AMPAL-AMERICAN ISRAEL CORP
Form 10-Q
November 14, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2011

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _______________________ to_______________

Commission file number 0-538

AMPAL-AMERICAN ISRAEL CORPORATION
(Exact Name of Registrant as Specified in Its Charter)

New York (State or Other Jurisdiction of Incorporation or Organization)	13-0435685 (I.R.S. Employer) Identification Number
555 Madison Avenue New York, NY, USA (Address of Principal Executive Offices)	10022 (Zip code)

Registrant’s Telephone Number, Including Area Code (866) 447-8636

Former Name, Former Address and Former Fiscal Year, If Changed Since Last Report.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer", "accelerated filer” and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

The number of shares outstanding of the issuer’s Class A Stock, par value $1.00 per share, its only authorized common stock, is 56,133,764 (as of October 28, 2011).

AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES

Index to Form 10-Q

ITEM 1. FINANCIAL STATEMENTS
AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS AS OF (U.S. Dollars in thousands)	September 30, 2011 (Unaudited)	December 31, 2010 (Audited)
Current assets:		
Cash and cash equivalents	$69,201	$33,341
Marketable securities	11,277	890
Accounts receivable (Net of allowance for doubtful amounts of $2,504 and $2,068, respectively)	120,998	113,837
Deposits, notes and loans receivable	9,782	14,053
Inventories	36,076	34,810
Other assets	30,385	29,283
Held for sale assets	--	412,239
Total current assets	277,719	638,453
Non-current assets:		
Investments	320,728	371,751
Fixed assets, less accumulated depreciation of $41,704 and $32,633, respectively	197,052	196,361
Deposits, notes and loans receivable	28,597	43,338
Deferred income taxes	27,189	41,422
Other assets	15,678	18,617
Goodwill	68,137	70,670
Intangible assets	12,478	17,063
Total Non-current assets	669,859	759,222
TOTAL ASSETS	$947,578	$1,397,675

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

1

AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

LIABILITIES AND EQUITY AS OF (U.S. Dollars in thousands, except share amounts)	September 30, 2011 (Unaudited)	December 31, 2010 (Audited)
LIABILITIES		
Current liabilities:		
Notes and loans payable and current maturities	$ 138,928	$ 195,342
Accounts payable, accrued expenses and others	90,705	102,104
Debentures – current maturities	44,894	14,749
Held for sale liabilities	1,212	292,240
Total current liabilities	275,739	604,435
Long term liabilities:		
Notes and loans payable	211,842	218,023
Notes to partners	98,739	103,274
Debentures	215,610	265,590
Deferred income taxes	13,878	13,775
Other long-term liabilities	16,814	14,030
Total long-term liabilities	556,883	614,692
Total liabilities	832,622	1,219,127
EQUITY		
Ampal's shareholders' equity:		
Class A Stock $1.00 par value; authorized 100,000,000 and 100,000,000 shares, respectively; issued 63,277,321 and 63,277,321 shares, respectively; outstanding 56,133,764 and 56,133,764 shares, respectively	63,277	63,277
Additional paid-in capital	183,403	182,924
Accumulated deficiency	(74,647)	(32,316)
Accumulated other comprehensive income (loss)	(9,670)	103
Treasury stock, at cost	(28,763)	(28,763)
Total Ampal shareholders' equity	133,600	185,225
Noncontrolling interest	(18,644)	(6,677)
Total equity	114,956	178,548
TOTAL LIABILITIES AND EQUITY	$ 947,578	$ 1,397,675

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

2

AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

NINE MONTHS ENDED SEPTEMBER 30, (U.S. Dollars in thousands, except per share amounts)	2011 (Unaudited)	2010(*) (Unaudited)
REVENUES:		
Chemical income	$413,291	$357,567
Real estate income	245	241
Realized gains on investments	--	866
Gain on sale of fixed assets	59	--
Realized and unrealized gains on marketable securities	297	515
Equity in earnings (loss) of affiliates	268	(156)
Interest income	2,239	581
Translation gain	12,620	--
Leisure-time income	2,265	2,240
Gain from redemption of debt and other income	6,111	2,708
Total revenues	437,395	364,562
EXPENSES:		
Chemical expense - cost of goods sold	375,392	327,163
Real estate expenses	475	506
Loss from impairment of investments	50,523	--
Interest expense	32,425	31,722
Translation loss	--	7,109
Marketing expenses	7,929	5,811
General, administrative and other	45,636	36,387
Total expenses	512,380	408,698
Loss from continuing operations before income taxes	(74,985)	(44,136)
Income tax expenses (benefit)	13,006	(1,937)
Net loss from continuing operations after tax benefits	(87,991)	(42,199)
Discontinued operations:		
Gain disposal, net of tax	28,891	--
Income from discontinued operations, net of tax	5,175	3,562
	34,066	3,562
Net loss	(53,925)	(38,637)
Less: Net loss attributable to noncontrolling interests	11,594	2,863
Net loss attributable to Ampal's shareholders	(42,331)	(35,774)
Basic and diluted EPS:		
Loss from continuing operations attributable to Ampal's shareholders	(1.36)	(0.70)
Discontinued operations attributable to Ampal's shareholders	0.61	0.06
	$(0.75)	$(0.64)
Shares used in EPS calculation (in thousands)	56,134	56,134

