income for the year ended December 31, 2007, after adjustment of those data by reference to the recognition, measurement and presentation rules of IFRS, in a note to the financial statements for 2007. In accordance with both this requirement and further disclosure requirements of the Securities Authority, these financial statements contain a note setting out the above required information together with further information relating to the manner in which the application of IFRS is expected to affect the group's financial statements for the year ended December 31, 2007 (including the effect on the opening balance sheet). The note also contains a description of the reliefs expected to be adopted by the group, and information relating to the accounting policy expected to be selected, the effect of which on the financial statements will or may be significant.

NOTE 2 - INVESTEE COMPANIES:

a. Composition

	<u>Consolidated</u>		<u>Company</u>	
	<u>December 31,</u>			
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	<u>NIS (thousands)</u>			
Shares:				
Cost	38,444	24,426	2,091	2,091
Share of retained earnings (accumulated losses) and reserves and of unrealized profits on Sales to associated company	(35,415)	(22,555)	196,024	167,706
Differences arising on translation of financial statements	183	103	1,379	100
	<u>3,212</u>	<u>1,974</u>	<u>199,494</u>	<u>169,897</u>
Loans and capital notes (see paragraph c below)	12,229	15,554	59,109	49,362
	<u>15,441</u>	<u>17,528</u>	<u>258,603</u>	<u>219,259</u>
Less: cost of Company shares held by subsidiary			(4,295)	(4,295)
	<u>15,441</u>	<u>17,528</u>	<u>254,308</u>	<u>214,964</u>

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 2 - INVESTEE COMPANIES (continued):

b. Movement in investments in 2007

	<u>Consolidated</u>	<u>Company</u>
	<u>NIS (thousands)</u>	
Balance at beginning of year	17,528	214,964
Movement in year:		
Investment in shares	14,018	
Share of earnings (losses)	(13,778)	31,773
Unrealized profits on sales to associated company, net	918	(789)
Dividend from subsidiary		(4,066)
Dividend paid to subsidiary		1,400
Differences arising on translation of financial statements	80	1,279
Loans and capital notes	(3,325)	9,747
Balance at end of year	<u>15,441</u>	<u>254,308</u>

c. Loans and capital notes issued to investee companies

In relation to currencies, linkage terms and interest rates, the loans and capital notes may be classified as follows:

	<u>Consolidated</u>		<u>Company</u>	
	<u>December 31,</u>			
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	<u>NIS (thousands)</u>			
Loans:				
In euros (1)	12,229	15,554	51,499	39,924
In shekels (linked to Consumer Price Index) (2)			1,130	1,094
In shekels (unlinked) (2)			6,480	5,642
Capital notes (2):				
In shekels (unlinked)				2,702
	<u>12,229</u>	<u>15,554</u>	<u>59,109</u>	<u>49,362</u>

- (1) The loans are linked to the higher (on the basis of a five-year cumulative calculation) of the exchange rate of the euro and a figure that is 4% above the increase in the Consumer Price Index.
- (2) The loans denominated in shekels and the capital notes are non-interest-bearing. The capital notes were repaid during the first quarter of 2007. Repayment dates for the loans have not yet been determined. In any event, the loans will not be repaid in 2008.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 2 - INVESTEE COMPANIES (continued):

d. Details of investee companies:

1) Wholly-owned subsidiaries

Castro Marketing (1985) Ltd. ("Castro Marketing") is engaged in the design and marketing of women's fashion goods under the registered trading name of 'Castro' and of men's fashion goods under the registered trading name of 'Castro Men.'

On November 9, 2006, the Company announced the merger of Castro Men (1997) Ltd. ("Castro Men") and Castro Marketing, the merger entering into force on December 31, 2006.

Castro Singapore Pte Ltd., a company incorporated in Singapore

Castro Asia (Macao Commercial Offshore) Ltd. ("Castro Asia"), a company incorporated in Macao. Castro Asia is owned by Castro Singapore Pte Ltd. and is engaged in the locating of sources of supply, the formalization of relations with suppliers, quality control and the administration of arrangements for international shipping. Castro Asia also supplies the group with a reliable supply chain infrastructure and quality control services with respect to supplier delivery dates.

Castro U.K. Ltd., a company incorporated in the United Kingdom. This company is a joint owner of the joint venture described in paragraph 3 below.

2) Company consolidated by means of the proportionate consolidation method

In July 2005, the Company entered into a contractual agreement with a U.K.-registered company for the establishment of Diva Fashion Accessories (Israel) Ltd. ("Diva"), the shares of which would be held in equal proportions by the parties. The company was established for the purpose of setting up a chain of accessory stores in Israel under the brand name of 'Diva,' a brand name owned by the U.K. company. Under the terms of the agreement, both the Company and the U.K.-registered company would jointly invest in the setting-up of the chain of stores, which would sell goods made by or for the U.K.-registered company. The operations of Diva commenced in September 2005 and, as of December 31, 2007, the chain comprised twenty-four stores. As of December 31, 2007, the group had invested NIS 6.48 million in Diva, mainly through the granting of shareholders' loans.

The tables below set out financial data relating to Diva. These data, reflected in the consolidated financial statements, are based on the Company's 50% holding in Diva.

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 2 - INVESTEE COMPANIES (continued):

a. Balance sheet data as of December 31:

	2007	2006
	NIS (thousands)	
Assets:		
Current assets	2,851	2,963
Long-term receivable	721	766
Fixed assets, after deduction of accumulated depreciation	2,298	2,686
	5,870	6,415
Liabilities:		
Current liabilities	1,451	1,327
Long-term liabilities	6,598	5,720
	8,049	7,047

b. Operating data:

	For the year ended December 31,		Period from September 1, 2005 (*) to December 31,
	2007	2006	2005
	NIS (thousands)		
Revenues	9,922	7,720	888
Costs and expenses:			
Cost of sales	3,141	1,870	180
Selling and marketing expenses and general and administrative expenses	7,729	6,246	926
Financing expenses	361	273	26
	11,231	8,389	1,132
Loss before taxes on income	1,309	669	244
Taxes on income (tax benefit)	237	(200)	(81)
Loss for year/period	1,546	469	163

* Date of commencement of operations.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 2 - INVESTEE COMPANIES (continued):

3) Associated company

On November 7, 2003, the Company and the German-registered company, Heinrich Heine GmbH, of the Otto Group, (“Heine”) entered into a long-term agreement for the establishment of a joint venture for the purpose of setting up a chain of Castro and Castro Men stores in Germany.

For the purpose of implementing the venture, the Company and Heine established a limited partnership in Germany. Through a wholly-controlled subsidiary incorporated in the United Kingdom specifically for this purpose, the Company holds 49% of the rights in the limited partnership.

The operations in Germany commenced in September 2004 with the opening of the first store in Cologne.

As of December 31, 2007, the group had invested approximately €9.1 million in the joint venture through investment in the capital of the partnership and the provision of partner loans.

NOTE 3 - PREPAID EXPENSES, AND LONG-TERM LOAN AND DEPOSITS NET OF CURRENT MATURITIES:

	Consolidated		Company	
	December 31,			
	2007	2006	2007	2006
	NIS (thousands)			
Deposits (1):				
With respect to the leasing of motor vehicles	275	282	275	282
With respect to the leasing of stores	2,013	1,807		
Payments for the vacating of stores (2)	3,536	2,187		78
Loan, after deduction of current maturities (see Note 8(a)(1))	5,491	6,154	5,491	6,154
Prepayment of expenses with respect to long-term agreement, after deduction of current portion of expenses (see Note 2d)	856	1,004	856	1,004
Miscellaneous	655	292	655	292
	12,826	11,726	7,277	7,810

(1) The deposits were made in relation to leasing obligations in recent months.

(2) These payments were made to the existing lessees of the stores leased by the subsidiary in shopping centers for the purpose of ensuring the early vacation of the stores. The payments are amortized by the straight-line method over the shorter of the period of the leasing contract and the estimated period during which the store will be used by the group.

CASTRO MODEL LTD.
 NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 4 - FIXED ASSETS:

a. Composition of assets and related accumulated depreciation and amortization, by principal groupings, and movement therein in 2007

	<u>C o s t</u>			<u>Accumulated depreciation</u>				<u>Depreciated balance</u>		
	<u>Balance at beginning of year</u>	<u>Additions</u>	<u>Disposals</u>	<u>Balance at end of year</u>	<u>Balance at beginning of year</u>	<u>Additions</u>	<u>Disposals</u>	<u>Balance at end of year</u>	<u>December 31,</u>	
									<u>2007</u>	<u>2006</u>
	<u>NIS in thousands</u>									
Consolidated:										
Land, buildings and stores	44,755	929	344	45,340	10,146	1,048	249	10,945	34,395	34,609
Machinery and equipment	943			943	848	17		865	78	95
Vehicles	5,730		760	4,970	2,313	780	621	2,472	2,498	3,417
Furniture and office equipment (including computers)	16,881	3,780	4,555	16,106	14,549	2,054	4,012	12,591	3,515	2,332
Improvements to premises	69,107	12,790	14,230	67,667	49,771	8,114	14,480	43,405	24,262	19,336
	<u>137,416</u>	<u>17,499</u>	<u>19,889</u>	<u>135,026</u>	<u>77,627</u>	<u>12,013</u>	<u>19,362</u>	<u>70,278</u>	<u>64,748</u>	<u>59,789</u>
Company:										
Land, buildings and stores	40,002	929	344	40,587	8,114	1,048	249	8,913	31,674	31,888
Machinery and equipment	943			943	848	17		865	78	95
Vehicles	5,730		760	4,970	2,313	780	621	2,472	2,498	3,417
Furniture and office equipment (including computers)	9,762	741		10,503	8,706	884		9,590	913	1,056
Improvements to premises	2,562			2,562	1,705	151		1,856	706	857
	<u>58,999</u>	<u>1,670</u>	<u>1,104</u>	<u>59,565</u>	<u>21,686</u>	<u>2,880</u>	<u>870</u>	<u>23,696</u>	<u>35,869</u>	<u>37,313</u>

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 4 - FIXED ASSETS (continued):

a. Composition of assets and related accumulated depreciation and amortization, by principal groupings, and movement therein in 2006

	Cost			Accumulated depreciation			Depreciated balance			
	Balance at beginning of year	Additions	Disposals	Balance at end of year	Balance at beginning of year	Additions	Disposals	Balance at end of year	December 31, 2006	2005
NIS in thousands										
Consolidated:										
Land, buildings and stores	44,227	527		44,755	9,046	1,100		10,146	34,609	35,181
Machinery and equipment	837	106		943	831	17		848	95	6
Vehicles	5,068	845	183	5,730	1,583	804	74	2,313	3,417	3,485
Furniture and office equipment (including computers)	15,550	1,331		16,881	12,312	2,237		14,549	2,332	3,238
Improvements to premises	57,249	12,705	847	69,107	43,066	7,177	472	49,771	19,336	14,183
	<u>122,931</u>	<u>15,515</u>	<u>1,030</u>	<u>137,416</u>	<u>66,838</u>	<u>11,335</u>	<u>546</u>	<u>77,627</u>	<u>59,789</u>	<u>56,093</u>
Company:										
Land, buildings and stores	39,475	527		40,002	7,014	1,100		8,114	31,888	32,461
Machinery and equipment	837	106		943	831	17		848	95	6
Vehicles	5,068	845	183	5,730	1,583	804	74	2,313	3,417	3,485
Furniture and office equipment (including computers)	9,239	523		9,762	7,737	969		8,706	1,056	1,502
Improvements to premises	2,562			2,562	1,554	151		1,705	857	1,008
	<u>57,181</u>	<u>2,001</u>	<u>183</u>	<u>58,999</u>	<u>18,719</u>	<u>3,041</u>	<u>74</u>	<u>21,686</u>	<u>37,313</u>	<u>38,462</u>

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 4 - FIXED ASSETS (continued):

- b. The group's rights in real estate are partly owned and partly leased (in an amount of approximately NIS 10.187 million) from the Israel Land Administration. The leasing rights were acquired for a period of forty-nine years expiring in 2035, with an option to renew the rights for a further forty-nine years.
- c. A factory in Bat Yam has still not been registered at the Land Registry in the name of the Company.
- d. For information relating to charges on assets, see Note 12.