(*) Retroactively adjusted to exclude the discontinued operations (see Note 8)

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

AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

THREE MONTHS ENDED SEPTEMBER 30, (U.S. Dollars in thousands, except per share amounts)	2011 (Unaudited)	2010(*) (Unaudited)
REVENUES:		
Chemical income	$ 139,120	$ 121,243
Real estate income	71	86
Realized gains on investments	--	52
Gain on sale of fixed assets	19	2
Realized and unrealized gains on marketable securities	276	429
Equity in earnings of affiliates	89	42
Interest income	903	309
Translation gain	19,876	--
Leisure-time income	716	770
Gain from redemption of debt and other income	4,341	283
Total revenues	165,411	123,216
EXPENSES:		
Chemical expense - cost of goods sold	126,178	110,648
Real estate expenses	175	38
Loss from impairment of investments	33,600	--
Interest expense	9,766	13,998
Translation loss	--	17,721
Marketing expenses	2,575	1,872
General, administrative and other	14,781	12,503
Total expenses	187,075	156,780
Loss from continuing operations before income taxes	(21,664)	(33,564)
Income tax benefit	(1,292)	(1,438)
Net loss from continuing operations after tax benefits	(20,372)	(32,126)
Discontinued operations		
Income from discontinued operations, net of tax	--	774
	--	774
Net loss	(20,372)	(31,352)
Less: Net loss attributable to noncontrolling interests	138	5,550
Net loss attributable to Ampal's shareholders	(20,234)	(25,802)
Basic and diluted EPS:		
Loss from continuing operations attributable to Ampal's shareholders	(0.36)	(0.47)
Discontinued operations attributable to Ampal's shareholders	--	0.01
	$ (0.36)	$ (0.46)
Shares used in EPS calculation (in thousands)	56,134	56,134

(*) Retroactively adjusted to exclude the discontinued operations (see Note 8)

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

4

AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

NINE MONTHS ENDED SEPTEMBER 30, (U.S. Dollars in thousands)	2011 (Unaudited)	2010(*) (Unaudited)
Cash flows from operating activities:		
Net loss for the period	$(53,925)	$(38,637)
Net income from discontinued operations	(34,066)	(3,562)
Loss from continuing operations	(87,991)	(42,199)
Adjustments to reconcile net loss for the period to net cash used in operating activities:		
Equity in losses (earnings) of affiliates	(268)	156
Realized and unrealized gain on investments, net	(297)	(1,381)
Depreciation and amortization expense	15,190	13,267
Loss (gain) from sale of fixed assets	(59)	12
Impairment of investment	50,523	--
Non cash stock based compensation	479	481
Translation loss (gain)	(12,620)	7,109
Decrease (increase) in other assets	12,840	(9,241)
Increase in inventories	(1,486)	(6,323)
Decrease (increase) in accounts receivable	(1,387)	4,041
Decrease in accounts payable, accrued expenses and other	(18,322)	(5,315)
Gain from repurchase of debentures	(4,677)	--
Proceeds from sale of trading securities	318	1,761
Investments made in trading securities	(12,687)	--
Dividends received from affiliates	--	928
Net cash used in operating activities	(60,444)	(36,704)
Cash flows from investing activities:		
Deposits, notes and loans receivable collected	18,618	10,500
Deposits, notes and loans receivable granted	--	(17,850)
Purchase and improvements of fixed assets	(6,704)	(4,551)
Investments made in affiliates and others	--	(30,428)
Investments made in available-for-sale shares	--	(3,737)
Proceeds from sale of available-for-sale shares	2,198	31,120
Acquisition of ADPO	--	(38,505)
Proceeds from disposal of investments in Affiliate and others	--	1,980
Increase in severance fund	(434)	--
Proceeds from sale of fixed assets	432	338
Net cash provided by (used in) investing activities	14,110	(51,133)

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

AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

NINE MONTHS ENDED SEPTEMBER 30, (U.S. Dollars in thousands)	2011 (Unaudited)	2010(*) (Unaudited)
Cash flows from financing activities:		
Proceeds from notes issued and loans received	$ 8,712	$ 124,631
Notes and loans payable repaid	(66,473)	(2,322)
Debentures repaid	(13,565)	(2,256)
Debentures issued	--	45,009
Acquisition of noncontrolling interests	--	(839)
Dividends paid to noncontrolling interests	(354)	(1,372)
Net cash provided by (used in) financing activities	(71,680)	162,851
Effect of exchange rate changes on cash and cash equivalents	(6,064)	3,609
Cash flows from discontinued operations:		
Cash provided by (used in) operating activities of discontinued operations	(18,124)	36,393
Cash provided by (used in) investing activities of discontinued operations	174,085	(341,534)
Cash provided by (used in) financing activities of discontinued operations	(3,973)	208,849
Effect of exchange rate changes on cash and cash equivalents of discontinued operations	(901)	566
Net cash provided by (used in) discontinued operations	151,087	(95,726)
Net increase (decrease) in cash and cash equivalents	27,009	(17,103)
Cash and cash equivalents at beginning of period (which includes $8,851 from discontinued operations in 2011)	42,192	71,484
Cash and cash equivalents at end of period	$ 69,201	$ 54,381
Less cash and cash equivalents of discontinued operations at end of the period	--	1,601
Cash and cash equivalents of continuing operations at end of the period	69,201	52,780