NOTE 5 - INTANGIBLE ASSETS

The composition of intangible assets and the related accumulated amortization, together with movement therein (consolidated and Company), for 2007, was as follows:

	<u>Cost</u>			<u>Accumulated amortization</u>			<u>Depreciated cost</u> <u>December 31</u> <u>2007</u>
	<u>Balance at beginning of year</u>	<u>Additions</u>	<u>Balance at end of year</u>	<u>Balance at beginning of year</u>	<u>Additions</u>	<u>Balance at end of year</u>	
Software and licenses	673	825	1,498	152	148	300	1,198

The composition of intangible assets and the related accumulated amortization, together with movement therein (consolidated and Company), for 2006, was as follows:

	<u>Cost</u>			<u>Accumulated amortization</u>			<u>Depreciated cost</u> <u>December 31</u> <u>2006</u>
	<u>Balance at beginning of year</u>	<u>Additions</u>	<u>Balance at end of year</u>	<u>Balance at beginning of year</u>	<u>Additions</u>	<u>Balance at end of year</u>	
Software and licenses	128	545	673	59	93	152	521

Amortization of intangible assets in 2007 in an amount of NIS 44,000 was charged to cost of sales (2006 – NIS 28,000, 2005 – NIS 18,000), with such amortization in an amount of NIS 104,000 being charged to general and administrative expenses (2006 – NIS 65,000, 2005 – NIS 41,000).

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 6 - LONG-TERM BANK LOANS:

a) Composition

	Weighted interest rates as of December 31, 2007 %	Consolidated		Company	
		December 31,			
		2007	2006	2007	2006
		NIS (thousands)			
In shekels (linked to Consumer Price Index	4.4	214,956	49,331	214,956	48,613
In shekels (unlinked)	6.5	3,654	6,105	3,654	6,105
In Swiss francs (*)	3.45	42	215		
		218,652	55,651	218,610	54,718
Less: current maturities		23,775	18,529	23,733	17,638
		194,877	37,122	194,877	37,080

* Bears interest at 0.75% above Swiss franc Libor rate

b) The above loans (after deducting current maturities) are repayable in coming years subsequent to the relevant balance sheet date, as follows:

	Consolidated		Company	
	December 31,			
	2007	2006	2007	2006
	NIS (thousands)			
Second year	20,082	17,194	20,082	17,152
Third year	38,537	13,558	38,537	13,558
Fourth year	31,986	6,370	31,986	6,370
Fifth year and thereafter (until 2015)	104,272		104,272	
	194,877	37,122	194,877	37,080

c) For information relating to charges on assets for the purpose of securing the repayment of the loans and restrictions imposed with respect to the proceeds of the loans, see Note 12.

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 7 - EMPLOYEE RIGHTS ON RETIREMENT

- a. Existing labor laws and agreements require Israel-registered group companies to make severance payments to employees who are dismissed or who retire from their employment in certain circumstances.

The severance pay liabilities of the companies are partly covered by regular deposits in the names of employees with recognized severance pay funds and by the purchase of insurance policies from an insurance company. The amounts funded as above are not reflected in the balance sheet since they are neither under the control nor the management of the companies.

The liability for severance pay is computed in accordance with existing labor agreements and by reference to those salary components which, in the opinion of management, entitle employees to the receipt of severance pay. The severance pay liabilities reflected in the balance sheets (see paragraph b below) represent that part of the liabilities not covered by the above-mentioned deposits and/or insurance policies. Part of the severance pay liability is funded by deposits in the names of the companies with recognized severance pay funds.

- b. The severance pay liabilities reflected in the balance sheets and the amount thereof funded through severance pay funds, are as follows:

	<u>Consolidated</u>		<u>Company</u>	
	<u>December 31,</u>			
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	<u>NIS (thousands)</u>			
Liability	9,640	8,814	3,583	3,221
Less: amount of funding	960	890	568	526
	<u>8,680</u>	<u>7,924</u>	<u>3,015</u>	<u>2,695</u>

The companies are not entitled to withdraw the funds deposited except for the sole purpose of making severance payments.

NOTE 8 - COMMITMENTS AND CONTINGENT LIABILITIES:

a. **Commitments:**

- 1) In April 2002, the Company entered into a fifteen-year contractual commitment for the lease of warehouses in Zrifin. The monthly lease payments amount to NIS 298,000 (in shekels of December 2007). In accordance with the terms of the agreement, the lessor constructed a building in accordance with the specifications of the Company. In March 2004, possession of the building was transferred to the Company. The Company provided the lessor with a loan of NIS 8.2 million, the loan being linked to the Consumer Price Index and bearing interest at a rate of 6.35%. The loan is repayable in monthly instalments over a period of ten years in accordance with a predetermined table of repayments, with each monthly payment being deducted, in turn, from the respective monthly lease payment made by the Company. The loan is presented under long-term receivables after deduction of current maturities. In connection with this matter, see also Note 3.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 8 - COMMITMENTS AND CONTINGENT LIABILITIES (continued):

- 2) The Company, the subsidiaries and the company consolidated by means of the proportionate consolidation method have entered into leasing agreements with respect to the buildings and stores used by those companies. The periods of the various leases, including the extension options provided to the subsidiaries in their leasing contracts, range from four years to twenty years. The leasing fees under the various contracts are linked partly to the Consumer Price Index, partly to the exchange rate of the U.S. dollar, and partly to a combined linkage mechanism involving both the Consumer Price Index and the exchange rate of the U.S. dollar. Some of the agreements specify that the basic leasing fees shall be increased by a certain percentage of the turnover of the store occupying the leased premises.
- 3) The projected basic annual leasing fees for the warehouses, the buildings and the stores referred to in paragraphs (1) and (2) above for the coming five years, computed on the basis of the levels prevailing as of December 31, 2007, are as follows:

	<u>NIS (thousands)</u>
2008	38,211
2009	34,453
2010	32,428
2011	29,289
2012	26,160
	<u>160,541</u>

- 4) The Company and a subsidiary have entered into a number of three-year operating lease agreements for motor vehicles used by their personnel. The projected annual leasing fees, computed on the basis of the levels prevailing as of December 31, 2007, total NIS 2.046 million.
- 5) For information relating to leasing agreements with an interested party, see Note 15b.
- 6) Until the beginning of the final quarter of 2005, the Company sold its products to franchisees in Israel on a wholesale basis. Under the franchising agreements with the Israel franchisees, the franchisees were, for the number of years specified in the agreement and subject to specifically-defined terms and conditions, granted the right to operate stores under the name of the Company, these stores selling exclusively the products of the Company. A uniformity of operation as between the stores operated by the group and the stores operated by franchisees was strictly enforced. In most cases, franchisees were awarded exclusivity rights in the immediate catchment area of the store. In order to retain the franchise, the franchisee was required to meet the predetermined sales targets on a continuing basis.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 8 - COMMITMENTS AND CONTINGENT LIABILITIES (continued)

During the fourth quarter of 2005, the Company began to change the basis of the contractual arrangements with its Israel franchisees. It was decided that the franchise operations would be terminated at the close of the year and be superseded by operating agreements for periods of between two and five years. The change essentially involved the transfer of the inventory in the franchisee stores to the ownership of the Company, the attribution of local sales to the Company and the deposit of all local sales receipts directly into the bank account of the Company either immediately upon the sale taking place or shortly thereafter. Under the operating agreement, the Company pays store operators an operating fee based on a stated percentage of local sales in return for the services provided to the Company by the operator.

- 7) The group has entered into franchise agreements for the wholesaling of its products to overseas franchisees in Germany (an associated company), Switzerland, Russia, the Ukraine, Latvia, Romania and Thailand. The franchising agreements provide the overseas franchisees, in consideration for the payment of royalties, with an exclusive franchise (except in Romania, where the franchise is not exclusive) for the setting up and operating of a chain of brand name stores in the territory defined in the agreement (the whole or a part of the target state) for the sale of the group's products, these having been purchased by the franchisee from the Company.

The stores will be set up and operated by the franchisees at their own expense. The franchisee is required to meet the level of turnover specified in the agreement and establish the number of stores specified therein, and he must also make a minimal investment in advertising. The duration of the franchise agreement ranges between five and fifteen years. In some agreements, the group undertakes to grant the franchisee a discount on surplus seasonal inventory, except where the group has decided to re-purchase those goods at the price determined in the agreement. The agreement contains a number of mutual non-competition undertakings.

The group provides variable financial support for the marketing operations of some of the overseas franchisees in accordance with the level of their operations and the extent of their financial commitment towards the penetration of the brand name in the target state.

During the course of 2007, the Company informed its franchisees in Russia, Latvia and the Ukraine of its decision to remove their right of exclusivity in light, inter alia, of their non-compliance with the undertaking contained in the respective agreements with respect to the pace at which new stores would be opened. Although the franchisees will continue to operate in these territories, the Company reserves the right to operate further brand name stores in these states either by itself or through other parties.

- 8) Management has decided to involve all of its employees (other than interested parties and employees of subsidiaries who already enjoy other benefit schemes) in a Company profit-sharing arrangement. The profit distributable is equivalent to approximately 15% of the increase as from 1998 in pre-tax consolidated profits after deducting the Company's share in the losses of an associated company.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 8 - COMMITMENTS AND CONTINGENT LIABILITIES (continued)

As a result of the implementation of this decision, the statements of income for 2007, 2006 and 2005 contain related expenses of NIS 9.16 million, NIS 11.38 million and NIS 10.37 million respectively.

- 9) On December 17, 2007, the Company entered into an agreement with TNT Fashion Group BV (“TNT”) (a company engaged in the provision of logistical and carriage services) for the operation of a logistical center in the Netherlands for the Company, from which center TNT will convey the Company’s products to various stores in Europe.

Under the agreement, TNT will provide the Company with such logistical services as are required, these services including, inter alia, customs clearance, transfer of goods to the TNT warehouse in the Netherlands, the provision of storage facilities in the warehouse, and the sorting and conveyance of the Company’s products to its various stores in Europe. The consideration payable to TNT will be based on the actual services provided.

The initial duration of the contract is three years (in certain circumstances, the parties may terminate the agreement prior to the expiry of this period). The contract may subsequently be renewed automatically for successive periods of one year. During the renewal periods, each party may, by the provision of advance notice, terminate the agreement.

TNT commenced supplying services to the Company under this agreement in January 2008. At this stage, services are only being provided to the Company’s stores in Germany.

- 10) For information relating to the compensation agreements with interested parties, see Note 15b.
- 11) See also Note 2(d)(2) and Note 2(d)(3).

b. Contingent liabilities:

- 1) Guarantees:
- a) The Company and Castro Marketing have provided unlimited mutual guarantees to various banks in relation to their respective bank liabilities.
 - b) The Company and Castro Marketing have provided guarantees to third parties in relation to the leasing of stores for the use of the Company and its subsidiaries. For information relating to the amounts of the guarantees and to the charges registered in connection therewith, see Note 12.
- 2) On March 13, 2007, in the Tel Aviv Magistrates’ Court, an indictment was brought against the Company, Castro Marketing, Mr. Gabriel Rotter (Joint General Manager of the Company and member of the Company’s Board of Directors) and Mrs. Orit Ben-Ami (operator of the brand name store in Petach-Tikva) by the legal advisor to the government (in the name of the Ministry of Industry, Trade and Employment). The indictment contained a number of accusations, as follows:

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 8 - COMMITMENTS AND CONTINGENT LIABILITIES (continued):

- a) Apparent deception of the consumer by the marking of the price and a rate of discount on a pair of shoes in two specific instances in apparent contravention of Sections 2 and 23, Consumer Protection Law, 1981 (“Consumer Protection Law”);
- b) Presentation of prices on goods offered for sale in a number of foreign currencies in addition to the presentation of the price in Israel currency in apparent contravention of Sections 17B(b), 23 and 2, Consumer Protection Law;
- c) One instance of apparent non-presentation of the price of a number of items presented in the display window;
- d) The presentation of prices in the display window by means of a signpost at the bottom of the mannequins on which the products were displayed, and not on the products in the window themselves in apparent contravention, inter alia, of Sections 17B, 23(c)(8) and 2, Consumer Protection Law in five different instances.

In total, the indictment contained eight different accusations, as described above.

The indictment was brought in the wake of the investigation of Mr. Gabriel Rotter, in his capacity as a Company officer, by the Ministry of Industry, Commerce and Employment. Under Section 23(a), Consumer Protection Law, an offence against the provisions of the law is punishable by a year’s imprisonment or a fine that is seven times greater than the fine specified in Section 61(a)(2), Penalties Law (i.e., a fine of up to NIS 182,000 for each accusation). As of the date of publication of these financial statements, the indictment had not yet been read. The accused, including the Company, have raised a series of preliminary arguments against the indictment, on which arguments the court has not yet pronounced. In addition, on June 20, 2007, the accused, including the Company, submitted a petition to the legal advisor to the government requesting a stay of proceedings. The decision of the legal advisor to the government on the petition has not yet been received.

- 3) On December 4, 2007, the Labor Federation submitted a request for relief as a party to a collective dispute against sixty-one different businesses, including the group, in respect of five instances of alleged breach of the Right to Work in Sitting Position Law, 2007 (“the Law.”) The Labor Federation seeks declaratory relief to the effect that the group breached the provisions of the Law, the granting of a mandatory injunction requiring the remedying of the alleged breaches, and an order directing that the provisions of the Law be implemented and that compensation be paid in the maximum amount stipulated by the Law for each breach, which is NIS 200,000 for each occurrence of a breach. The group has submitted a request for the disposal of the request of the Labor Federation *in limine* on account of a lack of jurisdiction, the absence of a pretext and a lack of good faith. After consulting its legal advisors, the group considers that the likelihood of this financial claim succeeding is low.

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 9 - SHAREHOLDERS' EQUITY:

a. Share capital:

- 1) The Company's share capital is comprised of NIS 1 Ordinary shares, as follows:

	<u>Number of shares and their par value in shekels</u>
	<u>December 31, 2006 and 2007</u>
Authorized	10,000,000
Issued and fully-paid	<u>5,787,000</u>

The shares are traded on the Tel Aviv Stock Exchange. As of December 31, 2007, the price of the Company's shares was NIS 81.05.

Ordinary shares provide their holders with voting rights, the right to participate in general meetings of the Company's shareholders, the right to profits and the right to a proportion of the proceeds of sale of surplus assets in the event of a liquidation of the Company.

- 2) As of December 31, 2007 and 2006, the subsidiary, Castro Marketing, held 397,121 Ordinary shares of the Company (6.86% of the issued and paid-up share capital as of December 31, 2007). As of December 31, 2007 and 2006, the Company held 124,507 treasury shares (2.15% of the issued and paid-up share capital as of December 31, 2007).

b. Capital reserves:

	<u>December 31, 2006 and 2007</u>
	<u>NIS (thousands)</u>
Share premium	30,553
Tax benefit stemming from options granted to employee, with respect to which no expense has been entered in the accounting records	141
Gain on sale of Company shares held by subsidiary	<u>2,271</u>
	<u>32,965</u>

c. Retained earnings

The balance of retained earnings as of December 31, 2007 includes an amount of NIS 44.266 million earmarked for the payment of a cash dividend. The payment of this dividend will involve a tax liability of 25% of the amount of the dividend because the earnings in question are derived from an approved enterprise and were exempt from tax by virtue of the Capital Investments Encouragement Law, 1959 (see Note 10c). Accordingly, the amount of the retained earnings earmarked for payment of a dividend will be reduced by the amount of the related tax liability.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 9 - SHAREHOLDERS' EQUITY (continued):

Under the provisions of the Companies Law, in determining the extent of the retained earnings available for the payment of a dividend, the total of retained earnings reflected in shareholders' equity must be reduced by the value of the Company's shares acquired by a subsidiary.

d. Proposed dividend

At its meeting on March 5, 2008, the Company's Board of Directors resolved upon the payment of a final cash dividend of NIS 25 million from retained earnings as of December 31, 2007. Of the amount earmarked for the payment of a dividend, NIS 1.673 million will be paid to a subsidiary. Although this liability will only be entered in the accounting records in 2008, the proposed dividend will be separately reflected in the statement of changes in shareholders' equity in tandem with a reduction in retained earnings.

NOTE 10 - TAXES ON INCOME:

a. Taxation of Israel-resident companies:

- 1) Measurement of operating results for tax purposes in accordance with provisions of Income Tax (Inflationary Adjustments) Law, 1985

Under the provisions of the Income Tax (Inflationary Adjustments) Law, 1985 ("the adjustments law"), the Company's operating results are index-linked for tax purposes on the basis of changes in the Consumer Price Index. The Company and the Israel-resident subsidiaries are subject to the provisions of the above law.

In accordance with the provisions of the Income Tax (Inflationary Adjustments) (Amendment No. 20) Law, 2008 ("the amendment"), which was passed in the Knesset on February 26, 2008, the provisions of the adjustments law will no longer be applicable to the Company and the Israel-resident subsidiaries as from the 2008 tax year. The amendment contains transitional provisions with respect to the cessation of applicability of the provisions of the adjustments law. The provisions of the adjustments law remain applicable to the Company and its Israel-resident subsidiaries until the end of the 2007 tax year.

- 2) Tax rates

The income of the Company and its Israel-resident subsidiaries are subject to company tax at the standard rate, except with respect to income from an approved enterprise (see paragraph c below). Until December 31, 2003, the rate of company tax was 36%. In July 2004, Amendment No. 140 to the Income Tax Ordinance was published. The amendment determined, inter alia, that the standard rate of company tax would be reduced on a gradual basis from 36% to 30%. In August 2005, Amendment No. 147 further revised the rates of company tax prescribed by the previous amendment. As a result of the provisions of the above two amendments, the rates of company tax as of 2005 are as follows: 2005 – 34%, 2006 – 31%, 2007 – 29%, 2008 – 27%, 2009 – 26% and 2010 and thereafter, 25%.

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 10 - TAXES ON INCOME (continued):

As a result of the above changes in tax rates, in 2004 and 2005, on the dates on which the above amendments were passed by the Knesset, the Company amended its deferred tax provision on the basis of the tax rates newly-expected to be applicable in coming years. The change in the deferred tax provision in each of the above years was reflected in the statement of income for that year.

b. Overseas subsidiaries

Those subsidiaries incorporated outside Israel are subject to the tax laws of their countries of residence.

c. Tax benefits under the Capital Investments Encouragement Law, 1959:

- 1) By virtue of the approved enterprise status previously accorded to some of its enterprises, the Company enjoyed a tax exemption on approved enterprise income in the period of benefits that ended in 1998.
- 2) On May 17, 2004, the Company received a further letter of approval for a plan under the alternative benefit track for the expansion of its factory in Bat Yam. In accordance with the terms of the letter of approval, the Company is entitled to a tax exemption during the first two years of operation of the approved enterprise, and subsequently, to a reduced tax rate of 25% for a further five years on chargeable income attributable to the approved enterprise. The period of benefits vis-à-vis the approved enterprise commenced in 2005. Receipt of the above benefits is conditional upon compliance with the provisions of the Capital Investments Encouragement Law, 1959 and the regulations promulgated thereunder, and with the terms of the letter of approval in accordance with which the investment in the approved enterprise was made. Non-compliance can lead to cancellation of the benefits, in whole or in part, and to a demand for the repayment of the benefits together with interest.
- 3) For information relating to the proposed payment of a cash dividend from tax-exempt income and the consequent tax liability, see Note 9c.

d. Tax loss carryforwards

The tax loss carryforwards of a company consolidated by means of the proportionate consolidation method totalled approximately NIS 2.318 million as of December 31, 2007 (NIS 2.643 million as of December 31, 2006).

CASTRO MODEL LTD.

NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 10 - TAXES ON INCOME (continued)

e. Deferred income taxes:

- 1) The composition of deferred taxes as of the respective balance sheet dates, and the movement therein during the respective years, are as follows:

	With respect to balance sheet items						With respect to tax loss carryforwards (see paragraph (d) above	Total
	Depreciable fixed assets	Provisions for employee rights Severance pay	Vacation pay	Provision for doubtful debts	Long-term prepayment of expenses	Marketable securities		
	NIS (thousands)							
Consolidated:								
Balance as of January 1, 2006	5,394	1,677	894	988	(237)	(794)	132	8,054
Changes in 2006 – charged or credited to statement of income	(182)	398	119	(62)	(325)	312	265	525
Balance as of December 31, 2006	5,212	2,075	1,013	926	(562)	(482)	397	8,579
Changes in 2007 – charged or credited to statement of income	(311)	96	43	(222)	(323)	471	197	(446)
Balance as of December 31, 2007	4,901	2,171	1,056	704	(885)	(11)	197	8,133
Company:								
Balance as of January 1, 2006	302	601	548	191		(693)		949
Changes in 2006 – charged or credited to statement of income	(14)	110	54	(5)		300		445
Balance as of December 31, 2006	288	711	602	186		(393)		1,394
Changes in 2007 – charged or credited to statement of income	124	43	76	(71)		393	197	762
Balance as of December 31, 2007	412	754	678	115		-,	197	2,156

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 10 - TAXES ON INCOME (continued)

2) Deferred taxes are presented in the balance sheet as follows:

	<u>Consolidated</u>		<u>Company</u>	
	<u>December 31,</u>			
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	<u>NIS (thousands)</u>			
In current assets	1,946	1,851	990	394
In long-term investments and receivables	6,187	6,728	1,166	1,000
Net debit balance	<u>8,133</u>	<u>8,579</u>	<u>2,156</u>	<u>1,394</u>

Utilization of the deferred tax assets is conditional upon the existence of sufficient chargeable income in future years.

f. Taxes on income reflected in statements of income:

1): As follows:

	<u>Consolidated</u>			<u>Company</u>		
	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
	<u>NIS (thousands)</u>					
Current	21,571	20,017	18,895	4,076	3,886	7,269
Deferred (see paragraph (e) above):						
With respect to the change in tax rates (see paragraph (a(2)) above)	93	195	260	17	68	38
With respect to the period under review	353	(720)	(1,227)	(779)	(513)	181
	<u>22,017</u>	<u>19,492</u>	<u>17,928</u>	<u>3,314</u>	<u>3,441</u>	<u>7,488</u>

Current taxes chargeable on the Company and the Israel-registered subsidiaries were computed in 2007, 2006 and 2005 at tax rates of 29%, 31% and 34% respectively.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 10 - TAXES ON INCOME (continued)

- 2) The following table presents a reconciliation between the amount of the theoretical tax that would have been chargeable had all income been charged to tax at the standard tax rates applicable to companies in Israel (see paragraph a(2) above) and the actual amount of tax charged in the statement of income for the year under review:

	Consolidated			Company		
	For the year ended December 31,					
	2007	2006	2005	2007	2006	2005
	NIS (thousands)					
Income before taxes on income, as reflected in statements of income	66,387	77,013	62,909	2,133	25,565	31,560
Theoretical tax on above income	19,252	23,874	21,389	619	7,925	10,730
Tax benefit stemming from approved enterprise status under alternative benefit track		(6,454)	(3,894)		(6,454)	(3,894)
Increase (decrease) in taxes stemming from permanent differences:						
Expenses not deductible for tax purposes	287	285	463	206	228	394
Other differences	1,001	(620)	627	415	(172)	414
Decrease in taxes stemming from the utilization in the year under review of capital losses for tax purposes brought forward from previous years, and for which no deferred tax assets were created			(451)			(451)
Increase in taxes stemming from the adjustment of the deferred tax provision on the change of tax rates (see Note a(2) above)	93	195	260	17	68	38
Increase (decrease) in taxes stemming from the difference between the bases of measurement of income for tax and accounting purposes, net	37	49	(690)	1,362	41	98
Taxes relating to prior years, net	1,596	1,110		1,200	1,110	
Increase in tax stemming from tax losses created in the year under review, and for which no deferred tax assets were created	333					
Increase (decrease) in taxes stemming from index-linked losses with respect to marketable securities for which no deferred tax assets had previously been created, and from the utilization of such losses	(582)	1,053	224	(505)	695	159
Taxes on income reflected in statements of income	22,017	19,492	17,928	3,314	3,441	7,488

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 10 - TAXES ON INCOME (continued)

g. Tax assessments

Final assessments have been raised on the Company for tax years up to and including the 2003 tax year. Final assessments have been raised on the subsidiaries, Castro Marketing and Castro Men for tax years up to and including 2002.

Overseas subsidiaries that commenced operations in 2004 have not yet been assessed to tax.

h. Effect of adoption of IFRS in Israel on tax liability

As stated in Note 1u, in accordance with the provisions of Standard No. 29, the Company will prepare its financial statements for accounting periods commencing on or after January 1, 2008 in accordance with the provisions of international financial reporting standards.

As already noted above, international financial reporting standards differ from accounting standards generally accepted in Israel, and accordingly, the preparation of financial statements under IFRS may reflect a financial position, operating results and cash flows that are significantly different from those presented in these financial statements.

On February 10, 2008, the Tax Authority published a notice (“the notice”) relating to the establishment of a joint forum encompassing the professional organizations for the purpose of clarifying the various accounting standard issues as they arise during the process of absorption of IFRS in Israel and the extent to which, in practice, the application of the new standards will affect tax returns.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 11 - LINKAGE TERMS FOR MONETARY BALANCES:

a.

	December 31, 2007		
	In or linked to foreign currency (*)	Linked to Consumer Price Index	Unlinked
Consolidated:			
Assets:			
Current assets:			
Cash and cash equivalents	8,399		37,262
Short-term investments	15,294	81,817	18,633
Receivables:			
Trade	11,885		71,655
Other	3,055	18,229	5,699
Long-term investments and receivables:			
Associated company (loan)	12,229		
Loan relating to the leasing of warehouses (including current maturity)		6,338	1,038
	<u>50,862</u>	<u>106,384</u>	<u>134,287</u>
Liabilities:			
Current liabilities:			
Payables:			
Trade	5,356		27,045
Other	1,632	6,585	33,334
Long-term bank loans (including current maturities)	42	214,956	3,654
	<u>7,030</u>	<u>221,541</u>	<u>64,033</u>
Company:			
Assets:			
Current assets:			
Cash and cash equivalents	6,354		7,227
Short-term investments	14,656	74,666	16,855
Receivables:			
Trade	11,877		18,614
Other	1,336	18,299	6,249
Long-term investments and receivables:			
Subsidiaries (loans)	51,499	1,130	6,480
Loan relating to the leasing of warehouses (including current maturity)		6,338	1,038
	<u>85,722</u>	<u>100,433</u>	<u>55,251</u>
Liabilities:			
Current liabilities:			
Payables:			
Trade	1,403		12,943
Other	2,467		91,157
Long-term bank loans (including current maturities)		214,956	3,654
	<u>3,870</u>	<u>214,956</u>	<u>107,754</u>

*Principally the U.S. dollar.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 11 - LINKAGE TERMS FOR MONETARY BALANCES (continued)

b. Data relating to foreign currency exchange rates and the Consumer Price Index

	<u>Exchange rate of \$1</u>	<u>Exchange rate of €1</u>	<u>Consumer Price Index (*)</u>
As at end of:			
2007	NIS 3.846	NIS 5.659	120.90 points
2006	NIS 4.225	NIS 5.564	116.93 points
2005	NIS 4.603	NIS 5.446	117.04 points
Increase (decrease) in:			
2007	(9.0%)	1.7%	3.4%
2006	(8.2%)	2.2%	(0.1%)
2005	6.8%	(7.3%)	2.4%

* In accordance with the index for the month ending on each balance sheet date (average basis of 1998 = 100).

NOTE 12 - LIABILITIES SECURED BY CHARGES AND RESTRICTIONS IMPOSED WITH RESPECT TO LIABILITIES:

a. As of the respective balance sheet dates, the amounts of the secured liabilities and guarantees were as follows:

	<u>Consolidated</u>		<u>Company</u>	
	<u>December 31,</u>			
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	<u>NIS (thousands)</u>			
Liabilities:				
Documentary credit	<u>28,650</u>	<u>28,596</u>		
Long-term loans (including current maturities)	<u>218,652</u>	<u>55,651</u>	<u>218,610</u>	<u>54,718</u>
Guarantees (see Note 8b)	<u>3,492</u>	<u>3,838</u>	<u>52</u>	<u>31</u>

- b. 1) In order to secure the liabilities and guarantees referred to in (a) above, the Company has registered charges on all the notes in which the Company possesses rights and mortgage charges on real estate assets in Bat Yam. The charges and mortgage charges were registered in favor of the lending banks.
- 2) A subsidiary has registered a charge in favor of a lending bank on all the rights that stem from an agreement for the acquisition of a real estate asset in Gan Ha'ir, Tel Aviv.

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 12 - LIABILITIES SECURED BY CHARGES AND RESTRICTIONS IMPOSED WITH RESPECT TO LIABILITIES (continued):

c. Restrictions imposed with respect to liabilities:

- 1) The group has give an undertaking to lending banks to the effect that it will not place charges on its assets in favor of other parties (negative charge).
- 2) The Company has given an undertaking to lending banks to the effect that it will abide by the terms of a covenant that requires the shareholders' equity of the Company to be not less than 35% of the consolidated balance sheet total. As of December 31, 2007, the Company was in compliance with the terms of the covenant.

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 13 - SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION:

Balance sheets:

a. Short-term investments:

	<u>Consolidated</u>		<u>Company</u>	
	<u>December 31,</u>			
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	<u>NIS (thousands)</u>			
Marketable securities:				
Debentures	115,744	27,224	106,177	17,834
Shares	5,042	5,376	3,027	4,601
Participation certificates in mutual funds	85,292	26,445	79,309	12,921
	<u>206,078</u>	<u>59,045</u>	<u>188,513</u>	<u>35,356</u>

b. Receivables:

1) Trade receivables:				
Open debts	23,628	20,621	15,899	13,107
Cheques receivable	3,004	3,029	1,013	1,074
Credit card companies	57,340	62,254	14,011	13,220
	<u>83,972</u>	<u>85,904</u>	<u>30,923</u>	<u>27,401</u>
The above items are presented after deduction of a provision for doubtful debts	2,608	3,194	427	642
2) Other receivables:				
Deferred tax assets (see Note 10e)	1,946	1,851	990	394
Current maturities of loan in connection with the leasing of warehouses (see Note 3)	847	773	847	773
Prepayment of expenses	2,099	738	1,568	304
Advance payments to suppliers	1,698	1,694	681	34
Employees	227	271	118	174
Accrued income	4,828	4,662	4,527	2,167
Income tax receivable	18,229	22,697	18,299	16,218
Shareholder in company consolidated by means of the proportionate consolidation method (see Note 2(d)(2))	354	503		
Miscellaneous	1,647	76	2,259	7
	<u>31,875</u>	<u>33,265</u>	<u>29,289</u>	<u>20,071</u>

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 13 - SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued)

c. Inventories:

	<u>Consolidated</u>		<u>Company</u>	
	<u>December 31,</u>			
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	NIS (thousands)			
Raw and auxiliary materials	2,672	3,886	2,672	3,886
Finished goods and purchased goods	79,290	60,351	9,426	5,131
	<u>81,962</u>	<u>64,237</u>	<u>12,098</u>	<u>9,017</u>

d. Payables:

	<u>Consolidated</u>		<u>Company</u>	
	<u>December 31,</u>			
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	NIS (thousands)			
1) Trade payables:				
Open debts	22,132	21,583	9,605	9,204
Cheques payable	10,269	7,452	4,741	3,662
	<u>32,401</u>	<u>29,035</u>	<u>14,346</u>	<u>12,866</u>
2) Other payables:				
Current account of subsidiary, net			79,794	46,951
Payroll and ancillary expenses	20,565	22,542	6,598	7,099
Provision for vacation pay	3,908	3,489	2,510	2,073
Government institutions	1,774	1,882	1,872	1,836
Income taxes payable	6,585	4,583		
Prepaid income and advances from customers	4,185	3,907	148	
Accrued expenses	7,657	4,179	2,850	1,258
Miscellaneous	1,062	914		431
	<u>45,736</u>	<u>41,496</u>	<u>93,772</u>	<u>59,648</u>