(*) Retroactively adjusted to exclude the discontinued operations (see Note 8)

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

AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(U.S. Dollars in thousands)

Unaudited

	Equity attributable to Ampal-American Israel Corporation shareholders							
	Class A Stock							
	Number of shares*	Amount	Additional paid-in capital	Accumulated deficiency	Accumulated other comprehensive income (loss)	Treasury stock	Non-controlling interests	Total equity
BALANCE AT JANUARY 1, 2011	63,277	63,277	182,924	(32,316)	103	(28,763)	(6,677)	178,548
CHANGES DURING THE NINE MONTHS ENDED SEPTEMBER 30, 2011:								
Net loss for the period				(42,331)			(11,594)	(53,925)
Unrealized loss from marketable securities					(5)			(5)
Foreign currency translation adjustments					(9,768)		(19)	(9,787)
Total comprehensive income (loss)								(63,717)
Dividend paid to noncontrolling interests							(354)	(354)
Share-based compensation expense			479					479
BALANCE AT SEPTEMBER 30, 2011	63,277	63,277	183,403	(74,647)	(9,670)	(28,763)	(18,644)	114,956

* In thousands

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

7

AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(U.S. Dollars in thousands)

Unaudited

	Equity attributable to Ampal-American Israel Corporation shareholders							
	Class A Stock							
	Number of shares*	Amount	Additional paid-in capital	Accumulated deficiency	Accumulated other comprehensive income (loss)	Treasury stock	Non-controlling Interests	Total equity
BALANCE AT JANUARY 1, 2010	63,277	63,277	184,287	12,426	(14,598)	(28,763)	(75)	216,554
CHANGES DURING THE NINE MONTHS ENDED SEPTEMBER 30, 2010:								
Net loss for the period				(35,774)			(2,863)	(38,637)
Unrealized loss from marketable securities					(11)			(11)
Foreign currency translation adjustments					7,706		(458)	7,248
Total comprehensive loss								(31,400)
Acquisition of noncontrolling interests			(368)					(368)
Dividends paid			(1,372)					(1,372)
Share-based compensation expense			625					625
BALANCE AT SEPTEMBER 30, 2010	63,277	63,277	183,172	(23,348)	(6,903)	(28,763)	(3,396)	184,039

* In thousands

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

AMPAL-AMERICAN ISRAEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. As used in these financial statements, the term the “Company” refers to Ampal-American Israel Corporation (“Ampal”) and its consolidated subsidiaries.

2. The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles (“GAAP”) in the United States of America, for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the interim period are not necessarily indicative of the results that may be expected for the full year. You should read these interim condensed consolidated financial statements in conjunction with the audited consolidated financial statements in the Annual Report on Form 10-K for the year ended December 31, 2010, filed with the Securities and Exchange Commission.

Reference should be made to the Company’s consolidated financial statements for the year ended December 31, 2010 for a description of the critical accounting policies. Also, reference should be made to the notes to the Company’s December 31, 2010 consolidated financial statements for additional information regarding the Company’s consolidated financial condition, results of operations and cash flows.

3. Recently Adopted and Recently Issued Accounting Pronouncements

In June 2011, the Financial Accounting Standard Board (“FASB”) issued Accounting Standards Update No. 2011-05 ("ASU 2011-05") which amended the comprehensive income presentation guidance. The amendment requires entities to report components of comprehensive income in either a continuous statement of comprehensive income or two separate but consecutive statements. The guidance is effective for interim and annual periods beginning after December 15, 2011. The Company is currently evaluating the potential impact of ASU 2011-05 on its financial statements.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04 ("ASU 2011-04") for Fair Value Measurements and Disclosures (Topic 820). The amendment clarifies the existing guidance and adds new disclosure requirements. The guidance is effective for interim and annual periods beginning after December 15, 2011. The Company is currently evaluating the potential impact of ASU 2011-04 on its financial statements.

In December 2010, the FASB issued Accounting Standards Update No. 2010-28 (“ASU 2010-28”) for Intangibles - Goodwill and Other (Topic 350): "Intangibles - Goodwill and Other: When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts." ASU 2010-28 impacted reporting units with zero or negative carrying amounts and required an additional test to be performed to determine whether goodwill has been impaired and to calculate the amount of that impairment. The adoption did not have a material impact on the Company's financial statements.

4. Cash and cash equivalents

Cash equivalents are short-term, highly liquid investments (bank accounts and bank deposits) that have original maturity dates of three months or less and are readily convertible into cash.

Cash equivalents equal to $1.0 million have been allocated as a compensating balance for various loans provided to the Company and would therefore be unavailable if the Company wished to pledge them in order to provide an additional source of cash.

5. Inventories – mainly chemicals and other materials intended for sale are valued at the lower of cost or market. Cost is determined based on the moving average basis.

6. East Mediterranean Gas Company

As of September 30, 2011, the Company's financial statements reflect a 16.8% interest in shares of East Mediterranean Gas Co. S.A.E., an Egyptian joint stock company ("EMG"), with 8.2% held directly and 8.6% held through Merhav Ampal Energy Holdings, LP, an Israeli limited partnership of which Ampal owns 50%.

The investment in EMG is accounted for as a cost method investment.

The Company evaluates the carrying value amount of its interest in EMG annually in connection with the preparation of its financial statements. In light of the recent developments in Egypt, the Company obtained updated interim valuations from an independent third-party valuation firm for the quarters ended September 30, 2011, June 30, 2011 and March 31, 2011. The periodic independent valuations obtained by the Company to assist in its preparation of financial statements customarily indicate a range of values depending on underlying assumptions. The valuation is based on the discounted cash flow (DCF) method. Due to current uncertainties, the valuation firm used a wide range of scenarios, including deferent assumptions regarding the profitability and discount rates of EMG. An adverse change in any of these assumptions, such as the price, quantity, delivery dates and reliability of the gas and discount rates, might result in additional reduction in the value of EMG.

The valuation ranges determined by the independent valuation firm for the following periods and the carrying amount of Ampal’s investment in EMG were:

At December 31, 2010, the valuation range was between $2,930 million and $3,280 million and the amount on which the carrying amount of Ampal's investment in EMG on a cost basis was based on a value of $2,151million.

At June 30, 2011, the valuation range was between $2,000 million and $2,300 million and the amount on which the carrying amount of Ampal's investment in EMG after impairment was based on a value of $2,050 million.

At September 30, 2011, the valuation range was between $1,900 million and $2,150 million and due to the recent development the amount on which the carrying amount of Ampal's investment in EMG after impairment was based on a value of $1,850 million.

In the independent valuation as of June 30, 2011, due to uncertainties in Egypt including the repeated gas supply interruptions and their length, the lower end of the indicated valuation range was materially lower than in the past and lower than the value at which EMG was carried on the Company's balance sheet. Management assessed the investment to determine if the decline in fair value was other than temporary. Based on these assessments, management determined that the decline in fair value of the investment was other than temporary and the Company recorded in the quarter ended June 30, 2011 charges of $16.9 million and decreased deferred income taxes in the amount of $14.1 million. The carrying amount of the investments in EMG as of June 30, 2011 was $344.4 million.

As of September 30, 2011, although the value at which EMG was carried in the Company's balance sheet was within the range of values in the independent valuation for that period, management determined due to the continued uncertainties related to EMG, including the repeated gas supply interruptions and their length, to use a lower value in the range of values determined by the independent valuation and to record on the Company's balance sheet a further decline in fair value of the investment. The Company recorded in the quarter ended September 30, 2011 charges of $33.6 million. The carrying amount of the investments in EMG as of September 30, 2011 was $310.8 million.

The Company recorded in the nine months ended September 30, 2011 charges of $50.5 million and decreased deferred income taxes in the amount of $14.1 million in connection with its investment in EMG.

EMG,organized in 2000 in accordance with the Egyptian Special Free Zones system, has been granted the right to export 7.0 billion cubic meters ("BCM")/year of natural gas from Egypt to Israel, other locations in the East Mediterranean basin and to other countries. EMG has linked the Israeli energy market with the Egyptian national gas grid via an East Mediterranean pipeline with the first gas delivery occurring in May 2008. EMG is the developer, owner and operator of the pipeline and its associated facilities on shore in both the point of departure at El Arish, Egypt and the point of entry in Ashkelon, Israel.

This project is governed by an agreement signed between Israel and Egypt which designates EMG as the authorized exporter of Egyptian gas, secures EMG’s tax exemption in Israel and provides for the Egyptian government’s guarantee for the delivery of 7 BCM/year of gas to the Israeli market.

Between February 5, 2011 and September 27, 2011, there were five explosions along the Egyptian gas pipeline owned and operated by GASCO (the Egyptian gas transport company) due to alleged terror attacks and on July 30, 2011, in the wake of violent incidents in El-Arish, Egypt, there was an attempt to cause damage to the EMG site near El-Arish. The security forces on site returned fire, prevented any penetration of the EMG site and repelled the attack. Neither EMG's site nor EMG's pipeline were damaged in the attacks.