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 13 - SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued)

Statements of income:

e. Cost of revenues:

	Consolidated			Company		
	For the year ended December 31,					
	2007	2006	2005	2007	2006	2005
	NIS (thousands)					
Purchased goods	202,871	177,632	145,737	68,791	55,047	4,350
Consumption of raw and auxiliary materials	22,942	9,587	10,044	22,942	9,587	10,044
Payroll and ancillary expenses	14,893	15,468	13,036	14,892	15,468	13,036
Subcontractors	6,828	5,632	5,140	6,828	5,632	4,720
Manufacturing and other expenses	16,225	14,861	11,791	17,266	13,999	10,459
Depreciation	905	982	946	905	982	946
Contribution towards expenses by subsidiaries				(16,860)	(17,297)	(18,070)
	<u>264,664</u>	<u>224,162</u>	<u>186,694</u>	<u>114,764</u>	<u>83,418</u>	<u>25,485</u>
Decrease (increase) in inventories of finished and purchased goods	(18,939)	(1,480)	(10,469)	(4,295)	288	341
	<u>245,725</u>	<u>222,682</u>	<u>176,225</u>	<u>110,469</u>	<u>83,706</u>	<u>25,826</u>

f. Selling and marketing expenses:

	Consolidated			Company		
	For the year ended December 31,					
	2007	2006	2005	2007	2006	2005
	NIS (thousands)					
Payroll and ancillary expenses	71,974	65,883	55,645	20,095	18,548	16,491
Rentals and maintenance	62,469	54,059	47,980	3,548	3,522	3,881
Depreciation	8,970	8,290	9,332	390	467	363
Advertising and sales promotion	39,325	37,033	34,934	9,597	4,696	3,012
Sales commission to operators (see Note 8(a)(6))	33,377	28,918	4,927	33,377	28,918	4,927
Vehicle maintenance	3,611	3,350	3,007	3,534	2,928	2,663
Bad and doubtful debts	(764)	(36)	2,551	(233)	(6)	551
Miscellaneous	3,812	2,846	1,638	3,450	2,746	1,588
Contribution towards expenses by subsidiaries				(21,856)	(17,219)	(20,047)
	<u>222,774</u>	<u>200,343</u>	<u>160,014</u>	<u>51,902</u>	<u>44,600</u>	<u>13,429</u>

CASTRO MODEL LTD.
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 13 - SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):

g. General and administrative expenses:

	<u>Consolidated</u>			<u>Company</u>		
	<u>For the year ended December 31,</u>					
	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
	<u>NIS (thousands)</u>					
Payroll and ancillary expenses	21,812	19,245	15,160	21,268	18,310	14,329
Rentals and maintenance	4,720	3,851	3,609	4,350	3,699	3,424
Professional services	2,880	4,186	3,487	1,817	3,271	2,608
Vehicle maintenance	1,650	1,470	1,281	1,650	1,470	1,281
Depreciation and amortization	1,125	1,311	1,257	988	958	912
Refreshments, gifts and donations	2,954	1,756	2,233	2,278	1,635	1,739
Overseas travelling expenses	1,063			1,063		
Miscellaneous	391	632	554	279	215	222
Contribution towards expenses by subsidiaries				(19,510)	(15,231)	(15,415)
	<u>36,595</u>	<u>32,451</u>	<u>27,581</u>	<u>14,183</u>	<u>14,327</u>	<u>9,100</u>

h. Financing income (expenses), net:

	<u>Consolidated</u>			<u>Company</u>		
	<u>For the year ended December 31,</u>					
	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
	<u>NIS (thousands)</u>					
With respect to long-term loans	(14,962)	(3,067)	(4,681)	(15,052)	(2,924)	(4,195)
With respect to cash equivalents and short-term deposits	2,214	634	1,648	2,408	248	682
Income Tax Department interest income (expense)	310	(395)		193	(280)	
Gain (loss) on forward transactions	210	(2,431)	1,645	2,263	(705)	542
Gain with respect to marketable securities	1,487	2,460	4,284	820	2,083	3,373
Erosion of monetary items, exchange rate differentials, bank charges and sundry items	(355)	(1,231)	(82)	(3,081)	1,478	(1,571)
	<u>(11,096)</u>	<u>(4,030)</u>	<u>2,814</u>	<u>(12,449)</u>	<u>(100)</u>	<u>(1,169)</u>

CASTRO MODEL LTD.
 NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 13 - SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued)

i. Other income, net

	<u>Consolidated</u>			<u>Company</u>		
	<u>For the year ended December 31,</u>					
	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
	<u>NIS (thousands)</u>					
Capital gain on realization of fixed assets	495	151	1,785	495	76	1,785
Management charges from company consolidated by means of the proportionate consolidation method	876	1,066	306	1,753	2,132	611
Miscellaneous	752	1,690	141	752	982	109
	<u>2,123</u>	<u>2,907</u>	<u>2,232</u>	<u>3,000</u>	<u>3,190</u>	<u>2,505</u>

NOTE 14 - FINANCIAL INSTRUMENTS AND RISK MANAGEMENT:

a. Market risks:

1. Exchange rate risk management

The group makes use of foreign currency derivatives in forward transactions mainly for the purpose of hedging against the risk that the final cash flows in dollars or other foreign currencies stemming from existing liabilities will be affected by changes in exchange rates. From an accounting standpoint, these transactions are not defined as hedging transactions. All these transactions are for periods of less than one year.

As of December 31, 2007, the group was committed through forward transactions to the purchase of \$2 million and NIS 75 million (index-linked) for NIS 8.32 million and NIS 72.771 million respectively.

2. Interest rate risk

The group's exposure to interest rate risk stems mainly from long-term loans. Loans bearing variable interest rates expose the group to cash flow risk, whereas loans bearing fixed interest rates expose the group to fair value interest rate risk.

As a general rule, the group's policy is to take loans bearing fixed interest rates.

3. Price risk

In relation to its holdings of securities, the group is exposed to price risk on account of expected market fluctuations. The group's holdings of securities are classified as a current investment and presented at market value.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 14 - FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

b. Concentration of credit risk

The greater part of the group's cash and cash equivalents and its investments in deposits and marketable securities as of December 31, 2007 and 2006 is placed with Israel banks. In the view of the Company, the credit risk with respect to the above is slight.

Most of the group's sales are made in Israel to a large number of customers in the retail sector and to overseas franchisees that provide the group with security. Most of the debts of customers in Israel are reflected in the credit card company balances. Accordingly, the exposure to credit risk concentration in relation to customer debtors is restricted. The group reviews the quality of customers on a regular basis in order to determine the amount of the required provision for doubtful debts. The financial statements contain a suitable provision for doubtful debts.

c. Liquidity risk

The group maintains a satisfactory level of cash and marketable securities and also ensures the availability of designated lines of credit in order to minimize the liquidity risk to which it is exposed.

d. Fair value of financial instruments

The group's financial instruments are mainly comprised of non-derivative assets and liabilities (including working capital items, long-term loans and deposits receivable, and repayable long-term liabilities) and derivative financial instruments.

Because of their nature, the fair value of the financial instruments serving the group's working capital is generally identical to or approximates their carrying value. The fair value of repayable long-term liabilities and of the loan granted in connection with the leasing of warehouses is also close to the carrying value, since these financial instruments bear interest at a rate that is close to the accepted market rate.

For information relating to the loans granted to investee companies, see Note 2(c).

As of December 31, 2007, the fair value of the derivative financial instruments included in receivables amounted to approximately NIS 1.605 million. The fair value of these instruments reflects the estimated amounts that the group would receive in order to close the contracts on the date of the balance sheet.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 15 - TRANSACTIONS WITH INTERESTED PARTIES

a. Revenues (expenses):

	<u>Consolidated</u>			<u>Company</u>		
	<u>For the year ended December 31,</u>					
	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
	<u>NIS (thousands)</u>					
Sales to subsidiaries and to associated company	<u>17,962</u>	<u>14,981</u>	<u>7,871</u>	<u>24,609</u>	<u>19,853</u>	<u>25,013</u>
Purchases from subsidiaries				<u>(68,791)</u>	<u>(55,047)</u>	<u>(4,350)</u>
Contribution of subsidiaries towards expenses				<u>58,226</u>	<u>49,747</u>	<u>53,532</u>
Contribution towards expenses of subsidiaries				<u>(5,055)</u>	<u>(1,768)</u>	<u>(3,946)</u>
Management charge payable to interested parties who serve as directors (4 people) (see paragraph (b) below)	<u>(6,477)</u>	<u>(7,194)</u>	<u>(6,273)</u>	<u>(2,008)</u>	<u>(2,087)</u>	<u>(1,005)</u>
Directors' remuneration (4 people)	<u>(187)</u>	<u>(179)</u>	<u>(105)</u>	<u>(187)</u>	<u>(179)</u>	<u>(105)</u>
Lease payments	<u>(2,825)</u>	<u>(2,064)</u>	<u>(1,739)</u>			

b. Agreements:

- a) The general meeting of shareholders on May 3, 2000 approved a leasing agreement between a subsidiary and interested parties for the leasing of a store in Allenby Street, Tel Aviv for a period of ten years, provided that construction works to be undertaken by the interested parties include an enlargement of the floor area by ten per cent. During 2005 and most of 2006, the store was not available for leasing because of the aforementioned construction works. The Company's operations at the store commenced on August 15, 2006. The monthly leasing fees during the period of the lease, which fees are linked to the Consumer Price Index, amount to approximately NIS 36,000.
- b) On May 6, 2002, the general meeting of shareholders approved an agreement between a subsidiary and interested parties for the leasing of a store at the corner of Dizengoff and King George streets in Tel Aviv for a period of ten years. The monthly leasing fees, linked to the Consumer Price Index, are NIS 139,000 (in shekels of December 2007). The level of leasing fees is subject to review after five years. In 2007, after obtaining a valuation from an assessor, the Company's audit committee approved the continuation of the leasing agreement for a further five years without any increase in the level of leasing fees.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 15 - TRANSACTIONS WITH INTERESTED PARTIES (continued)

- c) On March 21, 2005, the Company's Board of Directors approved the continuation of an agreement between a subsidiary and interested parties for the sub-leasing of a store currently being leased by the interested parties from a third party ("the lessor.") The approval of the Board of Directors related to a situation in which the interested parties were contemplating the purchase of the store from the lessor, and was conditional upon the new owners (the interested parties) not amending the terms of the leasing agreement or changing the level of leasing fees as stated in the agreement. On April 14, 2005, the interested parties purchased the store and began to lease the store to the subsidiary in accordance with the terms of the leasing agreement with the lessor for a monthly leasing fee of NIS 19,000, linked to the Consumer Price Index.
- d) On July 11, 2006, the Audit Committee and Board of Directors of the Company approved the leasing of an extension to the floor space of the leased store at the corner of Dizengoff and King George streets in Tel Aviv. The monthly leasing fees for the extension are NIS 47,000, linked to the Consumer Price Index. The extra floor space was acquired by the interested parties during the course of 2006. The leasing period with respect to this additional area commenced at the beginning of 2007 upon the transfer of the possession of the area to the interested parties by the vendors. At the end of 2007, the group decided to sub-lease the additional area to third parties.
- e) The Company and interested parties that serve, through a management company under their ownership, as officers of the Company have entered into a compensation agreement under the terms of which the management company is entitled to monthly management fees in a fixed amount of NIS 422,000 (shekels of December 2007), linked to the Consumer Price Index, as well as to compensation at a rate of approximately 6% of the increase in pre-tax profits since 1993.