Due to the alleged terror attacks, from February 5, 2011 to March 15, 2011, from April 27, 2011 to June 9, 2011, from July 4, 2011 to July 5, 2011 and from July 12, 2011 to October 23, 2011, the supply of gas to EMG, and therefore to EMG’s Israeli clients, was interrupted.

On November 10, 2011, there was an explosion along the Egyptian gas pipeline, approximately 20 kilometers (about 12 miles) west of EMG’s site at El-Arish, due to an alleged terror attack. The pipeline is owned and operated by GASCO, the Egyptian gas transport company, which is a subsidiary of EGAS, the Egyptian national gas company (EMG's gas supplier).

Following the explosion EGAS has initiated its standard shut down procedure affecting gas transportation throughout the Sinai area and gas supply to Jordan, Lebanon, Syria; to major Egyptian industries and gas consumers in the Sinai; and to EMG.

The extent of the damage to GASCO’s pipeline and the estimated repair period is unknown at this point. Neither EMG's site nor EMG's pipeline were damaged as the affected GASCO’s pipeline is not a part of the EMG pipeline system.

As a result of the continued interruption of gas supply to EMG and the delivery of gas to EMG below contracted quantities, the international shareholders of EMG, including Ampal, have commenced procedures under applicable bilateral investment treaties between their countries and Egypt. Such procedures may ultimately result in arbitration of claims under the various treaties, the company's gas supply agreement or other agreements.

Ampal has also been advised by EMG of EMG's following legal proceedings:

1. EMG filed a Request for Arbitration against Egyptian General Petroleum Corporation (“EGPC”) and Egyptian Natural Gas Holding Company (“EGAS”) (collectively, “EGPC/EGAS”) on October 7, 2011. EGPC and EGAS are Egyptian state-owned entities responsible for the development and transportation of Egypt’s hydrocarbon resources. EMG and EGPC/EGAS entered into a Gas Supply and Purchase Agreement on July 13, 2005 (the "Source Contract"). Through its Request for Arbitration, EMG seeks, in part, to enforce its rights to quantities of natural gas provided for in the Source Contract and to secure damages for EGPC/EGAS’s failure to supply contractual quantities.

Although the delivery shortfalls date back to EGPC/EGAS’s earliest deliveries under the Source Contract, EGPC/EGAS have subjected EMG to increasingly severe shortages (and at times to total stoppages) since February 2011. EGPC/EGAS have attempted to avoid liability for the shortages and stoppages by claiming that they are excused from their contractual obligations under the force majeure provisions of the Source Contract. EMG has asked that a tribunal affirm EGPC/EGAS’s inability to invoke force majeure, and therefore to affirm EGPC/EGAS’s liability to EMG.

EMG has named the Israel Electric Corporation, Ltd. (“IEC”) as an additional respondent. IEC is an Israeli state-owned electricity producer that entered into a Gas Sale and Purchase Agreement with EMG on August 8, 2005 (the "On-Sale Agreement"). Under the On-Sale Agreement, EMG promised to supply, and IEC promised to purchase, quantities of natural gas sold to EMG under the Source Contract; those quantities were in turn guaranteed by EGPC/EGAS through a Tripartite Agreement entered into by EMG, IEC and EGPC/EGAS on June 13, 2005 (the "Tripartite Agreement"). Therefore, EGPC/EGAS guaranteed that it would provide contractual quantities of gas to EMG (for sale to IEC) under both the Source Contract and the Tripartite Agreement. Because the contractual guarantees under these two agreements are coextensive, EMG filed for declaratory relief ensuring that EGPC/EGAS, and not EMG, are liable to IEC for supply deficiencies.

As part of its Request for Arbitration, EMG nominated an arbitrator to sit on the three-member tribunal. EGPC/EGAS and IEC are due to submit their respective answers to the Request, along with a nomination for an additional arbitrator, by November 9, 2011. As of November 13, 2011, EMG has not received such answers or nominations. The total amount of the claim has not yet been quantified and the Company cannot currently estimate the range of possible gain.

2. On September 21, 2011, EMG filed a Request for Arbitration against IEC as a sole respondent. In that arbitration, EMG seeks declaratory relief that IEC is not entitled to claim shortfall penalties from EMG as a result of EGPC/EGAS’s breaches of the GSPA and the Tripartite Agreement. EMG also seeks a declaration that it may seek

out additional customers, and renew contracts with existing customers, without breaching the On-Sale Agreement. EMG filed its Request for Arbitration, along with its nomination for an arbitrator, on September 21, 2011. IEC nominated its arbitrator to the three-person arbitral tribunal. EMG and IEC agreed to suspend the arbitration for six months, with each party having the right to renew proceedings on two weeks' notice. The total amount of the claim has not yet been quantified and the Company cannot currently estimate the range of possible gain.