NOTE 16 - OPERATING SEGMENTS:

a. General:

1) Operating segments

The group operates in two principal segments, as follows:

- The retail marketing of fashion goods in brand name stores operated by subsidiaries through store operators, and
- The wholesale marketing of fashion goods in brand name stores operated by franchisees.

The group's disclosures in these financial statements with respect to operating segments are based on the above fields of operation.

The retail segment includes the Company's operations in Israel, whilst the wholesale segment includes the Company's operations outside Israel.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 16 - OPERATING SEGMENTS (continued):

2) Segment assets and liabilities

Segment assets consist of all the operating assets used for the purposes of segment operations. These operating assets are mainly comprised of receivables, inventories and fixed assets after deduction of depreciation. Whilst most of these assets are directly attributable to segment operations, those assets that serve both segments are apportioned between the segments on the basis of the relevant proportions of total sales provided by each segment. Liabilities cannot be apportioned between segments.

3) Investment in associated company presented on equity basis

The group and the associated company have entered into a franchise agreement, under the terms of which the group's sales to the associated company are made on a wholesale basis. Accordingly, operations involving the associated company are reflected in the wholesale segment.

CASTRO MODEL LTD.

NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 16 - OPERATING SEGMENTS (continued)

b. Operating segment data:

	Retail			Wholesale			Total (consolidated)		
	2007	2006	2005	2007	2006	2005	2007	2006	2005
	NIS (thousands)								
Statement of income disclosures:									
Revenues from external customers, net	503,625	460,412	348,505	76,829	73,200	73,178	580,454	533,612	421,683
Income from ordinary operations	70,303	69,546	47,193	5,057	8,590	10,670	75,360	78,136	57,863
Financing income (expenses), net							(11,096)	(4,030)	2,814
Other income, net							2,123	2,907	2,232
Taxes on income							22,017	19,492	17,928
Share of losses of associated company				13,778	12,771	6,127	13,778	12,771	6,127
Income for year							30,592	44,750	38,854
Other disclosures:									
Segment assets	146,793	163,414		35,788	34,520		182,581	197,934	
Investment in associated company				15,441	17,528		15,441	17,528	
Assets used jointly and not apportioned between segments							351,926	149,912	
Total consolidated assets							549,948	365,374	
Capital expenses	16,611	15,610	4,886	167	450	717	16,778	16,060	5,603
Depreciation and amortization	11,799	10,840	11,238	362	588	1,234	12,161	11,428	12,472

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 17 - ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS:

a. General

As stated in Note 1t, in July 2006, the IASB published Accounting Standard No. 29 that discusses the adoption of international financial reporting standards. In accordance with the provisions of Standard No.29, as from accounting periods commencing on January 1, 2008, the group will begin to prepare its financial statements in accordance with IFRS. The transition to reporting under IFRS will be implemented in accordance with the provisions of IFRS 1, which discusses the manner of the initial implementation of IFRS. Under the provisions of IFRS 1, the group's financial statements for 2008 and its interim financial statements for that year will be prepared in accordance with IFRS. Other than in relation to certain reliefs and prohibitions, as noted below, all existing IFRS standards in force at the end of 2008 shall be applied on a retroactive basis to the annual and interim 2008 financial statements.

In accordance with the provisions of IFRS 1 and the Securities (Preparation of Annual Financial Statements) (Temporary Provision) Regulations, 2006, the group's financial statements for 2008, newly prepared under IFRS, will contain comparative data for just one year (2007). In consequence, the group is required to prepare an opening balance sheet as of January 1, 2007 (the date of commencement of reporting under IFRS) in accordance with the principles of all the above existing IFRS standards. The group will implement the following procedures during the course of preparation of the above opening balance sheet:

- 1) Recognition of all the assets and liabilities which are required to be recognized under IFRS;
- 2) Non-recognition as assets or liabilities of those items that are prohibited from being so recognized under IFRS;
- 3) Reclassification of those items recognized in accordance with accounting principles generally accepted in Israel as a particular type of asset, liability or capital component as a different type of asset, liability or capital component under IFRS; and
- 4) Application of the provisions of IFRS standards in the measurement of all the assets and liabilities recognized.

IFRS 1 specifies two groups of exceptions to the principle of retroactive implementation, as follows:

- 1) Reliefs from mandatory retroactive application with regard to certain matters, in conjunction with an option as to whether or not to utilize all or part of those reliefs, and
- 2) Prohibitions concerning retroactive application in relation to certain specific matters.

In accordance with the disclosure requirements of Standard No. 29 and further disclosure requirements published by the Securities Authority in its document relating to frequently-asked questions, 'FAQ 6 – Required disclosure in financial statements for year ended December 31, 2007 in connection with adoption of international financial reporting standards (IFRS),' further information is provided below in relation to the expected effect of the application of IFRS on the financial statements of the group for the year ended December 31, 2007, including the effect on the opening balance sheet. The information provided will also include a description of the reliefs which are expected to be adopted by the group, and details relating to the accounting policy expected to be selected, the effect of which on the financial statements will or may be significant.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 17 - ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

It should be noted that the data presented in paragraphs c(1), c(2) and c(3) below under 'Reporting in accordance with accounting principles generally accepted in Israel' have been adjusted so as to incorporate the implications of the initial application of the new IASB accounting standards which entered into force on January 1, 2007 (see also Note 1 above).

It must also be emphasized that the information presented below cannot be regarded as final and may change as a result of the publication of new IFRS standards, clarifications to existing IFRS standards issued by the International Financial Reporting Interpretations Committee, and amendments to existing standards and clarifications that may be published before the date of publication of the financial statements for 2008. This information may also be affected by future decisions or interpretations in relation to the application of IFRS standards in Israel and by changes that may be made to tax legislation as a consequence of the transition to reporting under IFRS (as stated in Note 10, the Tax Authority has not yet stated its position with respect to the tax implications of the transition to reporting under IFRS in Israel).

Further, with respect to index-linked loans received, the data presented in paragraphs (b) and (c) below under 'Reporting under IFRS standards' are based on the alternative treatment contained in the publication of the professional committee of the IASB, 'International Accounting Standard No. 39, *Financial Instruments – Recognition and Measurement*; index-linked assets and liabilities that are not measured by reference to fair value' (February 2008) (see paragraph d(9) below).

b. Consolidated balance sheets and statement of income prepared in accordance with IFRS

1) Consolidated balance sheets

	December 31, 2007	January 1, 2007
	NIS (thousands)	
Assets		
Current assets:		
Cash and cash equivalents	45,661	26,631
Financial assets at fair value through profit or loss	206,078	59,045
Trade receivables	83,972	85,904
Receivables	29,929	31,414
Inventories	81,962	64,237
	447,602	267,231
Non-current assets:		
Investments in associated companies	15,441	17,528
Derivative financial instruments	1,055	1,208
Prepayment of expenses with respect to operating leases	8,063	8,159
Long-term investments and receivables	12,826	11,726
Fixed assets, after deduction of accumulated depreciation	53,156	48,197
Intangible assets, after deduction of accumulated amortization	1,198	521
Deferred income taxes	8,618	8,924
	100,357	96,263
Total assets	547,959	363,494

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 17 - ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

	December 31, 2007	January 1, 2007
	NIS (thousands)	
Liabilities and shareholders' equity		
Current liabilities:		
Current maturities of long-term loans	23,775	18,529
Trade payables	32,401	29,035
Income taxes payable	6,585	4,583
Other payables	39,151	36,913
	101,912	89,060
Non-current liabilities		
Long-term loans, after deduction of current maturities	194,877	37,122
Employee rights on retirement, net	8,232	7,175
	203,109	44,297
Total liabilities	305,021	133,357
Shareholders' capital:		
Shareholders' equity attributable to Company shareholders:		
Share capital	11,262	11,262
Share premium	32,965	32,965
Other capital reserves	1,304	100
Retained earnings	210,159	198,562
Less: cost of Company shares held by subsidiary and cost of treasury shares	(12,752)	(12,752)
Total shareholders' equity	242,938	230,137
Total liabilities and shareholders' equity	547,959	363,494

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 17 - ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

2) Consolidated statement of income

	For the year ended December 31, 2007
	<u>NIS (thousands)</u>
Revenues, net	580,454
Cost of revenues	<u>245,725</u>
Gross profit	334,729
Selling and marketing expenses	223,309
General and administrative expenses	36,691
Other income	<u>3,850</u>
Operating income	78,579
Financing income	2,214
Financing expenses	<u>15,115</u>
Financing expenses, net	<u>12,901</u>
Income before taxes on income	65,678
Taxes on income	<u>21,959</u>
Income from operations of Company and subsidiaries	43,719
Share of losses of associated company	<u>(13,778)</u>
Net income	<u>29,941</u>
Attribution of net income for year - to Company shareholders	<u>29,941</u>
Net earnings per share attributable to Company shareholders (basic) (in thousands of shekels)	<u>5.69</u>
Number of shares used in computation of basic earnings per share	<u>5,265</u>

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 17 - ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued):

c. Effect of transition to IFRS:

- 1) Effect of transition on consolidated balance sheets

January 1, 2007

<u>Explanation</u>	Reporting in accordance with accounting principles generally accepted in Israel	Effect of transition to IFRS	Reporting under IFRS
	<u>NIS (thousands)</u>		
Current assets:			
Cash and cash equivalents	26,631		26,631
Financial assets at fair value through profit or loss	59,045		59,045
Trade receivables	85,904		85,904
Receivables	33,265	(1,851)	31,414
Inventories	64,237		64,237
	<u>269,082</u>		<u>267,231</u>
Non-current assets:			
Investments in associated companies	17,528		17,528
Derivative financial instruments	1	1,208	1,208
Prepayment of expenses with respect to operating lease	2	8,159	8,159
Long-term investments and receivables	11,726		11,726
Fixed assets, after deduction of accumulated depreciation	2	(11,592)	48,197
Intangible assets, after deduction of accumulated amortization	521		521
Deferred tax assets	1,2,4,5	2,196	8,924
	<u>96,292</u>		<u>96,263</u>
Total assets	<u>365,374</u>		<u>363,494</u>

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 17 - ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