3. The Company and other EMG shareholders have issued letters to the Government of the Arab Republic of Egypt seeking consultation relative to several bilateral investment treaties. No formal arbitral proceedings have yet begun for EMG's investors under these treaties. The claim relates to the same subject matter described above, and rests on the assertion that the conduct of Egypt and of entities that it owns and/or controls (including EGPC/EGAS) constitutes a violation of the substantive protections found in the applicable investment protection treaties. These protections include the prohibition against expropriation without compensation, the commitment to accord fair and equitable treatment, the obligation to protect and secure investments, and the prohibition against discrimination in the treatment of investments. Should no amicable solution to this dispute be reached, the Company plans to initiate arbitration against the Government of Egypt seeking compensation for the damage caused to its investment in EMG.

7. Gadot Chemical Tankers and Terminals Ltd. ("Gadot")

Gadot, a wholly owned subsidiary of Ampal (99.99% on a fully diluted basis), was founded in 1958 as a privately-held Israeli company with operations in distribution and marketing of liquid chemicals for raw materials used for industrial purposes. Since then, Gadot has expanded into a group of companies, which currently forms Israel's leading chemical distribution organization. Through its subsidiaries, Gadot ships, stores, and distributes liquid chemicals, oils, and a large variety of materials to countries across the globe, with an emphasis on Israel and Western Europe. In our description of Gadot's business operations, the term "Gadot" refers to Gadot and its consolidated subsidiaries.

Gadot’s business is influenced by certain economic factors, which include (i) global changes in demand for chemicals used as raw materials for industrial purposes, (ii) price fluctuations of chemicals and raw materials, (iii) price fluctuations of shipping costs, ship leases and ship fuel, (iv) general global financial stability, and (v) currency fluctuations between the New Israeli Shekel ("NIS") and other currencies, primarily the U.S. Dollar.

Gadot’s operations are divided into three main service sectors:

- Importing, marketing and sale of chemicals and other raw materials in Israel and Europe;
- Shipping, primarily between the European ports of the Atlantic Ocean and the Mediterranean sea port and agency services for shipping companies and docked ships; and
- Logistical services in Israel and Europe.

These service sectors are synergistic and complementary, so that Gadot provides its customers with a full range of services, from acquiring chemicals based on a customer’s needs, logistical handling including shipping and transport, offloading, storage and delivery. Members of the Gadot group of companies also provide services for other members of the group, strengthening the group as a whole.

Ampal funded the Gadot acquisition with a combination of available cash and the proceeds of the credit facility, dated November 29, 2007(the "Credit Facilities"), between Merhav-Ampal Group Ltd. (formerly Merhav-Ampal Energy Ltd.), an Israeli corporation and wholly owned subsidiary of Ampal ("MAG"), and Israel Discount Bank Ltd. ("IDB"), for approximately $87.4 million (As of September 30, 2011, the outstanding debt under the Credit Facilities amounts to $79.5 million). The Company has certain financial and other covenants in the Credit Facilities. The Company determined that in connection with the preparation of its September 30, 2011 financial statements that it would not meet the covenants relating to minimum equity. On November 8, 2011, MAG and IDB signed an amendment to the Credit Facility amending certain requirements under certain of our equity maintenance covenants so that they will not apply until the filing of the Company’s Quarterly Report on Form 10-Q for the first quarter of the 2013 fiscal year. In connection with the amendments, the interest rate on both loans increased by 1% to LIBOR plus 3%.

8. Discontinued operations

On March 3, 2011, MAG completed its sale of all of the outstanding shares of 012 Smile Telecom Ltd., a wholly owned subsidiary of MAG ("012"), to Partner Communications Company Ltd. ("Partner"), in accordance with the Share Purchase Agreement between MAG, 012 and Partner, signed on October 13, 2010 (the “012 Sale”). As part of the 012 Sale, Partner also assumed approximately NIS 800 million (approximately $225.4 million) of the total debt of 012 Smile. Accordingly, 012 Smile has been reported as discontinued operations since December 31, 2010. The 012 Sale closed on March 3, 2011. Partner paid to Ampal approximately NIS 650 million (approximately $180 million) out of which Ampal recorded a gain of $28.9 million, net of an early repayment fee the Company paid in connection with the repayment of a loan received to finance the purchase of 012 and net of tax, from the 012 Sale. In addition the Company recorded income from discontinued operations of $19.9 million in 2010 and $5.2 million in the period ended September 30, 2011.

All the indirect interest expenses were recorded as a continuing operation.

Classification

We classified certain operations as discontinued using GAAP, as the associated operations and cash flows will be eliminated from our ongoing operations and we will not have any significant continuing involvement in their operations after the respective sale transactions. For all periods presented, all of the operating results for these operations were removed from continuing operations and are presented separately as discontinued operations, net of tax. The Notes to the Consolidated Financial Statements were adjusted to exclude discontinued operations unless otherwise noted.