<u>Explanation</u>	Reporting in accordance with accounting principles generally accepted in Israel	Effect of transition to IFRS	Reporting under IFRS
	<u>NIS (thousands)</u>		
Current liabilities:			
Current maturities of long-term loans	18,529		18,529
Trade payables	29,035		29,035
Income taxes payable	3	4,583	4,583
Other payables	3	(4,583)	36,913
	<u>89,060</u>		<u>89,060</u>
Non-current liabilities:			
Long-term loans, after deduction of current maturities	37,122		37,122
Employee rights on retirement, net	5	(749)	7,175
	<u>45,046</u>		<u>44,297</u>
Total liabilities	<u>134,106</u>		<u>133,357</u>
Shareholders' equity:			
Share capital	11,262		11,262
Share premium	32,965		32,965
Other capital reserves	100		100
Retained earnings	199,693	(1,131)	198,562
Less: cost of Company shares held by subsidiary and cost of treasury shares	(12,752)		(12,752)
Total shareholders' equity	<u>231,268</u>		<u>230,137</u>
Total liabilities and shareholders' equity	<u>365,374</u>		<u>363,494</u>

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 17 - ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

<u>December 31, 2007 :</u>	<u>Explanation</u>	Reporting in accordance with accounting principles generally accepted in Israel	Effect of transition to IFRS	Reporting under IFRS
		NIS (thousands)		
Current assets:				
		45,661		45,661
		206,078		206,078
		83,972		83,972
	4	31,875	(1,946)	29,929
		81,962		81,962
		<u>449,548</u>		<u>447,602</u>
Non-current assets:				
		15,441		15,441
	1		1,055	1,055
	2		8,063	8,063
		12,826		12,826
	2	64,748	(11,592)	53,156
		1,198		1,198
	1,2,4,5	6,187	2,431	8,618
		<u>100,400</u>		<u>100,357</u>
Total assets		<u>549,948</u>		<u>547,959</u>

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 17 - ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued):

<u>Explanation</u>	Reporting in accordance with accounting principles generally accepted in Israel	Effect of transition to IFRS	Reporting under IFRS
	<u>NIS (thousands)</u>		
Current liabilities:			
Current maturities of long-term loans	23,775		23,775
Trade payables	32,401		32,401
Income taxes payable	3	6,585	6,585
Other payables	3	(6,585)	39,151
	<u>101,912</u>		<u>101,912</u>
Non-current liabilities:			
Long-term loans, after deduction of current maturities	194,877		194,877
Employee rights on retirement, net	5	(448)	8,232
	<u>203,557</u>		<u>203,109</u>
Total liabilities	<u>305,469</u>		<u>305,021</u>
Shareholders' equity:			
Share capital	11,262		11,262
Share premium	32,965		32,965
Other capital reserves	6	(75)	1,304
Retained earnings	211,625	(1,466)	210,159
Less: cost of Company shares held by subsidiary and cost of treasury shares	(12,752)		(12,752)
Total shareholders' equity	<u>244,479</u>		<u>243,938</u>
Total liabilities and shareholders' equity	<u>549,948</u>		<u>547,959</u>

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 17 - ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued):

- 2) Effect of transition on consolidated statement of income for year ended December 31, 2007

Explanation		Reporting in accordance with accounting principles generally accepted in Israel	Effect of transition to IFRS	Reporting under IFRS
		NIS (thousands)		
Revenues, net		580,454		580,454
Cost of revenues		245,725		245,725
Gross profit		334,729		334,729
Selling and marketing expenses	5	222,774	535	223,309
General and administrative expenses	2	36,595	96	36,691
Other income	6,7,8		3,850	3,850
Operating income		75,360		78,579
Financing income	8		2,214	2,214
Financing expenses	1,8	(11,096)	(4,019)	(15,115)
Financing expenses, net		(11,096)		(12,901)
Other income, net	7	2,123	(2,123)	
Income before taxes on income		66,387		65,678
Taxes on income	1,2,5	(22,017)	58	(21,959)
Income from operations of Company and subsidiaries		44,370		43,719
Share of losses of associated company		(13,778)		(13,778)
Net income		30,592		29,941
Attribution of net income for year – to Company shareholders		30,592		29,941
Net earnings per share attributable to Company shareholders (basic) (in thousands of shekels)		5.81		5.69
Number of shares used in computation of basic earnings per share		5,265		5,265

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 17 - ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued):

3) Effect of transition on specific capital items:

Retained earnings:

	<u>Explanation</u>	<u>NIS (thousands)</u>
Balance as presented on January 1, 2007 in accordance with accounting principles generally accepted in Israel		199,693
Adjustment to fair value of derivative financial instruments	1	882
Adjustment with respect to rights in land leased from the Israel Land Administration	2	(2,575)
Adjustment with respect to liability for employee rights on retirement, net	5	<u>562</u>
Balance as of January 1, 2007 in accordance with principles of IFRS standards		<u>198,562</u>
Balance as presented on December 31, 2007 in accordance with accounting principles generally accepted in Israel		211,625
Change in fair value of derivative financial instruments	1	770
Adjustment with respect to amortization of prepayment of expenses in relation to lease of land from the Israel Land Administration	2	(2,647)
Adjustment with respect to liability for employee rights on retirement, net	5	336
Other adjustments		<u>75</u>
Balance as of December 31, 2007 in accordance with principles of IFRS standards		<u>210,159</u>

d. Explanations of adjustments in relation to the transition to reporting under IFRS:

1) Derivative financial instruments and embedded derivatives

The Company has entered into a number of dollar-denominated agreements in relation to operating leases, the dollar not being a functional currency of any of the principal parties to the agreements.

Under accounting principles generally accepted in Israel, a leasing agreement is regarded as one single unit for accounting purposes and is not separated into components, as described below. Current lease payments (including related exchange rate differentials) are charged against income as they become due.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 17 - ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

In accordance with the provisions of International Accounting Standard No. 39, 'Financial Instruments – Recognition and Measurement,' the above leasing agreements would be regarded as agreements containing embedded derivatives that must be separated from the host contract (the leasing agreement). The embedded derivatives must be separated from the leasing agreements and measured separately at each balance sheet date by reference to their fair value. The changes in the fair value of the separated embedded derivatives must be charged or credited to the statement of income at the end of each period.

With the transition to reporting under IFRS on January 1, 2007, the embedded derivatives in the leasing agreements were measured by reference to their fair value and presented as an asset under derivative financial instruments. The fair value of the embedded derivatives, which, as of the above date, amounted to NIS 1.208 million, has been classified as a long-term asset relating to certain leasing agreements. With the transition to reporting under IFRS, the net value of the asset was debited against retained earnings as of January 1, 2007, with the associated tax effect of NIS 326,000 serving to reduce the deferred tax provision.

The fair value of the embedded derivatives as of December 31, 2007 amounted to NIS 1.055 million. The net change in fair value for the year ended December 31, 2007 reflects an expense of NIS 153,000 that will be charged as a financing expense in the consolidated statement of income prepared in accordance with IFRS. In addition, the separation of the embedded derivatives will lead to an increase of NIS 234,000 in leasing expenses (a component of selling and marketing expenses) for the year in question.

2) Rights in leased land

Under the leasing agreement of November 1992 with the Tel Aviv Municipality, and the leasing agreements with the Israel Land Administration of December 1993 and January 1996, the Company was provided with leasing rights in certain plots of land for periods of 198 years, 98 years and 98 years respectively (including extension options). The leasing agreements will terminate in 2190, 2091 and 2094 respectively. The Company paid capitalized leasing fees of NIS 1.739 million to Tel Aviv Municipality and capitalized leasing fees of NIS 4.792 million and NIS 5.061 million respectively to the Israel Land Administration. The leasing agreements do not allow the Company to extend the agreement for any further period over and above the extension option referred to above.

In accordance with accounting principles generally accepted in Israel, the capitalized amounts paid to the Tel Aviv Municipality and the Israel Land Administration for the leasing rights would be presented as 'land' and classified as fixed assets. The amounts paid have not been depreciated.

Under IFRS, the above leases would be classified in accordance with the provisions of IAS 17 ('Leases') as operating leases. Accordingly, the amounts paid, which take the form of leasing fees paid in advance, have been removed from fixed assets and presented as a prepayment of expenses with respect to operating leases. The expenses are amortized over the period of utilization of the rights.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 17 - ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

With the transition to reporting under IFRS on January 1, 2007, the balance of NIS 11.592 million described as 'land' (in respect of the above leasing agreements) and categorized under fixed assets will be eliminated. Prepayments of expenses with respect to operating leases will rise by NIS 8.159 million and deferred tax assets will rise by NIS 858,000. The net difference of NIS 2.575 million will be debited against retained earnings.

The balance of leasing fees paid in advance as of December 31, 2007 amounts to NIS 8.063 million. The decrease of NIS 96,000 reflecting the leasing fees attributable to the year ended December 31, 2007 will be charged to general and administrative expenses in the statement of income for the year prepared under IFRS. The related tax effect will be reflected in a decrease of NIS 24,000 in taxes on income for the year.

3) Classification of income taxes payable

Under accounting principles generally accepted in Israel, income taxes payable are presented under other payables. Under the provisions of IAS 1, 'Presentation of Financial Statements,' income taxes payable are presented separately on the balance sheet.

4) Classification of deferred income taxes

Under accounting principles generally accepted in Israel, deferred tax balances created in relation to current balance sheet items are classified under current assets (other receivables) and under current liabilities (other payables). In accordance with the provisions of IAS 1, 'Presentation of Financial Statements,' the Company presents all the deferred tax balances under non-current assets and non-current liabilities. Accordingly, upon the transition to reporting under IFRS on January 1, 2007, the Company reclassified its deferred tax assets totaling NIS 1.851 million and presented this item under non-current assets (deferred taxes) instead of under other receivables. As of December 31, 2007, deferred tax assets so reclassified totaled NIS 1.946 million.

5) Liability for employee rights on retirement, net

Under accounting principles generally accepted in Israel, on each balance sheet date the liability with respect to employee rights on retirement is measured on the basis of the number of years of employment and the employee's final monthly salary (one monthly salary for each year of employment). The corresponding accumulated severance pay funding is measured by reference to redemption values as of each balance sheet date.

Under IFRS the liability for employee rights on retirement is computed in accordance with the provisions of IAS 19, 'Employee Benefits' ("IAS 19"). In accordance with the provisions of IAS 19, the group's severance pay scheme is now classified as a defined benefit plan, as that term is defined in IAS 19. Accordingly, the measurement of the liability stemming from the plan is now undertaken on an actuarial basis, and takes account, inter alia, of future salary costs and the rate of employee turnover. The measuring process is implemented by capitalizing anticipated future cash flows at the prevailing interest rates for government debentures, insofar as the period prior to the date of repayment of those debentures resembles the period remaining before actual payment of the severance pay liability is due.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 17 - ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued):

Under the provisions of IAS 19, the capitalization rate used in the calculation of the actuarial liability is determined by reference to the market returns as on the balance sheet date of high quality corporate debentures. IAS 19 notes that, in those countries where there is no deep market in debentures of this kind, use should be made of the market returns on government debentures as on the date of the balance sheet.

As stated above, the interest rate used by the Company for the purpose of capitalizing anticipated future cash flows in order to compute the actuarial liability is based on the prevailing interest rates of government debentures, because, in the opinion of management, there is no deep market in industrial debentures in Israel.

Insofar as management is aware, the issue touching upon the question as to whether there exists in Israel a deep market in corporate debentures is reflected in the analysis of the Securities Authority with the assistance of the Bank of Israel. Should a future decision on this matter be reached by these two bodies that is at variance with the position taken by the Company, the Company's reported results for 2008 under IFRS may differ, on this matter, from those reported within the framework of this note.

Severance pay funding is measured by reference to fair value.

In accordance with the definition in IAS 19, the severance pay funding represents 'plan assets,' and is accordingly offset against the liability for the purpose of balance sheet presentation.

As an accounting policy, the group has elected to credit or charge its actuarial gains or losses arising from plan appraisals under IAS 19 to the statement of income on a regular basis. With the transition to reporting under IFRS, the group will credit or charge all its net actuarial gains or losses as of January 1, 2007 to retained earnings. Accordingly, the opening balance sheet under IFRS as of January 1, 2007 will reflect the entirety of the group's net actuarial liability under the plan. The difference between the amount of the above net measured liability for severance pay under the rules of IAS 19 as of January 1, 2007 and the equivalent amount presented in accordance with accounting principles generally accepted in Israel – a reduction in the liability of NIS 749,000, after adjustment for the tax effect of NIS 187,000 – was credited to retained earnings on the date of transition to reporting under IFRS.

The net liability for employee rights on retirement as of December 31, 2007, presented in accordance with IFRS principles, amounts to NIS 8.232 million. The increase in the expense of NIS 301,000 for the year ended December 31, 2007, in the wake of the transition to reporting under IFRS, will be charged to selling and marketing expenses. The change in the deferred tax balance in 2007 as a result of the increase in this expense amounted to approximately NIS 75,000.

6) Functional currency

In accordance with accounting principles generally accepted in Israel, the currency in which the financial statements of all group members resident in Israel are prepared is the New Israel Shekel. The subsidiaries that are located in, and operate in, Macao and Singapore are autonomous units of the group, and their financial statements are prepared in U.S. dollars.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 17 - ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued):

With the transition to reporting under IFRS, and in accordance with the criteria set out in International Accounting Standard No. 21, 'The Effect of Changes in Foreign Currency Exchange Rates,' the Company is required to determine its functional currency and that for each of the group entities by reference to the currency of the principal economic environment in which each of the group entities operates.

Management has concluded that, in accordance with the criteria set out in IAS 21, the functional currency of the Company and its Israel-resident subsidiaries is the New Israel Shekel. The functional currency of the subsidiaries located and operating in Macao and Singapore will, under IAS 21, continue to be the U.S. dollar, as was the case under accounting principles generally accepted in Israel.

Management has elected for the New Israel Shekel to be the currency of presentation of the group's consolidated financial statements.

As of January 1, 2007, and in accordance with the relief provided in IFRS 1, the accumulated translation differences which, under accounting principles generally accepted in Israel, were reflected in shareholders' equity, will be erased completely in the opening balance sheet prepared under IFRS principles as of the above date.

As of December 31, 2007, the balance of the accumulated translation differences in respect of the translation of the financial statements of the subsidiaries in Macao and Singapore amounted to NIS 75,000. The increase in this expense for the year ended December 31, 2007 will be deducted from shareholders' equity and charged to other capital reserves.

7) Other income and expenses

In accordance with accounting principles generally accepted in Israel, other income and expenses were presented in the financial statements on a net basis after operating income. These items of income and expenses include such items as gains or losses on the disposal of fixed assets and income from management charges.

In accordance with the provisions of IAS 1, 'Presentation of Financial Statements,' the group presents its other income and expenses in the statement of income before operating income.

8) Financing expenses and income

In accordance with accounting principles generally accepted in Israel, financing expenses and income included interest and exchange rate differentials with respect to securities and exchange rate differentials with respect to customer and supplier accounts. Financing expenses and income were presented in the statement of income on a net basis after operating income.

Under IFRS, the group presents those financing expenses and income which constitute a part of the ordinary operations of the group before operating income under 'other income.' Financing expenses and income with respect to credit facilities obtained for the purpose of financing the operations of the group and with respect to funds held on deposit for that purpose are presented as two separate items (income and expenses) after operating income.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 17 - ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued):

9) Index-linked loans received

The group has received index-linked bank loans which are measured at an amortized cost. As permitted by a publication of the professional committee of the IASB from February 2008, 'International Accounting Standard No. 39, *Financial Instruments – Recognition and Measurement*; index-linked assets and liabilities that are not measured by reference to fair value' ("the publication"), the group has elected to account for the above loans in accordance with this note (including in relation to data presented in an IFRS reporting framework) in the same manner as that in which the loans were treated under accounting principles generally accepted in Israel, i.e., for the purpose of presenting the loan at an amortized cost, the effective interest embodied in the loan is computed on the date that the loan is received, by reference to the related projected nominal cash flows (without considering forecasts of future changes in the Consumer Price Index). At the date of each balance sheet, the nominal balance of the amortized cost of the loans is linked to the Consumer Price Index as of the date of the balance sheet. The effect of changes in the Consumer Price Index on the balance of the loan during the course of any period is reflected in financing costs for that period.

The publication states that the professional committee of the IASB intends to approach the International Financial Reporting Interpretations Committee ("IFRIC") in order to obtain an appraisal of the committee's position with respect to the accounting treatment of index-linked assets and liabilities under international accounting standards, insofar as, until such time as the position of IFRIC on the matter is obtained, any of the three different alternatives specified in the publication, including the alternative selected by the group, may be applied. Accordingly, upon the transition to actual reporting under IFRS in 2008, the group's IFRS accounting treatment on this matter may change.

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 18 - COMPANY DATA IN NOMINAL HISTORIC VALUES FOR TAX PURPOSES:

a. Balance sheet data:

	NIS (thousands) (nominal)	
	December 31,	
	2007	2006
Assets		
Current assets:		
Cash and cash equivalents	13,581	7,742
Short-term investments	188,513	35,356
Receivables:		
Trade	30,923	27,401
Other	29,289	20,071
Inventories	12,098	9,017
T o t a l current assets	274,404	99,587
Long-term investments and receivables:		
Subsidiaries	252,640	213,389
Prepayment of expenses, loan and deposits	7,277	7,810
Deferred income taxes	865	887
	260,782	222,086
Fixed assets:		
Cost	47,262	*46,345
Less – accumulated depreciation	20,673	*18,530
	26,589	27,815
Intangible assets, after deduction of accumulated amortization	1,198	*521
	562,973	350,009
Liabilities and shareholders' equity		
Current liabilities:		
Current maturities of long-term bank loans	23,733	17,638
Payables:		
Trade	14,346	12,866
Other	93,772	59,648
T o t a l current liabilities	131,851	90,152
Long-term liabilities		
Bank loans, after deduction of current maturities	194,877	37,080
Employee rights on retirement, net of funding with severance pay funds	3,015	2,695
T o t a l long-term liabilities	197,892	39,775
T o t a l liabilities	329,743	129,927
Shareholders' equity (see (c) below)	233,230	220,082
	562,973	350,009

* After retroactive application of change in accounting policy (see Note 1t)

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 18 - COMPANY DATA IN NOMINAL HISTORIC VALUES FOR TAX PURPOSES

(continued):

b. Data relating to operating results:

	NIS (thousands) (nominal)		
	For the year ended December 31,		
	2007	2006	2005
Revenues, net	188,138	165,108	78,579
Cost of revenues	110,432	83,666	37,637
Gross profit	77,706	81,442	40,942
Selling and marketing expenses	51,878	44,551	13,202
General and administrative expenses	14,119	14,261	9,003
Income from ordinary operations	11,709	22,630	18,737
Financing income (expenses), net	(12,449)	(100)	(1,169)
Other income, net	3,091	3,190	2,977
Income before taxes on income	2,351	25,720	20,545
Taxes on income	3,502	3,395	7,505
Income (loss) from operations of			
Company	(1,151)	22,325	13,040
Income of subsidiaries	31,680	22,832	27,247
Net income (nominal)	30,529	45,157	40,287

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 18 - COMPANY DATA IN NOMINAL HISTORIC VALUES FOR TAX PURPOSES

c. Statement of changes in shareholders' equity

	<u>Share capital</u>	<u>Capital reserves</u>	<u>Differences arising on translation of foreign currency financial statements of associated company</u>	<u>Retained earnings</u>	<u>Appropriation for payment of dividend declared subsequent to balance sheet date</u>	<u>Cost of Company shares held by subsidiary and cost of treasury shares</u>	<u>Total</u>
	<u>NIS (thousands) (nominal)</u>						
BALANCE AT JANUARY 1, 2005	5,774	18,335	383	136,148	11,773	(3,022)	169,391
MOVEMENT IN 2005:							
Net income				40,287			40,287
Conversion of warrants into shares	8	67					75
Tax benefit stemming from exercise of options granted to employee		141					141
Differences arising on translation of financial statements			(274)				(274)
Acquisition of treasury shares						(6,775)	(6,775)
Dividend paid					(11,773)		(11,773)
Dividend proposed				(14,456)	14,456		
Issue of bonus	6	414		(420)			
BALANCE AT DECEMBER 31, 2005	5,788	18,957	109	161,559	14,456	(9,797)	191,072
MOVEMENT IN 2006:							
Net income				45,157			45,157
Differences arising on translation of financial statements			(9)				(9)
Acquisition of treasury shares						(1,682)	(1,682)
Dividend paid					(14,456)		(14,456)
Dividend proposed				(18,660)	18,660		
BALANCE AT DECEMBER 31, 2006	5,788	18,957	100	188,056	18,660	(11,479)	220,082

CASTRO MODEL LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 18 - COMPANY DATA IN NOMINAL HISTORIC VALUES FOR TAX PURPOSES

	<u>Share capital</u>	<u>Capital reserves</u>	<u>Differences arising on translation of foreign currency financial statements of associated company</u>	<u>Retained earnings</u>	<u>Appropriation for payment of dividend declared subsequent to balance sheet date</u>	<u>Cost of Company shares held by subsidiary and cost of treasury shares</u>	<u>Total</u>
	NIS (thousands) (see note 1b)						
BALANCE AT DECEMBER 31, 2006	5,788	18,957	100	188,056	18,660	(11,479)	220,082
MOVEMENT IN 2007:							
Net income				30,529			30,529
Differences arising on translation of financial statements			1,279				1,279
Dividend paid					(18,660)		(18,660)
Dividend proposed				(23,327)	23,327		
BALANCE AT DECEMBER 31, 2007	<u>5,788</u>	<u>18,957</u>	<u>1,379</u>	<u>195,258</u>	<u>23,327</u>	<u>(11,479)</u>	<u>233,230</u>

The Company's adjusted financial statements for tax purposes are based on the nominal data presented above, this being the sole reason for the inclusion of this data in these financial statements. The data is based on the Company's accounting records, which are maintained on a daily basis in terms of nominal historic shekels. The accounting policy applied for the purpose of preparing and presenting the nominal data is identical to that used as a basis for the preparation of the financial statements.