9. Sugarcane Ethanol Production Project

On December 31, 2009, Ampal signed an option exercise agreement (the "Exercise Agreement") with Merhav (M.N.F.) Ltd. ("Merhav") pursuant to which it exercised, subject to certain conditions, its option (the "Option") to convert Ampal's existing loan to Merhav (consisting of $20 million of principal plus accrued interest) (the "Loan") into a 25% equity interest in the sugarcane ethanol production project in Colombia (the "Project") being developed by Merhav. The Loan is evidenced by an Amended and Restated Promissory Note, dated December 25, 2008 (the "Note"), issued by Merhav in favor of Ampal, and is secured by Merhav's pledge of its shares of Class A Stock of Ampal, pursuant to that certain Pledge Agreement, dated December 24, 2007, between Merhav and Ampal (the "Pledge Agreement"). Merhav's obligations under the Note are guaranteed by Mr. Yosef A. Maiman pursuant to a personal guaranty, dated as of December 25, 2008 (the "Guaranty"). The Option is evidenced by an Option Agreement, dated December 25, 2007, between Merhav and Ampal, as amended on December 25, 2008 (the "Option Agreement"). The Loan, Option and related transactions are summarized in the Company's previously filed annual and periodic reports. On December 31, 2010, all the rights and obligations of Ampal in the Project were assigned to MAG.

Pursuant to the Exercise Agreement, the conversion of the Loan into a 25% equity interest in the Project will take the form of the issuance to MAG of 25% of all of the issued and outstanding equity interests in Merhav Renewable Energies Limited, a Cyprus corporation and subsidiary of Merhav ("Merhav Energies"). The purchase price for the 25% equity stake in Merhav Energies, to be paid at closing, is the outstanding balance of the Note on December 31, 2009, or approximately $22.3 million. The closing of the purchase of the 25% equity stake and the conversion of the Loan is subject to, among other things, (i) the initial disbursement of (or other evidence of) long-term debt financing for the Project obtained from Banco do Brasil or any other unaffiliated third party lender (the date such financing is obtained, the "Qualified Financing Date"), (ii) the payment in full of all outstanding amounts due and payable under the Note, and (iii) the delivery at closing of the Shareholders' Agreement (as defined below) by Merhav and MAG, setting forth certain agreements relating to the governance of Merhav Energies. At closing, the Note and the Guaranty shall be cancelled and the pledge of Merhav's shares of Class A Stock under the Pledge Agreement shall be released. The closing was to occur on the Qualified Financing Date or as soon as practicable thereafter, but no later than December 31, 2010 (the "Termination Date"). Since the Qualified Financing Date did not occur prior to December 31, 2010, on December 31, 2010, the parties amended the Exercise Agreement such that the Termination Date and the maturity date of the Note was extended to December 31, 2011.

The Exercise Agreement contains other customary closing conditions, as well as customary representations and warranties.

Pursuant to the Exercise Agreement, the Note was amended to extend its maturity date to the earlier of the Qualified Financing Date or December 31, 2011. Additionally, Merhav and Ampal have agreed that, under certain circumstances, each will arrange for loans to Merhav Energies from time to time through third parties, directly or indirectly, for up to $15 million.

As stated above, as a condition to closing MAG's purchase of a 25% equity stake in Merhav Energies, Merhav, MAG and Merhav Energies will enter into a Shareholders' Agreement (the "Shareholders' Agreement") to provide for, among other things, (i) restrictions on the transfer of shares of Merhav Energies, (ii) a right of first refusal on transfers of shares of Merhav Energies, (iii) tag-along and drag-along rights on the transfer of shares of Merhav Energies, (iv) preemptive rights on the issuance of new shares of capital stock (or other equity interest) by Merhav Energies, subject to the anti-dilution rights of MAG, and (v) the right of MAG to designate 25% of the directors of Merhav Energies. In addition to preemptive rights under the Shareholders' Agreement, MAG has been granted anti-dilution protection, which may result in the issuance of additional shares of Merhav Energies to MAG, in the event that, prior to end of the 180-day period following the commencement of the Project's operations, Merhav sells, or Merhav Energies issues, shares of Merhav Energies at a per share price that is less than the per share price paid by MAG under the Exercise Agreement.

Merhav is a multinational corporation with interests in a range of sectors, including energy, infrastructure projects and agriculture. Merhav is a significant shareholder of Ampal and is wholly owned by Mr. Yosef A. Maiman, the President, CEO and a member of the controlling shareholder group of Ampal. Because of the foregoing relationship, a special committee of the Board of Directors of Ampal composed of Ampal's independent directors negotiated and approved the transaction. Houlihan Lokey Financial Advisors, Inc., which has been retained as financial advisor to the special committee, advised the special committee on this transaction.

10. Services and Management Agreements

In February 2009, Ampal and Gadot entered into a management services agreement (intercompany transaction), according to which Ampal provides Gadot with management services for an annual consideration calculated as a percentage of Gadot's profits.

On December 30, 2010, Ampal entered into a management services agreement with Merhav, according to which Merhav provides the Company and its subsidiaries with management, marketing, financial, development and other administrative services for an annual consideration which will be determined annually and shall be equal to a percentage of the direct and indirect expenses incurred by Merhav in connection with providing services to or for the benefit of Ampal. The management fee shall be determined by the Special Committee of the Board of Directors of Ampal (composed solely of independent directors) at or around the end of each fiscal year.

On January 1, 2011, Ampal entered into an Aircraft Sharing Agreement with Merhav, according to which Ampal has a limited and non-exclusive right to use the aircraft possessed and operated by Merhav. For the usage of the aircraft, Ampal will pay Merhav a pro rata share of the fixed costs related to the aircraft (calculated annually based on the flight hours of the aircraft used by Ampal compared to the total flight hours of the aircraft, with a maximum amount of $500,000 per annum) and the direct costs and expenses of operating each flight for Ampal.

As stipulated above, Yosef A. Maiman, the Chairman, President and CEO of Ampal and a member of the controlling shareholder group of Ampal, is the sole owner of Merhav. Because of the foregoing relationship, a special committee of the Board of Directors composed of Ampal's independent directors negotiated and approved the transactions between Ampal and Merhav.

11. Derivatives and Other Financial Instruments

The Company is exposed to certain risks relating to its ongoing business operations, including financial, market, political, and economic risks. The following discussion provides information regarding the Company's exposure to the risks of changing commodity prices, interest rates, and foreign currency exchange rates.

The Company’s derivative activities are subject to management's discretion.

The interest rate and foreign exchange contracts are held for purposes other than trading. They are used primarily to mitigate uncertainty and volatility, and in order to cover underlying exposures. On May 15, 2009, the Company entered into a swap contract to convert some of its NIS denominated debt in the amount of NIS 150 million (approximately $43.9 million) into U.S. Dollar denominated debt and to convert Israeli interest rates into LIBOR interest rates.

On April 1, 2009, the Company signed an interest rate swap contract in order to convert some of the Company's LIBOR interest rate denominated debt in the amount of $43.7 million into fixed interest rate debt, for a contractual term of 10 years.

Gadot

The Company uses foreign currency forward contracts to mitigate fluctuations in foreign currency exchange rates due to variations in payment or receipt of currencies other than the Company's functional currency. The Company uses contracts to purchase U.S. Dollars and sell Euros, contracts to purchase Euros and sell U.S. Dollars and contracts to purchase U.S. Dollars and sell NIS.

The Company enters into derivative financial instruments, including swaps and forward agreements. The Company reports the fair value of the derivatives on our balance sheet. The derivatives used are not designated as a hedging instrument under Accounting Standards Codification ("ASC") No. 815. Changes in fair value are recognized in earnings in the period of change.

The following summarizes the gross fair market value of all derivative instruments and their locations in our consolidated balance sheet, and indicates which instruments are in an asset or liability position.

Asset Derivatives

		(U.S. Dollars in thousands)		
Derivative Instrument	Location	September 30, 2011	December 31, 2010	September 30, 2010
SWAP contract	Other assets	$ 3,414	$ 5,552	$ 3,691
Foreign currency exchange contracts	Other assets	$ 6	-	-

Liability Derivatives

		(U.S. Dollars in thousands)		
Derivative Instrument	Location	September 30, 2011	December 31, 2010	September 30, 2010
SWAP contract	Accounts payable, accrued expenses and others	$ 1,930	-	$ 1,465
Foreign currency exchange contracts	Accounts payable, accrued expenses and others	$ 83	-	$ 76

Statements of Operations

		(U.S. Dollars in thousands) Nine months ended September 30,	
Derivative Instrument	Location	2011	2010
SWAP contract	Translation (loss) gain	$ (2,090)	$ 2,178
Interest rate SWAP contract	Interest loss	$ 1,978	$ 3,075
	Translation (loss) gain	$ 330	$ (39)

Foreign currency exchange contracts

14

12. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer the liability (an exit price) in an orderly transaction between market participants and also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The fair value hierarchy used by the Company within ASC No. 820 distinguishes between three levels of inputs that may be utilized when measuring fair values, including Level 1 inputs (using quoted prices in active markets for identical assets or liabilities), Level 2 inputs (using inputs other than Level 1 prices such as quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability) and Level 3 inputs (unobservable inputs supported by little or no market activity based on the Company's own assumptions used to measure assets and liabilities). A financial asset's or liability’s classification within the above hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The following section describes the valuation methodologies used by the Company to measure derivative contracts at fair value, including an indication of the level in the fair value hierarchy at which each instrument is generally classified. Where appropriate, the description includes details of the valuation models, the key inputs to those models, and any significant assumptions.

Derivative contracts are valued using quoted market prices and significant other observable and unobservable inputs. Such financial instruments consist of interest rate and foreign exchange contracts. The fair values for the majority of these derivative contracts are based upon current quoted market prices. These financial instruments are typically exchange-traded and are generally classified within Level 1 or Level 2 of the fair value hierarchy depending on whether the exchange is deemed to be an active market or not.

Financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2011 consisted of the following (in thousands):

Fair Value Measurements as of:						
	September 30, 2011			December 31, 2010		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Trading securities *	$ 10,808	$ -				